FANCL

# REGAINING UPWARD MOMENTUM

FANCL Corporation

ANNUAL REPORT 2005

# CORPORATE PROFILE

## FANCL as a Specialist in Both Inner and Outer “Beauty and Health”

Since our establishment in 1980, FANCL has continued to rewrite the industry’s “established practices” with its basic management philosophy of “eliminating negative qualities like insecurity and inconvenience” for consumers in their pursuit of beauty and health.

In our first attempt to remove the barrier of the industry’s established practices, we developed cosmetics free of preservatives and other additives that women with sensitive skin can use without anxiety. The market for “preservative-free cosmetics,” a first in the Japanese cosmetics industry, expanded rapidly as such cosmetics helped to eliminate concerns for many consumers with skin problems. Following, in 1994, in the sector of nutritional supplements, where essential but expensive daily products were the industry norm, we created “high-quality and reasonably priced” nutritional supplements by establishing an integrated in-house system that covers all aspects of the business from raw materials procurement to manufacturing and sales. As a new line of healthy food, we also developed “high nutritional value and easy-to-eat” germinated brown rice and “easy-to-drink and reasonably priced” kale juice.

Setting out on our “second foundation,” we are proposing products from our unique perspective of fusing cosmetics and nutritional supplements by advancing FANCL as a specialist in both inner and outer “beauty and health.” We are addressing beauty and health from both inside and outside the body while reinforcing our “product strategy based on added value.” This puts us before our competitors in terms of “ingredients and materials” and “functionality,” in addition to “reliable, safe, gentle, and preservative-free” brand assets.

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Statements made in this annual report with respect to FANCL’s current plans, strategies, estimates, and beliefs, as well as other statements that are not historical facts, are forward-looking statements about the future performance of FANCL. These statements are based on management’s beliefs in light of information available to it at the time of the writing of this report. The actual performance of the Company could differ significantly from these forward-looking statements as a result of unpredictable factors such as changes in customer preferences, social conditions, and economic conditions. Moreover, FANCL is under no obligation to revise forward-looking statements, irrespective of new data, future events, or other developments. Readers should therefore not place undue reliance on them.

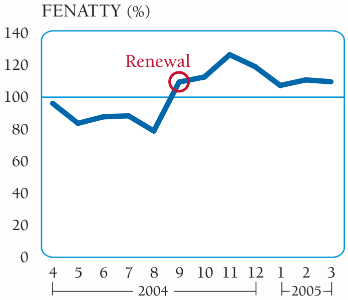
# SIGNS OF CHANGE SEEN TOWARD NEW GROWTH

## 1. Sales of Products with Original Ingredients and New Functions Rising Sharply

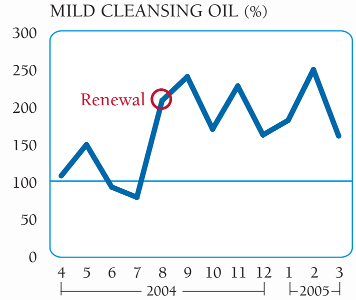
Sales were strongly driven by products with original ingredients and new functions developed in-house, including renewed items such as FENATTY and MILD CLEANSING OIL in the cosmetics field and TWINTOSE, which drastically enhances the absorption of minerals, in the nutritional supplements field. Note: Please refer to Special Feature 2 (page 12).

Year-on-Year Sales Trends

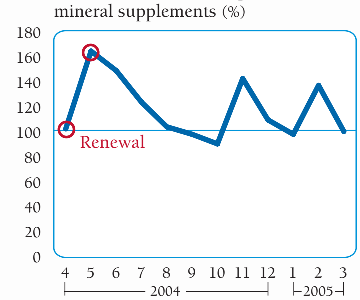
FENATTY (%)




MILD CLEANSING OIL (%)



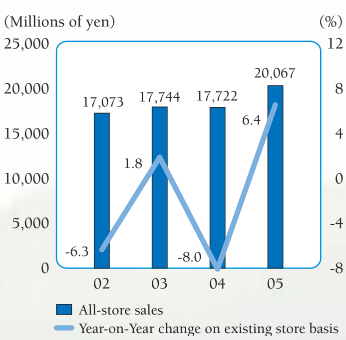

Four TWINTOSE-incorporated mineral supplements (%)




## 2. Strengthened Retail Store Sales Channel Reaps Results

—Sales at existing stores increase 6.4% in rapid recovery

Retail Store Sales Performance




Retail store sales are expanding thanks to the proactive establishment of new stores and renewal of existing stores. At the end of fiscal 2005, the number of retail stores stood at 168, a net increase of 26 stores year-on-year. Our renewal of retail stores with the main theme of "easy-to-look around, easy-to-buy, and easy-to-choose" and our efforts to strengthen the human resources base, that is, build a mechanism to raise skills and motivate our staff, along with the building of the new visual identity, have produced positive results.

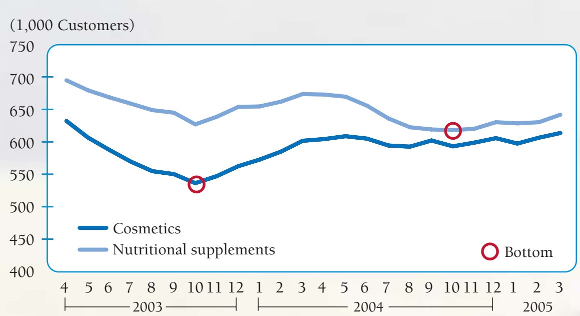
Note: Please refer to Special Feature 1 (pages 10-11) and Business Overview and Strategy, By Sales Channel (pages 22-24).

## 3. Recovery Trend in Number of Mail-Order Sales Customers

In the mail-order sales channel, the number of active customers is once again on an upward trend, albeit moderate, after bottoming out in October 2003 for cosmetics and October 2004 for nutritional supplements. Contributing to this has been aggressive spending on marketing and a growth of mail-order sales over the Internet.

*For marketing purposes, we define "active customers" as customers who have made at least one purchase during the preceding seven-month period.

Number of Active Mail-Order Customers



# FINANCIAL HIGHLIGHTS

FANCL CORPORATION and Consolidated Subsidiaries

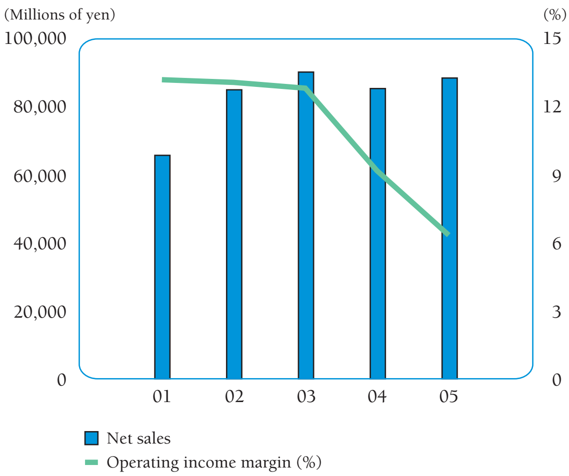
| Years ended March 31 | Millions of yen 2005 | 2004 | 2003 | 2002 | 2001 | Thousands of U.S. dollars 2005 |
|---|---|---|---|---|---|---|
| **FOR THE YEAR:** | | | | | | |
| Net sales | ¥87,937 | ¥84,957 | ¥90,026 | ¥84,657 | ¥65,418 | $818,857 |
| Cosmetics | 37,098 | 34,926 | 37,155 | 36,748 | 35,669 | 345,451 |
| Nutritional supplements | 31,132 | 29,656 | 29,211 | 28,995 | 25,408 | 289,897 |
| Others | 19,707 | 20,375 | 23,660 | 18,914 | 4,341 | 183,509 |
| Operating income (loss) | 5,428 | 7,769 | 11,526 | 11,118 | 8,632 | 50,545 |
| Cosmetics | 4,745 | 6,283 | 8,099 | 8,406 | 8,320 | 44,184 |
| Nutritional supplements | 4,638 | 5,371 | 6,879 | 5,960 | 4,694 | 43,189 |
| Others | (1,967) | (1,821) | (1,646) | (1,681) | (2,532) | (18,316) |
| Net income | 1,710 | 3,387 | 6,429 | 5,995 | 4,867 | 15,923 |
| Advertising expenses | 11,105 | 9,865 | 9,262 | 10,213 | 8,896 | 103,416 |
| Sales promotion expenses | 9,475 | 7,998 | 8,615 | 8,161 | 5,810 | 88,234 |
| Net cash provided by operating activities | 4,638 | 5,861 | 9,828 | 7,426 | 6,083 | 43,188 |
| Net cash used in investing activities | (4,807) | (4,117) | (5,582) | (5,416) | (4,838) | (44,762) |
| Net cash used in financing activities | (1,090) | (4,533) | (5,432) | (2,456) | (1,410) | (10,150) |
| **AT YEAR-END:** | | | | | | |
| Total assets | 79,416 | 78,479 | 79,804 | 79,026 | 75,481 | 739,510 |
| Shareholders' equity | 66,203 | 65,613 | 66,350 | 64,719 | 59,482 | 616,473 |

| | Yen | | | | | U.S. dollars |
|---|---|---|---|---|---|---|
| **PER SHARE:** | | | | | | |
| Net income | ¥80.3 | ¥154.6 | ¥279.5 | ¥307.6 | ¥249.8 | $0.75 |
| Shareholders' equity | 3,111.2 | 3,082.4 | 2,976.3 | 3,320.2 | 3,051.4 | 28.97 |
| Cash dividends | 50.0 | 42.5 | 35.0 | 25.0 | 25.0 | 0.47 |

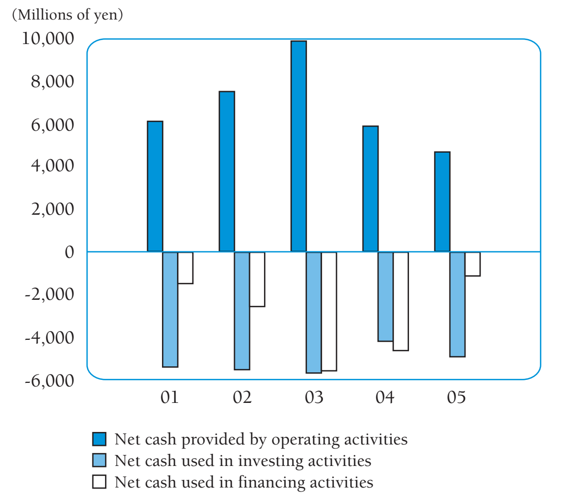
| | % | | | | |
|---|---|---|---|---|---|
| **RATIOS:** | | | | | |
| Operating income margin | 6.2 | 9.1 | 12.8 | 13.1 | 13.2 |
| Advertising and sales promotion expenses ratio | 23.4 | 21.0 | 19.9 | 21.7 | 22.5 |
| ROE | 2.6 | 5.1 | 9.8 | 9.7 | 8.5 |
| Equity ratio | 83.4 | 83.6 | 83.1 | 81.9 | 78.8 |

Note: U.S. dollar amounts are the yen equivalent, calculated, for convenience only, at a rate of 107.39 = U.S.$1, the approximate Tokyo foreign exchange market rate as of March 31, 2005.

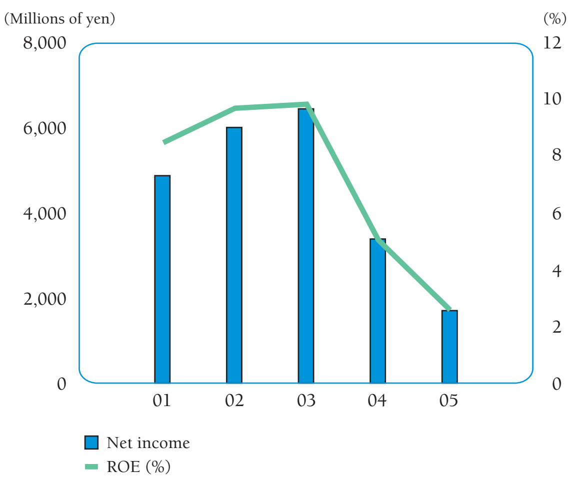
## Net Sales and Operating Income Margin



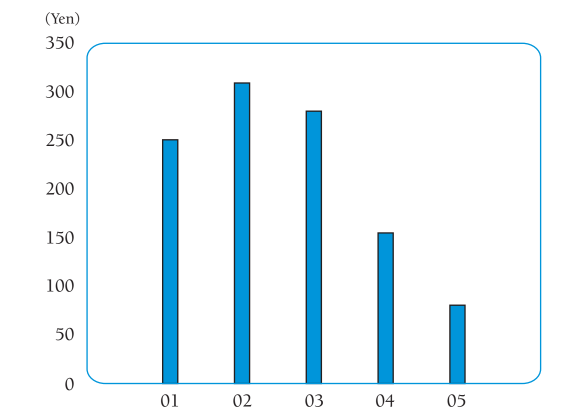

## Cash Flows



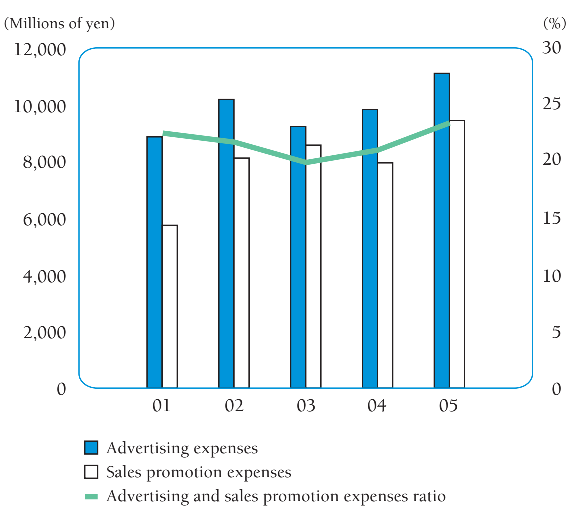

## Net Income and ROE



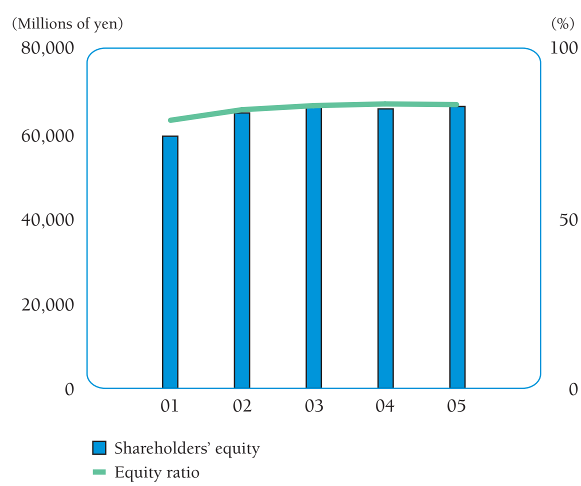

## Net Income per Share




## Advertising Expenses and Sales Promotion Expenses




## Shareholders' Equity and Equity Ratio




Please refer to Six-Year Summary (page 32).

## TO OUR SHAREHOLDERS AND ALL OUR STAKEHOLDERS

Over the previous year, we have focused our efforts on achieving a renaissance for the FANCL brand. We have been rewarded with results including a revival in cosmetics sales and further growth achieved in nutritional supplements. Boosted by our achievements and determined to see that they continue to grow, we will persist in the current fiscal year to introduce new and unique products that proudly bear the FANCL brand name.

### FISCAL 2005 CONSOLIDATED RESULTS

In fiscal 2005, the year ended March 31, 2005, despite a stagnant trend in the cosmetics industry as a whole, some areas recorded growth, notably skin care cosmetics such as sun-block products and beauty lotions. At the same time, the Nutritional Supplements Business expanded thanks to the general strengthening of interest among the public in health and health products, characterized by the boom in popularity of co-enzyme $Q_{10}$. Expansion was, however, offset somewhat by intensified competition brought about by new market entrants.

Amid these conditions, FANCL bolstered its activities toward rebuilding brand vitality. For this, we invested in product renewal, prioritized advertising and sales promotion expenses, refurbished retail stores, and actively increased our number of stores. These efforts have proved effective, with sales growing in both the cosmetics and nutritional supplements sectors, and consolidated sales rising 3.5% to ¥87.9 billion compared with the previous year. The Cosmetics Business, which marked a fall in revenue in the previous year, bounced back thanks to a renewal of the FENATTY series and MILD CLEANSING OIL, almost recovering to levels of two years ago with a year-on-year increase in sales of 6.2% to ¥37.1 billion. Moreover, growth in the Nutritional Supplements Business, including co-enzyme $Q_{10}$ and TWINTOSE-incorporated mineral supplements, accelerated to an increase of 5.0% year-on-year to ¥31.1 billion.

Meanwhile, in terms of profitability, we were obliged to sacrifice profitability temporarily, as we prioritized forward-looking investment in rebuilding our brands and customer base in fiscal 2005. Operating income declined 30.1% year-on-year to ¥5.4 billion, due to such factors as temporary increases in marketing expenses, which amounted to a rise of ¥2.7 billion for advertising and sales promotion. In addition, net income for the period was down 49.5% from a year before to ¥1.7 billion, incorporating the loss arising from a cancellation of leases due to the introduction of a new method to manufacture germinated brown rice. Net income per share dropped by ¥74.3 from the previous year to ¥80.3.

We now have within sight the goal of a top-line recovery for our core businesses. From fiscal 2006, we are sure that we will be able to achieve a convincing about-turn in our bottom-line products while maintaining and strengthening top-line growth momentum by shifting our emphasis to pinpoint marketing. We, therefore, have decided to implement annual dividends of ¥50 per share in this period, an increase of ¥7.5 per share.

FY2005 Earnings (Billions of yen)

| Factors for Sales Growth and Decline | |
|---|---|
| **Positive Factors** | |
| FANCL cosmetics | +1.4 |
| ATTENIR cosmetics | +0.9 |
| Nutritional supplements | +1.5 |
| Kale juice | +0.5 |
| Sundries, undergarments, and others | +0.1 |
| **Negative Factors** | |
| Germinated brown rice | -0.3 |
| IIMONO OHKOKU | -1.1 |
| Balance | +3.0 |

| Factors Affecting Operating Income | |
|---|---|
| **Positive Factors** | |
| Improved margins for nutritional supplements | +0.6 |
| Improved income from FANCL Square | +0.2 |
| **Negative Factors** | |
| Higher advertising expenses | -1.2 |
| Higher sales promotion expenses | -1.5 |
| Increased store-related expenses | -0.4 |
| Balance | -2.3 |

### EFFORTS RELATING TO THE THREE-YEAR MEDIUM-TERM MANAGEMENT PLAN (FANCL CHANGE & CHALLENGE PLAN)

Increasingly intense market competition has brought us to a point where our previously successful campaigns to promote our preservative-free cosmetics and reasonably priced nutritional supplements are no longer sufficient to guarantee success in a highly competitive market. We must now make further efforts to achieve market recognition of the unique added value provided by FANCL products, including functionality. We now have an opportunity to provide new value in FANCL products and raise the curtain on the Company's “second foundation.” As a first step along this path, in fiscal 2005 we launched a three-year management plan known as the FANCL Change & Challenge Plan (CC Plan). FANCL is making the best of this new start, positioning fiscal 2005 as a year for “change and structure,” followed by “structure and progress” in fiscal 2006, and “progress” in fiscal 2007.

**1. Even with a Downward Revision to Final Targets under the CC Plan, Earnings Targets in Our Core Businesses Remain Unchanged**

Fiscal 2005 was the launch year of the CC Plan, during which we targeted change and structure as a means of achieving a renaissance in the FANCL brand. In the Cosmetics Business, which had marked a fall in revenue in the previous fiscal year, post-renewal sales of our MILD CLEANSING OIL with its outstanding functionality surged to twice their previous level, and were the driving force behind our sales turnaround. Our core brand FENATTY series also contributed to enhanced sales after its renewal, in which we further enhanced its unique functionality. Moreover, in the nutritional supplements sector, sales of products with TWINTOSE-incorporated mineral supplements achieved approximately 20% growth in comparison to sales prior to the addition of this new ingredient. These facts have provided us with definite and clear feedback that our differentiation strategy is capable of realizing a renaissance of the FANCL brand and that there is still plenty of growth potential.

As the figures clearly show, while our core businesses of cosmetics and nutritional supplements are on track as originally planned, our other businesses, especially IIMONO OHKOKU (Kingdom of Wonderful Things) mail-order sales and germinated brown rice are still facing difficulties. We set an overall sales target for the initial year of the CC Plan in fiscal 2005 of ¥93 billion. However, impacted by the sluggish sales performance of IIMONO OHKOKU and germinated brown rice, actual sales reached a level ¥5 billion lower than the figure set out in the initial plan. Faced with these results, we have conducted a revision of the fiscal 2007 final targets, focusing on the “others” sector of our businesses, revising sales downward from ¥120 billion to ¥105 billion, and operating income down from ¥16 billion to ¥12 billion. I would like to stress, however, that the profit targets for our core sectors of cosmetics and nutritional supplements remain unchanged.

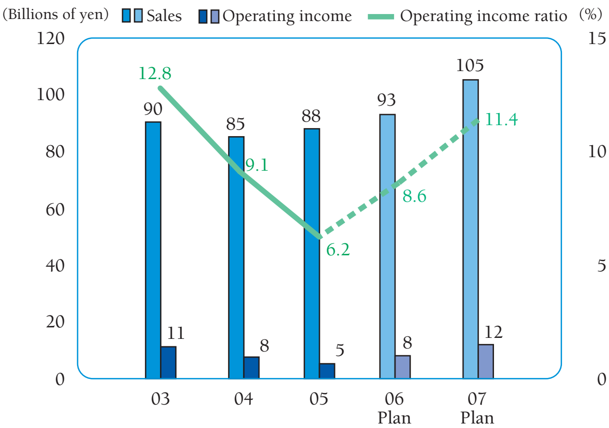
I am sure that a downward revision in the CC Plan after the first year of its launch must be a cause of great concern to all our shareholders. However, I would like to assure you that we are achieving definite results in our change and structure phase, which is dedicated to restoring FANCL to a healthy growth track. Using these results as a new springboard, we will aim to achieve a turnaround in sales and operating income, working toward the objective of achieving historic bests in both sales and profitability in fiscal 2007.

**2. Revitalizing Our Other Businesses**

The Germinated Brown Rice Business was positioned as a growth business in the CC Plan. However, its underperformance, coupled with lackluster figures for our IIMONO OHKOKU Mail-Order Business, has made the

Kenji Fujiwara
President and Representative Director

Mid-Term Management Plan FY2007 (Revised)




revision of the original CC Plan inevitable. By revising the income structure in our Other Businesses sector, we expect to swiftly eliminate deficits and turn them into profitable businesses.

In the Kale Juice Business, sales of the frozen type which had been suspended due to a lack of raw materials brought about by inclement weather were restarted in May 2004. In July, we launched sales of the powder type containing TWINTOSE with mineral absorption properties. The highly profitable powder type has performed strongly since its launch and in the second half of fiscal 2005 its sales reached a breakeven point. In fiscal 2006 we expect this business to become profitable with the frozen type making a comeback as a product containing TWINTOSE .

Meanwhile, with the Germinated Brown Rice Business, we will be implementing a comprehensive cost structure revision. We will be converting to a strategy that seeks to ensure stability in sales, working to expand clients who place standing orders, for example, from a strategy of expanding our client base by actively investing in marketing expenses. We will make further active efforts in the development of processed foods.

Moreover, in the IIMONO OHKOKU Mail-Order Business, by implementing significant cost reductions we achieved a profit in the second half of fiscal 2005. Moving forward, as we pursue enhanced efficiency within the group as a whole. The IIMONO OHKOKU Business will take over purchasing and quality control operations of the sundry division of FANCL. In this way, we will continue to seek cost reductions. We will also seek to build a stable profit structure by developing products that are likely to encourage customers to make repeat purchases.

## MAJOR STRATEGIES FOR FISCAL 2006

### 1. Product Strategy
### —Further enhancing our strong points

*(1) Cosmetics Business*

In the Cosmetics Business, we will create peerless brand strength in our preservative-free skin care products, one of the strengths of FANCL cosmetics. To this end, at the same time as we continue to expand the market for MILD CLEANSING OIL and FENATTY, during the first half of this fiscal year we are planning to engage in a renewal of our facial washing powder products, adding further unique functionality. The facial washing powder market

Mid-Term Management Plan FY2007—Revision of Final Targets (Billions of yen)

| | FY2005 | | | FY2007 | | |
|---|---|---|---|---|---|---|
| | Initial plan | Results | Difference | Initial Plan | Revised plan | Difference |
| Sales | ¥93.0 | ¥87.9 | ¥(5.1) | ¥120.0 | ¥105.0 | ¥(15.0) |
| Cosmetics | 36.3 | 37.1 | 0.8 | 48.6 | 46.2 | (2.4) |
| Nutritional supplements | 31.5 | 31.1 | (0.4) | 36.1 | 37.5 | 1.4 |
| Others | 25.2 | 19.7 | (5.5) | 35.3 | 21.3 | (14.0) |
| Germinated brown rice | 7.2 | 5.0 | (2.2) | 13.0 | 5.5 | (7.5) |
| Kale juice | 4.1 | 3.5 | (0.6) | 7.0 | 4.5 | (2.5) |
| IIMONO OHKOKU | 10.0 | 7.2 | (2.8) | 11.6 | 7.6 | (4.0) |
| Others | 3.9 | 4.0 | 0.1 | 3.7 | 3.7 | 0.0 |
| Operating income | 5.2 | 5.4 | 0.2 | 16.0 | 12.0 | (4.0) |
| Cosmetics | 4.8 | 4.7 | (0.1) | 8.6 | 8.6 | 0.0 |
| Nutritional supplements | 3.7 | 4.6 | 0.9 | 5.2 | 5.2 | 0.0 |
| Others | (1.4) | (2.0) | (0.6) | 4.0 | 0.0 | (4.0) |
| Operating income ratio | 5.6% | 6.2% | 0.6 pt | 13.3% | 11.4% | (1.9) pt |

Initial plan: Announced Nov. 2003. Revised plan: Announced Apr. 2005.

FANCL seeks to target is rapidly expanding, given the appeal of its hydrating properties and the appearance of foaming types (amounting to an estimated market value of ¥32.3 billion in 2003). With the renewed products, we aim to capture a prominent share of this market. In addition, as the centerpiece of the second half of the fiscal year, we plan to introduce anti-aging products, given an upswing in needs in this area of business due to the aging population. Not forgetting the ATTENIR range, which continues to outperform sales figures each year thanks to its sales points of "high quality, high functionality at a reasonable price," our objective is to achieve further growth by introducing aging-prevention care products, targeting women in their 30s and above.

***(2) Nutritional Supplements Business***

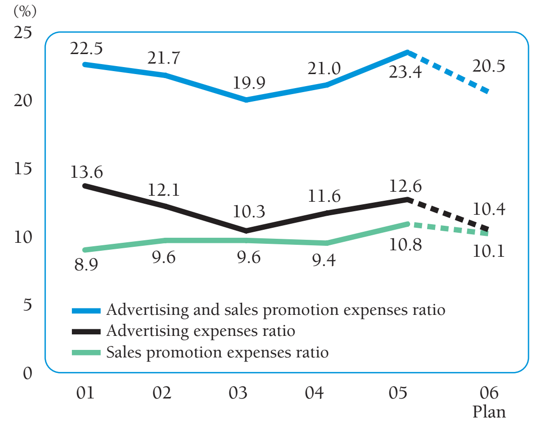
In the Nutritional Supplements Business, we will first further enhance our differentiation strategy, using TWINTOSE as a potent weapon. TWINTOSE is a type of oligosaccharide that drastically improves mineral absorption. As such, we expect that demand will expand for TWINTOSE to be incorporated into various food products. In addition to our present lineup of supplements that incorporate TWINTOSE, we will work to activate sales of TWINTOSE in a powder form. Using the appeal of TWINTOSE's particularly strong property to improve calcium absorption, we expect to develop needs for this to be mixed with milk or yogurt.

Secondly, we are going to pursue synergy effects in terms of our "inner and outer beauty" strategy, in cooperation with our Cosmetics Business operations. To this end, we will be paring down from the current ten to six items our range of beauty supplements that support beautiful skin and anti-aging from within based on the concept of "inner and outer beauty." We are also aiming to expand our product range incorporating our proprietary ingredient "HTC Collagen."

**2. Marketing Strategy**
**—Effective promotion through a pinpoint approach**

In fiscal 2006, as we return to a standard momentum in terms of advertising and sales promotion expenses, we aim to promote pinpoint marketing to utilize promotion costs optimally. In these efforts, it will be important to establish just what products we should make efforts to promote, as well as the targets and elements we can use to differentiate

Trends in Advertising and Sales Promotion Expenses as a Proportion of Sales




our products. Before investing in high-cost television commercials, we will clarify our product strategy, accurately analyze current customer needs and provide accurate and timely information to customers through direct mailing campaigns, renovate our stores to provide an "easy to see, easy to buy, easy to choose" environment, and improve store staff's customer care skills. We are sure that by shifting sales promotion activities from a quantitative to a qualitative approach, we will be in a ripe position to control costs and see further sales growth.

However, with regard to popular products that have been or will be renewed, including MILD CLEANSING OIL and facial washing powder, by continuing to promote these actively we aim to expand our client base. To achieve this, we would like to see our number of active customers increase (those who have made a purchase within the previous seven months), particularly those in the currently troubled mail-order channel, excluding Internet sales.

At the same time, as a means of making our pinpoint marketing highly effective it will be necessary to enhance our customer information gathering and analysis and to improve precision in strategy formulation. To this end, we newly established a Marketing Headquarters in November 2004. The Marketing Headquarters consists of a Marketing Division, which is responsible for the gathering and analysis of customer information, and an Advertising Division, which formulates advertising strategies and area vitalization strategies based on information from the Marketing Division. Through this new organization, we aim to enable seamless and more precise marketing activities—our pinpoint strategy.

**3. Retail Store Strategy—Active increase of store numbers and reinvigoration of existing stores**

In fiscal 2005, combined retail store sales from new and existing stores marked a year-on-year increase of 13.2% (fiscal 2004 sales were down 0.1% compared with fiscal 2003). Breaking this figure down further shows that sales at existing retail stores were up 6.4% on the year (fiscal 2004 sales were down 8.0% compared with fiscal 2003). We are demonstrating a rapid recovery in an intensely competitive environment.

Bringing our key FANCL concept of "caring for beauty and health both on the inside and the outside" to greater prominence, we are accelerating our store expansion, focusing on the FANCL House model and FANCL House J model, which is a store concept to attract all customers, regardless of gender or age. We are also advancing refurbishments to our existing stores with the aim of creating a new visual identity, an environment that provides an optimum purchasing setting for customers and an ideal working environment for staff. In order to dynamically promote improvements in staff skills and motivation, we have implemented a series of measures. These are: (1) revising of wage system and training system; (2) enhancing counseling skills through the cultivation of inner and outer beauty advisors (providing in-house certification to staff); and (3) strengthening the store guidance system through a new structure including supervisors. We regard the strong sales results of our stores as an indication that these measures are working well.

Given the excellent performance of our retail stores, we are aiming to quickly move to establish a 300 retail store chain, which was laid out in the sales channel strategy of the CC Plan, with 61 new stores planned for fiscal 2006. By the end of this fiscal year we aim to have a 229-store chain.

## CORPORATE GOVERNANCE

It is vital that we are a company trusted by all our stakeholders, including our shareholders. To maintain the trust of our stakeholders, we have created a through-going structure of corporate governance. This has been achieved by: (1) dividing supervisory and operating functions through a managing officer system; (2) improving transparency and improving oversight functions through an outside director system; (3) strengthening legal compliance by moving the Compliance Office to inside the Administrative Headquarters; and (4) strengthening systems for the protection and management of the personal information of our customers. Furthermore, from June 2005, the term of office for a company director will be shorted from two years to one year. This will enable us to further clarify the management responsibility of directors and to create an appropriate management structure that responds to changes in management needs in a quick and flexible manner.

With the changes scheduled to take effect in June 2005, the founder of FANCL and one of our major shareholders, Mr. Kenji Ikemori, will leave his position as director. He will continue to serve at the company in the capacity as Founder, and we look forward to continuing to benefit from his advice on management aspects as a representative of our shareholders.

## TOWARD THE EXPANSION OF CORPORATE VALUE

By reinvigorating the highly profitable Cosmetics and Nutritional Supplements Businesses, we are aiming to achieve operating income of ¥12 billion in fiscal 2007, which would set a new record for FANCL and be a way of expressing our gratitude to our shareholders. This is not our ultimate goal, however. In order to maintain long-term growth, we must acquire the ability to be able to continuously create peerless products that will be chosen by our customers—"one of a kind" products. With a new and enhanced lineup, we will strive to step up our marketing power and product development prowess and move proactively forward to respond accurately to changing needs in a health-conscious and aging society. We are dedicated to strengthening FANCL's presence as a specialist in inner and outer "beauty and health."

I ask for your continued support and understanding in our ongoing efforts as we move forward.

Kenji Fujiwara

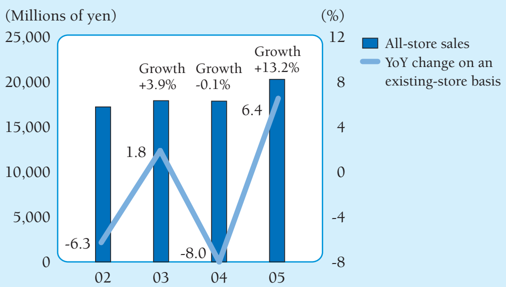
Kenji Fujiwara, President and Representative Director
July 2005

# STORE ENHANCEMENT AND PRODUCT DIFFERENTIATION STRATEGIES
## —Drivers for Restoring FANCL's High-Growth Momentum

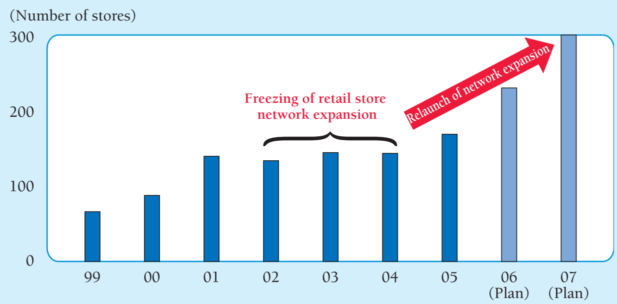
## SPECIAL FEATURE 1: Reforming the Retail Store Channel

In fiscal 2005, we strengthened our retail store network, positioning it more strategically as an important sales channel. This has involved efforts to broadly strengthen both the operational aspects of our business as well as the expansion of our network and refurbishment of existing stores. The fruits of our efforts are already translating into increased sales.

Trends in Retail Store Sales




Trends and Projections in Retail Store Expansion




### FIRST EXPANSION PHASE: From Showrooms to Secondary Sales Channels

FANCL began operations as a mail-order retailer, initially positioning retail stores as our showrooms or supplementary outlets to our mail-order sales channel. Over time, retail stores have increased in importance to become a significant second sales channel.

Our retail stores trace their history to 1995. The popularity of our preservative-free cosmetics created demand from department stores to open retail outlets. In response, we opened the first FANCL HOUSE as a pilot store in Shizuoka City. Our first store proved to be a great success. Even more importantly, the store was a valuable source of information for identifying customer needs, given the fact that customers were able to see and try the products for themselves, something that is not possible through mail-order sales. This led to our realization that retail stores were a highly promising sales channel. With this encouraging start, we expanded our store network, which by August 2000 totaled more than 100 stores.

### GROWTH PLATEAU: Freezing of Retail Store Network Expansion Strategy from Fiscal 2002 to Fiscal 2004

Once our retail store network reached the 100-outlet level, expansionary moves that had been progressing robustly began to stall, while existing store sales also began to gradually plateau. As a result, fiscal 2002 became a period of stagnation for us. We, therefore, made the decision to freeze our expansion strategy from fiscal 2002 and shift our priority to reinvigorating existing stores. It also became apparent that one reason for our lack of sales vigor in existing stores was that our expansionary moves had continued without a clear chain store operation structure in place. Moreover, given that personnel and training systems were not sufficiently developed, personnel turnover at retail stores was high, and this increasing personnel turnover rate led to a drop in service quality, which prompted customers to shop elsewhere.

### SECOND EXPANSION PHASE:
### Relaunch Retail Store Network Expansion, Aiming for 300 Stores Nationwide Starting in Fiscal 2005

During fiscal 2005, we recruited personnel with retail experience from outside the Company. Through the establishment of a chain store operation and by bolstering our personnel base in this way, we were able to relaunch simultaneously our retail store network expansion strategy.

Although our basic sales style remains unchanged in that we offer advice to our customers only when they ask for it, what we have changed is a structure through which we are able to promote more actively our new products and unique brand appeal. Moreover, strengthened communication between headquarters and retail stores has enabled us to initiate promotional activities at stores in synchronization with advertising campaigns run by headquarters. These efforts resulted in fiscal 2005 net sales at existing stores increasing 6.4% from the previous year. The results, coupled with the effect of opening new stores, have been the driving force behind FANCL's sales figures recovery.

## SPECIFIC MEASURES FOR FISCAL 2005

### (1) Enhancing Systems and Structures—Nurturing retail store staff adept at providing counseling in response to customer requests

*Enhancing Counseling Capabilities*

- Introduction of a new training system based on an analysis of retail store staff sales skills
- Establishment of a FANCL ACADEMY in combination with in-store training as measures to strengthen the education system
- Strengthen training of inner and outer "beauty and health" advisers* (store staff possessing qualifications: 87 persons)

* This is an in-house qualification accredited by FANCL to staff who have acquired knowledge about nutrition, dermatology, the FANCL concepts of beauty, and have the capability to provide counseling services for both nutritional supplements and cosmetics.

*Improving Motivation*

- Reforms to move from a seniority-based wage system to a system based on roles and responsibilities
- Creation of a registration system for contract employees to become full-time employees
- Creation of a reemployment system for those returning after maternity or childcare leave

*Developing a Chain Store Management Structure*

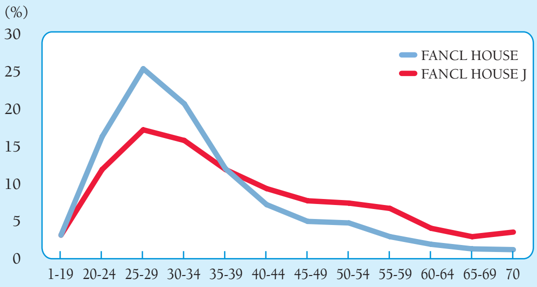
- Systemization of the store supervisor (SV) system (from July 2004)
- Introduction of area-based retailing advisors (from November 2004)

### (2) Enhancing Hardware—Stores gather customers and convey FANCL's brand

In May 2004, the construction of a new visual identity was completed, and in fiscal 2005, we implemented the refurbishment of a total of 54 retail stores. We have moved away from a business model in which our retail stores were centered on cosmetics to a new style of "stores that provide beauty and vitality" based on our unique concept of inner and outer "beauty and health."

Additionally, we launched FANCL House J as a new store model in May 2004. In comparison to the FANCL House concept, which is aimed at women in their 20s and 30s, the FANCL House J stores are designed to attract a wider age-range and also appeal to male customers.

Age Composition by Store Type

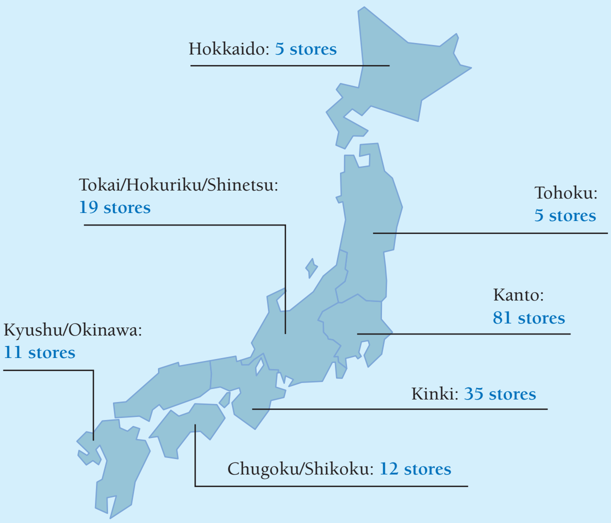



### (3) Area Strategy

Under the Medium-Term Management Plan (FANCL Change & Challenge Plan) we are scheduled to complete development of a 300-store network by the end of fiscal 2007. Our stores are generally 40 to 50m² in area and we plan for them to be located generally in department stores, shopping centers, and railroad station buildings. There are approximately 900 potential locations for stores, and from these we intend to choose 130 locations, actively establishing new stores over the coming two-year period.

Our policy is to focus our expansion strategy on prefectures where we currently have no representation (there were seven such prefectures as of the end of March 2005), as well as metropolitan and city areas.

**Retail Store Network** (Please also see page 23 for "Retail store Expansion")



## **SPECIAL FEATURE 2:** Achieving a Renaissance in Product Brand Power through New and Unique Functionality and Ingredients

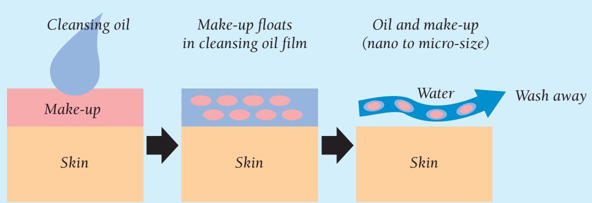
Key to the FANCL Brand Renaissance is two concepts: our overarching preservative-free concept, as well as the pursuit of new and unique functionality and ingredients. In fiscal 2005, under this new differentiation strategy, our sales revival was led by the renewed MILD CLEANSING OIL and FENATTY in the cosmetics sector and TWINTOSE, a unique ingredient that drastically improves mineral absorption capabilities, in the nutritional supplements sector.

### MILD CLEANSING OIL—Introduction of nano-cleansing system

MILD CLEANSING OIL is FANCL's largest single product, with sales doubling after its branding renewal in August 2004.

The nano-cleansing system (patent applied) that we introduced with the renewal of the MILD CLEANSING OIL is characterized by its ability to quickly and completely cleanse skin. This is achieved through a natural oil that comprises a unique blend of ingredients that lift off make-up and dirt instantly, deconstructing components to a nano-size. Other cleansing oils on the market that "can be used with wet hands" generally are water-based to enable them to blend easily with water. However, given this water-based composition, it is difficult for such oils to blend with make-up. FANCL's unique design ensures that water particles mix with oil at the nano-level, ensuring that it is possible even with wet hands to enjoy a high degree of cleansing. Our efforts have born fruit in a ground-breaking product that naturally gives the user a feeling of having used extremely pure, natural plant extract oils and also provides a high degree of functionality, so that it can be used easily even in a home bathroom.

Nano-Cleansing System




### TWINTOSE—Booster of mineral absorption properties

Given ever-worsening chronic mineral deficiencies, including calcium, iron, magnesium, and zinc, FANCL decided to focus its efforts on TWINTOSE* as an ingredient capable of boosting mineral absorption properties. Receiving a research subsidy grant from the government in November 2001, a joint industry-academia-government research project was launched in cooperation with Hokkaido University and Nippon Beet Sugar Manufacturing Co., Ltd. The fruits of this joint research were not only an increase in mineral absorption properties, but also the revealing of functions that enable drastically improved body retention rates for minerals. Having established the world's first technology for its mass-production, we moved in fiscal 2005 to create a commercial product and bring it to the market.

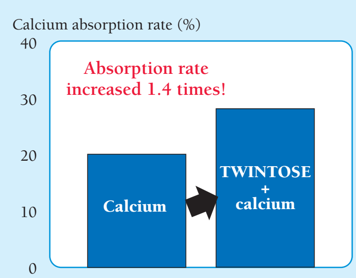
TWINTOSE is a new ingredient that combines the excellent qualities of freshness and sweetness of flavor with highly promising processing characteristics such that we have positioned it with confidence as a blockbuster product that has many uses in compounds with food products and not just as a supplement. Given TWINTOSE's excellent absorption properties and body retention promoting effects for calcium, we expect needs to be particularly large in milk and yogurt-based products.

We are also progressing with the discovery of new properties. TWINTOSE is a low calorie compound, and is, therefore, capable of controlling sudden upswings in blood sugar levels and not adversely affecting them. This property is particularly useful for people who have dietary restrictions due to diabetes or people who are dieting. Given its stable construction, it is also heat resistant and could be easily used in hot foods such as stews. TWINTOSE really is a new compound with limitless potential.

***What is TWINTOSE?**
TWINTOSE is a refined ingredient created from water-soluble enzyme-processed plant fiber extracted from chicory. Given its characteristics as an oligosaccharide derived from natural vegetables, it has a high degree of safety for consumption; however, the biggest issue to overcome was how to extract sufficient quantities of the fiber. FANCL was successful in developing the world's first technology for its mass-production. This technology has enabled us to create TWINTOSE, which when combined with calcium in particular, has been proven to increase **absorption rates by as much as 1.4 times**, and **body retention rates by six times.**

Chicory

Improvements in Calcium Absorption Rates Achieved in Humans



## BUSINESS OVERVIEW AND STRATEGY

FANCL's businesses include its Cosmetics Business, the Nutritional Supplements Business, as well as Other Businesses (germinated brown rice, kale juice, IIMONO OHKOKU mail-order, and others). In Japan, we have three sales channels: mail-order, retail store, and wholesale sales. We also sell cosmetics and nutritional supplements overseas, centering on Asia.

CONTENTS



## MANAGEMENT SYSTEM

FANCL, in a bid to be a corporation that shareholders and all other stakeholders can trust, is making efforts to improve corporate governance and compliance, as well as the fair and prompt disclosure of information. While contributing to society through business activities that focus on "beauty and health," we are also proactively involved in environmental conservation activities as well as community service activities as a "good corporate citizen."

CONTENTS



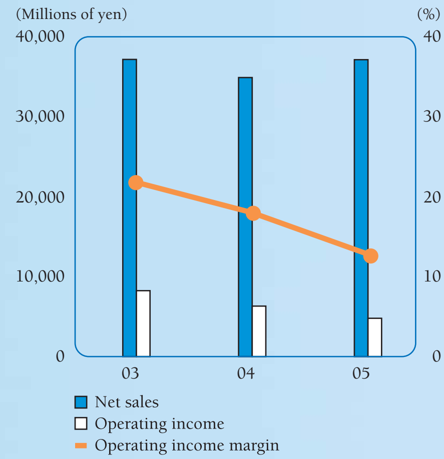
| | PRODUCTS | NET SALES AND OPERATING INCOME (LOSS) |
|---|---|---|

## COSMETICS BUSINESS

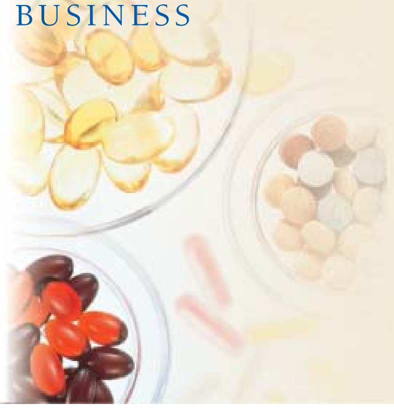

# 42.2%

### OF TOTAL NET SALES

- FANCL cosmetics
  (Preservative-free cosmetics that contain no ingredients known to cause skin allergies)
- ATTENIR cosmetics
  (Attractive, quality cosmetics at reasonable prices)



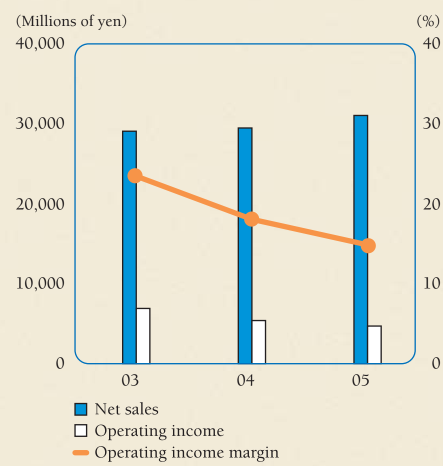

## NUTRITIONAL SUPPLEMENTS BUSINESS



# 35.4%

### OF TOTAL NET SALES

- Health supplements
  (High-quality nutritional supplements at competitive prices)
- Beauty supplements
  (Nutritional supplements for inner beauty)

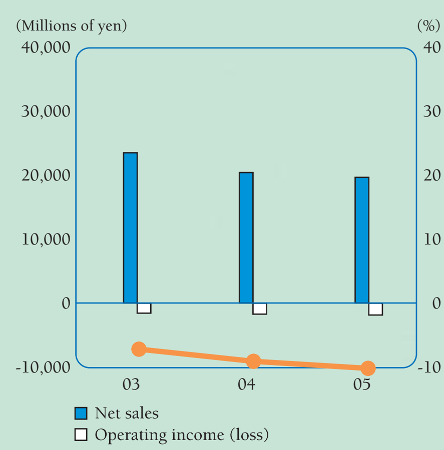



## OTHER BUSINESSES

# 22.4%

### OF TOTAL NET SALES

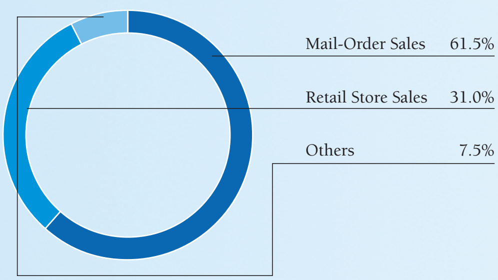
- Germinated brown rice
- Kale juice
- Comfort undergarments
- Health equipment and lifestyle goods



## SALES CHANNEL BREAKDOWNS

## MAJOR DEVELOPMENTS DURING FISCAL 2005 AND STRATEGIC FOCUS FOR FISCAL 2006

Sales Breakdown by Sales Channel
Year Ended March 31, 2005



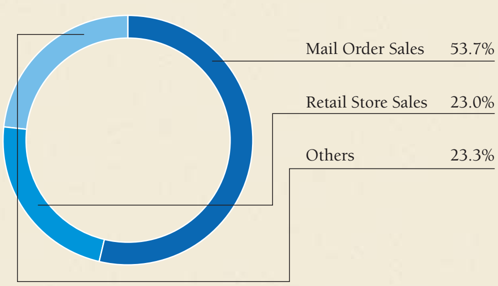

### SUMMARY FOR FISCAL 2005

- Sales of FANCL cosmetics improved, driven by MILD CLEANSING OIL and FENATTY with added unique functions.
- The number of active customers using ATTENIR cosmetics set a new record, repeating the previous term's performance, and sales also reached a new high thanks to the effects of advertising and sales promotion activities.
- Sales at existing retail stores improved as measures to enhance retail store sales capacity proved successful.
- Operating income declined due to aggressive advertising and sales promotion activities associated with product renewal.

### STRATEGIC FOCUS FOR FISCAL 2006

- We will renew our facial washing powder product by adding unique functions and focus on the differentiation of FANCL cosmetics.

Sales Breakdown by Sales Channel
Year Ended March 31, 2005



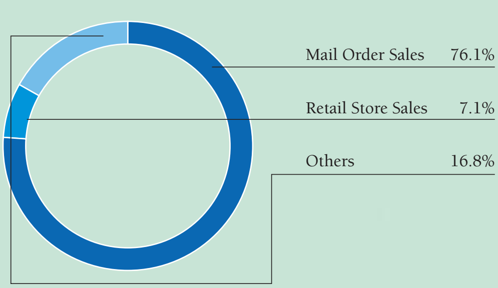

### SUMMARY FOR FISCAL 2005

- As a result of the renewal of minerals supplements by incorporating the new functional ingredient TWINTOSE, sales of TWINTOSE-incorporated products increased as a whole.
- Mail-order sales were firm thanks in part to the co-enzyme $Q_{10}$ boom.
- Retail store sales grew in part because of the effect of new store openings of FANCL House J, carrying a broad range of nutritional supplements.
- Operating income declined as we aggressively spent on advertising to promote consumer recognition of TWINTOSE.

### STRATEGIC FOCUS FOR FISCAL 2006

- In addition to the line of TWINTOSE-incorporated products, we will push ahead with product differentiation by introducing original ingredients such as HTC Collagen.

Sales Breakdown by Sales Channel
Year Ended March 31, 2005




### SUMMARY FOR FISCAL 2005

- Sales of germinated brown rice declined despite efforts to improve the taste significantly by adopting a new processing method.
- Sales of kale juice increased, with the powdered version incorporating TWINTOSE and the frozen version recording a strong performance.
- Stagnant sales in the main catalogue business resulted in a decline in revenue from the IIMONO OHKOKU (Kingdom of Wonderful Things) Mail-Order Business.
- Operating loss in other businesses increased, affected by the poor performance of the IIMONO OHKOKU Mail-Order Business.

### STRATEGIC FOCUS FOR FISCAL 2006

- We will seek to improve profitability through a review of our cost structure.

# COSMETICS BUSINESS

Cosmetics Business Performance and CC Plan (Targets)

| | Millions of yen | | | | |
|---|---|---|---|---|---|
| | *2007 (plan)* | *2006 (plan)* | **2005** | 2004 | 2003 |
| Net sales | *46,200* | *39,600* | **37,098** | 34,926 | 37,155 |
| FANCL cosmetics | *34,200* | *29,500* | **27,759** | 26,370 | 29,683 |
| ATTENIR cosmetics | *11,600* | *9,800* | **9,042** | 8,147 | 7,078 |
| Others | *400* | *300* | **297** | 407 | 394 |
| Gross profit | | *29,300* | **27,592** | 26,394 | 28,407 |
| Selling, general and administrative expenses | | *23,600* | **22,847** | 20,111 | 20,308 |
| Advertising expenses | | *4,600* | **5,073** | 3,932 | 3,328 |
| Operating income | *8,600* | *5,700* | **4,745** | 6,283 | 8,099 |
| Operating income margin | *18.6%* | *14.4%* | **12.8%** | 18.0% | 21.8% |
| | Customers | | | | |
| Number of active customers* at fiscal year-end: | | | | | |
| FANCL cosmetics (Mail-order and retail store) | | | **1,157,014** | 1,041,054 | 1,128,785 |
| ATTENIR cosmetics (Mail-order) | | | **432,200** | 372,679 | 306,327 |

* Active customers: Customers making at least one purchase during the preceding seven months.
Sundries customers are included in the number of FANCL cosmetics' active customers in 2003, but not in 2004 and 2005.

## FISCAL 2004 RESULTS

**—Sales of FANCL cosmetics improve, ATTENIR cosmetics achieve record sales**

### *Sales*

Cosmetics Business sales improved, increasing 6.2% over the previous year to ¥37,098 million. For FANCL cosmetics with the preservative-free concept, to achieve a brand revitalization of basic skincare products, we renewed our best-selling single item MILD CLEANSING OIL in August and our mainstay brand in the line of skincare products FENATTY in September. For ATTENIR cosmetics with the concept of reasonable prices, high quality, and high functionality, we renewed makeup products and launched the high-functionality skin-lightening beauty lotion NIGHT WHITE CC.

As a result, sales of FANCL cosmetics rose 5.3% from the previous year to ¥27,759 million, with renewal products providing the driving force in the second half to make up for pre-renewal buying restraints in the first half. ATTENIR cosmetics posted record sales of ¥9,042 million, a rise of 11.0% over the previous year, with both new products and renewal products faring well thanks to effective advertising and sales promotion activities.

### *Sales, by Sales Channel*

Mail-order sales increased 4.4% over the previous year to ¥22,829 million. Mail-order sales of FANCL cosmetics rose 1.4% year-on-year to ¥14,432 million on the strength of makeup products and limited-time seasonal products as well as renewal products. Mail-order sales of ATTENIR cosmetics continued to show strong growth, rising 10.0% over the previous year to ¥8,392 million.

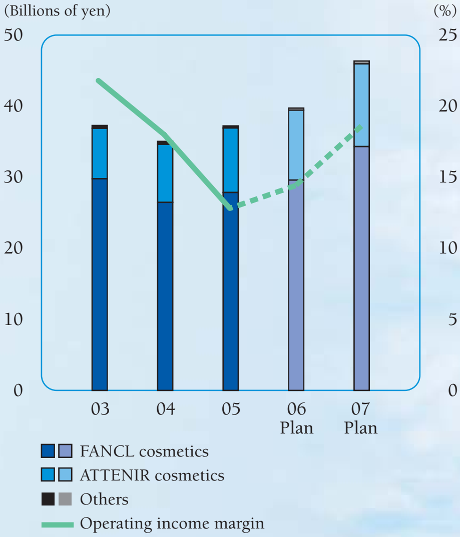
In retail store sales, existing-store sales improved as a result of proactive efforts to boost sales capability, such as measures to help raise the motivation of store staff and store renovations. These efforts, combined with the effects of new store openings (please refer to page 23), pushed retail store sales of cosmetics up 8.3% year-on-year to ¥11,491 million.

Other sales channels increased 13.5% year-on-year to ¥2,777 million. While convenience store sales fell short of the previous year's level, this was offset by strong overseas sales in Hong Kong and other markets.

### *Profit and Loss*

Operating income dropped 24.5% year-on-year to ¥4,745 million, while operating income margin fell 5.2 percentage

Cosmetics Business Net Sales and Operating Income Margin




FANCL cosmetics
**FENATTY series**

FANCL cosmetics
**MILD CLEANSING OIL**

ATTENIR cosmetics
**NIGHT WHITE CC**


points from the previous year to 12.8%. In addition to higher fixed costs due to the start-up of the Shiga Factory and higher personnel costs associated with the increase in store numbers, operating income was weighed down by aggressive spending on advertising and sales promotion activities associated with product renewal.

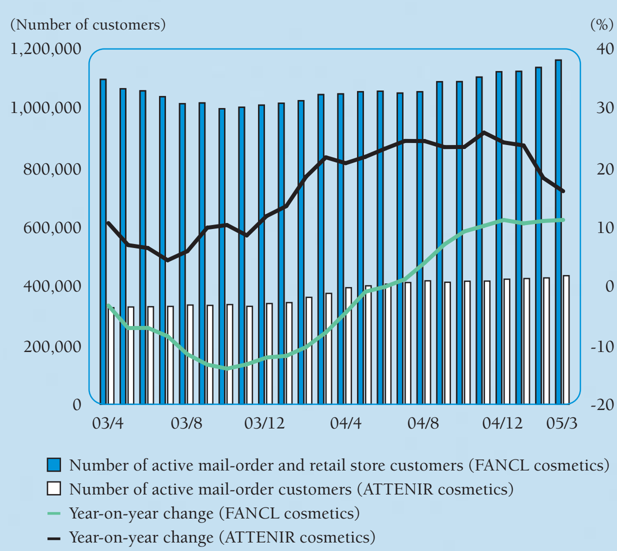
## FISCAL 2005 OVERVIEW AND FISCAL 2006 STRATEGY

**—Renewal of facial washing powder in fiscal 2006**

In fiscal 2005, we primarily sought to reinforce our line of skincare products by differentiating them from competing products through the renewal of the FENATTY series. As a consequence, monthly sales of the post-renewal FENATTY line rose about 20% from the previous year's level, and we succeeded in turning around the FENATTY line of preservative-free skincare products, the mainstay of FANCL cosmetics. Moreover, sales of MILD CLEANSING OIL doubled after the renewal, making us even more confident in our strategy to revive brands through the incorporation of "original ingredients and unique functions."

In fiscal 2006, we will continue to engage in proactive sales promotion activities to convince potential customers of the excellent product attributes of MILD CLEANSING OIL and FENATTY. We will also renew our facial washing powders, the starting point of skincare, by renewing them as products with appealing unique functionality, and launch them by the end of the first half. Furthermore, we are planning to launch high-functionality anti-aging beauty lotion employing our original materials.

Active Cosmetics Customers



# NUTRITIONAL SUPPLEMENTS BUSINESS

Nutritional Supplements Business Performance and CC Plan (Targets)

| | Millions of yen | | | | |
|---|---|---|---|---|---|
| | *2007 (plan)* | *2006 (plan)* | **2005** | 2004 | 2003 |
| Net sales | *37,500* | *33,200* | **31,132** | 29,656 | 29,211 |
| Gross profit | | *21,450* | **20,623** | 19,047 | 19,161 |
| Selling, general and administrative expenses | | *16,850* | **15,985** | 13,676 | 12,282 |
| Advertising expenses | | *3,200* | **3,291** | 2,501 | 1,825 |
| Operating income | *5,200* | *4,600* | **4,638** | 5,371 | 6,879 |
| Operating income margin | *13.9%* | *13.9%* | **14.9%** | 18.1% | 23.5% |
| | Customers | | | | |
| Number of active customers* at fiscal year-end: Mail-order and Retail store | | | **1,114,282** | 1,066,078 | 1,109,821 |

*Active customers: Customers making at least one purchase during the preceding seven months.

## FISCAL 2005 RESULTS

**—Higher sales increase on the TWINTOSE effect and the co-enzyme $Q_{10}$ boom**

### *Sales*

Nutritional Supplements Business sales increased 5.0% over the previous year to ¥31,132 million. Amid the continued expansion of the supplements market against the backdrop of heightened health consciousness, higher sales were achieved in April and May 2004 by four mineral supplements renewed with the incorporation of TWINTOSE, which boosts the body's capacity to absorb minerals.

Meanwhile, co-enzyme $Q_{10}$ became highly popular across Japan after it was introduced as an ingredient with powerful antioxidant properties in a health information television program. Sales of FANCL's reasonably priced $Q_{10}$ supplement soared sevenfold following the television program in September from the monthly average sales the previous year. Demand for $Q_{10}$ supplements was fueled further by regulatory approval of the use of $Q_{10}$ in cosmetics in October 2004.

### *Sales, by Sales Channel*

Mail-order sales increased 1.6% year-on-year to ¥16,709 million, supported by the $Q_{10}$ boom and the solid performance of TWINTOSE-incorporated products.

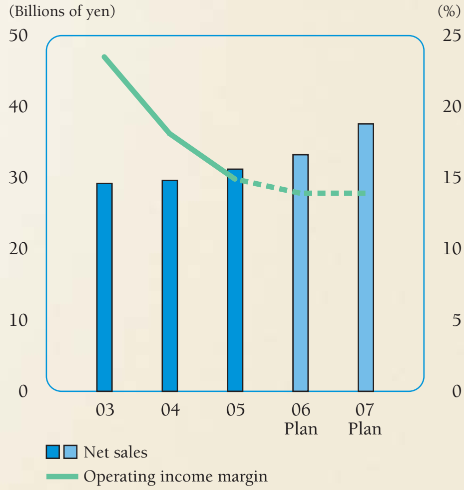
Retail store sales posted a strong rise of 19.7% over the previous year to ¥7,175 million as more customers of cosmetics-oriented FANCL House took interest in the "inner and outer beauty" concept advocated by FANCL as well as the increase in the number of FANCL House J stores, which carry a more extensive line of nutritional supplements than FANCL House stores.

Other sales channels were up 0.3% year-on-year to ¥7,246 million. Although sales at convenience stores and supermarkets declined from the previous year due to intensified competition, sales in Hong Kong and other overseas markets increased.

### *Profit and Loss*

Operating profit decreased 13.6% year-on-year to ¥4,638 million and operating income margin also declined 3.2

Nutritional Supplements Business Net Sales
and Operating Income Margin




TWINTOSE and
TWINTOSE-incorporated
mineral supplements

HTC Collagen

Co-enzyme Q10

percentage points to 14.9%, due principally to aggressive spending on advertising to help boost consumer recognition of TWINTOSE. An improvement in the cost ratio through a review of raw materials prices and other measures did not offset this increased spending.

## FISCAL 2005 OVERVIEW AND FISCAL 2006 STRATEGY

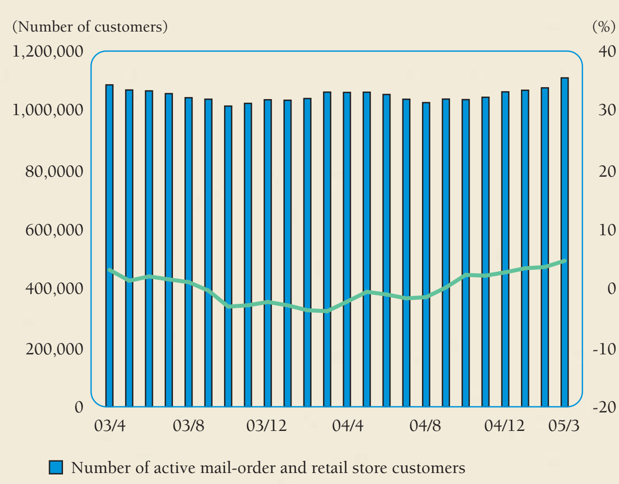
**—Focus on sales expansion of TWINTOSE and beauty supplements**

In fiscal 2005, our strategy to revitalize existing minerals supplements with the incorporation of TWINTOSE proved successful. According to one survey, however, the degree of recognition of TWINTOSE, which we position as a major growth product that would also affect the food industry, was only 4%, far lower than the 57% mark for catechin and the 42% mark for DHA.

Under these circumstances, we will redouble efforts to push for further growth of products incorporating TWINTOSE, centering on the powdered version of TWINTOSE that can effectively boost the body's capacity to absorb calcium when mixed with milk or yogurt. While responding to the strong underlying demand for co-enzyme Q10, we will also strengthen our line of beauty supplements using original materials such as HTC* Collagen, thereby aggressively promoting the concept of "inner and outer beauty."

*HTC: High Tripeptide Containing

Active Nutritional Supplements Customers



# OTHER BUSINESSES

Other Business Performance and CC Plan (Targets)

| | Millions of yen | | | | |
|---|---|---|---|---|---|
| | 2007 (plan) | 2006 (plan) | 2005 | 2004 | 2003 |
| Net sales | 21,300 | 20,220 | 19,707 | 20,375 | 23,660 |
| Germinated brown rice | 5,500 | 5,200 | 5,026 | 5,383 | 6,844 |
| Kale juice | 4,500 | 4,000 | 3,524 | 2,985 | 2,501 |
| IIMONO OHKOKU mail-order | 7,600 | 7,400 | 7,153 | 8,270 | 10,936 |
| Others | 3,700 | 3,600 | 4,002 | 3,736 | 3,376 |
| Gross profit | | 10,350 | 9,689 | 10,254 | 11,413 |
| Selling, general and administrative expenses | | 10,750 | 11,656 | 12,075 | 13,059 |
| Advertising expenses | | 1,900 | 2,740 | 3,430 | 4,107 |
| Operating income | 0 | (400) | (1,967) | (1,821) | (1,646) |
| Operating income margin | 0.0% | (2.0%) | (10.0%) | (8.9%) | (7.0%) |
| | Customers | | | | |
| Number of active customers at fiscal year-ended: | | | | | |
| Germinated brown rice (Mail-order) | | | 236,304 | 340,764 | 464,264 |
| Kale juice (Mail-order) | | | 99,564 | 113,775 | 116,146 |

*Active customers: Customers making at least one purchase during the preceding seven months.

## FY2005 RESULTS

**—Kale juice and IIMONO OHKOKU mail-order turn profitable in the 2nd half**

### *Sales*

Other Businesses sales dropped 3.3% year-on-year to ¥19,707 million.

### *Sales, by Category*

Germinated Brown Rice Business sales fell 6.6% year-on-year to ¥5,026 million. We launched germinated brown rice with an improved taste, smell, and texture, processed with under a new method. We began to aggressively push mail-order and retail store sales of this new germinated brown rice in June and wholesale sales to supermarkets in September. However, we were not able to fully differentiate the new product with competing products offered by other companies. The number of mail-order sales customers continued to decline, while sales to supermarkets failed to make a substantial recovery.

Kale Juice Business sales rose 18.1% year-on-year to ¥3,524 million. In fiscal 2004, we found ourselves in a serious situation when we could not procure materials due to bad weather and were forced to suspend the supply of kale juice from mid-February. In fiscal 2005, however, we increased the acreage of land contracted for growing kale in warmer regions as well as regions less affected by typhoons, and we resumed sales of kale juice through all sales channels in May 2004. In addition to the conventional frozen version, the TWINTOSE-added powdered version launched in July fared strongly, with sales increasing in all sales channels.

IIMONO OHKOKU (Kingdom of Wonderful Things) Mail-Order Business sales declined 13.5% year-on-year to ¥7,153 million. According to a thorough review of the business, catalog sales were sluggish.

Other Related Businesses sales rose 7.1% year-on-year to ¥4,002 million thanks to strong sales of undergarments and sundries.

### *Profit and Loss*

Operating loss widened ¥146 million from the previous year to ¥1,967 million, due chiefly to larger losses by the IIMONO OHKOKU Mail-Order Business. In the second half, however, the profitability of the Kale Juice Business improved thanks to the launch of the highly profitable TWINTOSE-added kale juice and that of the IIMONO OHKOKU Business also improved due to restructuring effects, with both the Kale Juice Business and IIMONO OHKOKU Business pulling out of loss-making situations.

Other Businesses Net Sales and Operating Income Margin


Germinated brown rice products

Powdered kale juice

IIMONO OHKOKU mail-order catalogs

## FISCAL 2005 OVERVIEW AND FISCAL 2006 STRATEGY

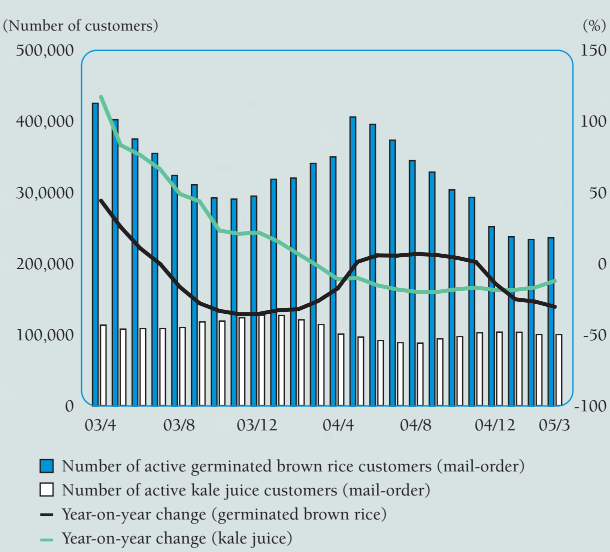
**—High expectations for TWINTOSE-added kale juice in fiscal 2006**

In the Germinated Brown Rice Business, though the number of active mail-order customers was on a downward trend, customers placing standing orders increased. We will continue to strive to increase the number of these customers and boost the development of new products geared toward processed food manufacturers. In April 2005, we started production of private-brand products for major retailers. We will seek to enhance profitability by raising capacity utilization.

In the Kale Juice Business, we will seek to improve profitability by adding high value-added products incorporating TWINTOSE, which abundantly boosts the body's capacity to absorb minerals contained in kale juice, to the loss-making frozen version. We will also revamp the system for stable procurement by diversifying locations of kale-growing land and promote product differentiation over the medium term by introducing new growing methods to augment the nutritious value of kale.

The IIMONO OHKOKU Mail-Order Business will take over the purchasing and quality control operations of the Sundry Division of FANCL, thereby contributing to higher efficiency across the Group. We will also make cost-cutting efforts on a continuing basis, and seek to establish stable profitability by developing products that are likely to prompt customers to make recurrent purchases.

Active Germinated Brown Rice and Kale Juice Customers



FANCL has a multiple-channel sales system of mail-order, retail store, and wholesale sales. While giving importance to mail-order sales as the principal channel of sales, the FANCL Change & Challenge Plan (CC Plan) identifies the expansion of the retail store network as a priority task to expand the new customer base.

## POSITIONING OF EACH SALES CHANNEL

Mail-order sales (including the Internet) are our main sales channel and account for some 62% of total sales. FANCL's preservative-free cosmetics are produced in factories in an aseptic condition, with the manufacturing date displayed on all products. Mail-order is the most appropriate channel to directly deliver freshly-made products to customers. At the same time, mail-order is widely used as a convenient channel to purchase nutritional supplements.

On the other hand, retail stores are increasingly gaining importance for their role as a place where customers can actually see and try products. Many Japanese consumers prefer to make purchases at retail stores, and retail stores can attract new customers who cannot be won over through the mail-order channel. As such, under the CC Plan, we are working to build a network of 300 retail stores, about double the number in fiscal 2004.

For wholesale sales, we have been strategically increasing our number of business partners, centering on supermarkets and convenience stores, as a channel to enhance the "convenience of customers," and we also launched efforts to sell our products to medical and pharmaceutical institutions as a new channel.

## MAIL-ORDER SALES

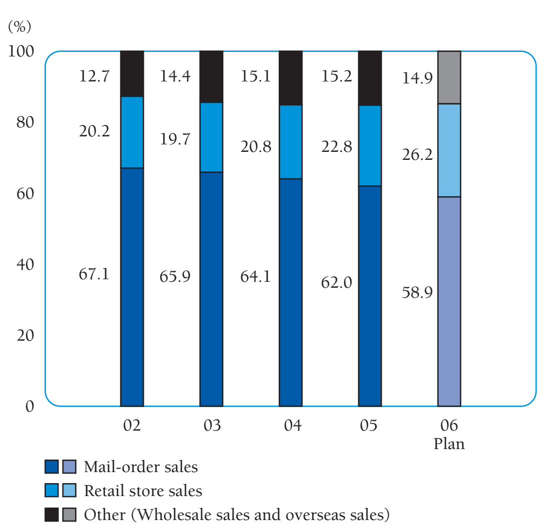
**Internet-Based Sales Growing Steadily**

The number of active mail-order customers is recovering for both cosmetics and nutritional supplements. In particular, the number of active customers using the Internet has been increasing steadily. As a way to further increase the number of new customers acquired over the Internet, we are strengthening the mechanism to guide customers visiting portal sites in search of the types of products that we offer. This is an efficient means of introducing FANCL products. We will also provide our Internet customers with timely information via e-mail according to their characteristics and closely follow up our correspondence to make them enthusiasts of FANCL products, as well as regular repeat users.

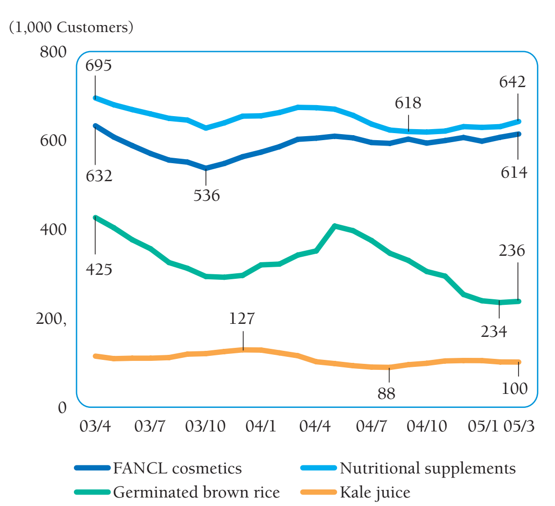
**Raising the Level of Mail-Order Sales as a Whole**

While Internet-based sales are increasing, other mail-order sales are still at a low level. Given this situation, we are intensifying proactive and detailed sales promotion activities according to customer attributes based on a detailed analysis of customer data by our Marketing Headquarters. We also started a review of our publica-

Sales Composition, by Channel




Number of Active Mail-Order Customers, by Products



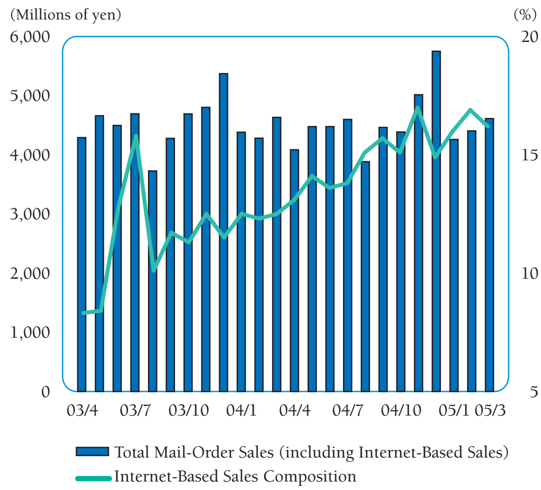

Active customers: Customers making at least one purchase during the preceding seven months tions with the purpose of having customers more deeply understand the uniqueness of our products particularly in terms of functionality, and the concept of inner and outer "beauty and health." As a way to gain new customers, we will pursue efficient and effective advertising activities that include screening media publications, chiefly newspapers and magazines (advertising plus public relations) as well as flyers, more carefully than before.

## RETAIL STORE SALES

### Aiming to Open 61 New Stores in Fiscal 2006

In line with the 300-Store Network policy under the CC Plan, we are pushing ahead with our strategy to establish a dominant presence in major metropolitan areas and to accelerate the pace of new store openings in urban districts where we currently have no or only a few retail stores, and in regional cities around Japan. At the end of fiscal 2005, the number of retail stores stood at 168, a net rise of 26 stores year-on-year. By type, we opened 14 FANCL House retail stores (one store closed, 17 stores were converted into FANCL House J stores), 10 FANCL House J retail stores, and three ATTENIR Shops. At the same time, we renewed a total of 54 retail stores as "easy-to-enter, easy-to-look-around, and easy-to-buy" stores under a unified brand image.

Mail-Order Sales and Composition of Internet-Based Sales




### FANCL HOUSE

*(110 stores, as of March 31, 2005)*
FANCL House specializes in all FANCL brand products, particularly cosmetics, and targets female customers.

### FANCL HOUSE J

*(37 stores, as of March 31, 2005)*
FANCL House J specializes in all FANCL brand products in both categories of customers and supplements, is equipped with a juice bar stand, and targets both male and female customers.

### Genki Station

*(9 stores, as of March 31, 2005)*
Genki Station specializes in sales of supplements, germinated brown rice, and kale juice, and is equipped with a juice bar stand.

### FANCL SQUARE

FANCL's flagship store is situated on a main boulevard in Tokyo's Ginza district, which is a prime location for advertising our products. FANCL Square offers a total solution for beauty and health in one location, with a self-check and counseling floor, an esthetic salon where customers can sample FANCL products in store, and a floor for health-conscious food and beverage products.

### Others

*(9 ATTENIR Shops, 1 FANCL GARDEN store, 2 Genki net stores, as of March 31, 2005)*

Retail store Expansion

(Stores)

| Years ended March 31 | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| FANCL House | 110 | 114 | 119 | 114 | 121 |
| FANCL House J | 37 | 10 | 1 | — | — |
| Genki Station | 9 | 9 | 8 | 8 | 7 |
| ATTENIR Shop | 9 | 6 | 5 | 5 | 5 |
| Others | 3 | 3 | 11 | 6 | 5 |
| Total | 168 | 142 | 144 | 133 | 138 |

In fiscal 2006, we will seek to establish a network of 229 stores by opening 60 new retail stores, focusing mainly on FANCL House and FANCL House J stores, and one ATTENIR Shop. We also plan to renovate 70 existing stores.

On the other hand, the rapid increase in the number of retail stores has presented a problem of standardizing retail store operations. To deal with this, we are establishing a chain store management system at a torrid pace by introducing a store supervisor (SV) system and an area-based training system.

**Revamp of Retail Store Staff Personnel and Education Systems**

In parallel with the renovation of retail stores, we are making efforts to build a mechanism for raising both the skills and motivation of our retail store staff. Specifically, we have established the FANCL Academy with a retail store as an educational institution for training. We are also seeking to upgrade staff capabilities, from waiting on customers to counseling them, by creating an in-house qualification system for inner and outer "beauty and health" advisers. As part of the review of the personnel system, we created a system of promoting retail store staff—most of whom are contract workers—to regular permanent employees, and changed the wage system to one that reflects the roles and responsibilities of employees more precisely. We also made efforts to improve working conditions, including the creation of a system of reemployment for female employees after childbirth.

## WHOLESALE SALES

**Expanding the Business Sphere from General Merchandise Store (GMS), Convenience Store (CVS) to the Medical Sector**

Wholesale sales are an important channel to secure large-volume sales of vitamins, which are widely recognized to be effective and efficacious, as well as germinated brown rice and kale juice. Beginning with Seven-Eleven Japan Co., Ltd. in 1999, we have concluded contracts for wholesale sales of nutritional supplements with limited business partners who understand the brand value of FANCL products, including GMSs (such as Ito-Yokado and JUSCO) and CVSs (such as Seven-Eleven and Lawson). We are now seeking to increase business partners for germinated brown rice and kale juice, centering on GMS and CVS.

Amid increasing interest in the health support function of supplements, we created a sales force dedicated to wholesale sales to medical and pharmaceutical institutions in order to mount a full-fledged effort to cultivate this particular market. We are already engaged in activities to approach medical professionals by making active use of academic conferences and seminars, including setting up a booth at the Integrated Medicine Exhibition and Conference 2005, the first joint exhibition in Japan on preventive and alternative medicine.

**Seeking to Bolster Our Sales Force**

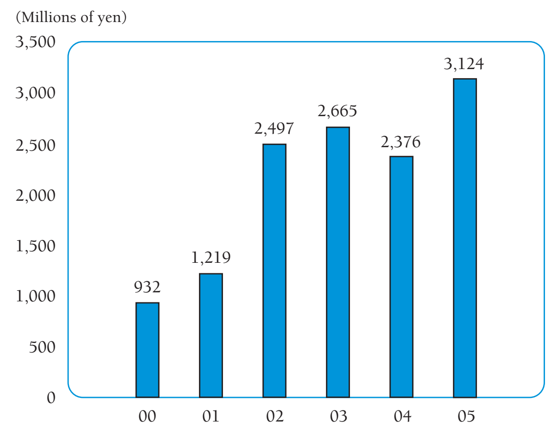
Given the evolution of our business primarily based on mail-order sales, we cannot deny the lack of know-how about the highly competitive wholesale sales market. To make up for this deficiency, we are hiring wholesale sales specialists with a meticulous sales approach to bolster our sales activities with wholesale clients. At the same time, we are reviewing our sales system that has relied heavily on clients for sales promotion. Specifically, we are making self-allocation proposals with the highly precise collection and analysis of store floor information and by capitalizing on our "support ladies" who engage in sales promotion activities. For germinated brown rice and kale juice, we will seek to encourage repeat purchases through the distribution of coupons.

As for the struggling Germinated Brown Rice Business, for which wholesale sales are positioned as the main sales channel, we will bolster our sector-specific sales forces for such sectors as processed food, take-home meals, school lunches, and restaurants. For example, we will broaden our approach to schools for lunches, and enhance our ability to propose menus to restaurants in cooperation with our processed food development division.

FANCL's overseas business started with distributor sales in Hong Kong in October 1996. Currently, we are expanding our business in Hong Kong, Singapore, Taiwan, China, Indonesia, Thailand, and the United States, mainly through our Singapore-based subsidiary FANCL ASIA (PTE.,) LTD. Combined overseas wholesale and retail sales for fiscal 2005 totaled ¥3,124 million, an increase of 31.5% year-on-year.

Overseas Development (As of March 31, 2005)


Overseas Sales




## HONG KONG SALES CONTINUE TO GROW

Sales in Hong Kong (through our distributor) continued to show a solid performance. On the domestic market, sales of collagen drinks have been on a constant rise, together with MILD CLEANSING OIL and FENATTY, which underwent a product renewal the previous year. Taiwan is a very promising market, with sales per retail store increasing steadily.

## FANCL SHOP OPENING IN SHANGHAI


Shanghai Pacific Ocean store

In November 2004, FANCL Shop Shanghai, our first retail store in mainland China, opened at Parkson Department Store. Many Asian women tend not to use much makeup until they reach adulthood, taking great care of the natural beauty of their skin. In that sense, Asia is a very promising market for FANCL, due to our focus on skincare. For the time being, we will conduct an intensive campaign in the Shanghai area to promote a "preservative-free, reliable, and safe" brand image of our products in order to enhance consumer recognition of FANCL. For business in China, we have an exclusive contract with a distributor, who has been very successful in Hong Kong.

## FULL LAUNCH OF BOSCIA IN THE UNITED STATES

Boscia Travel Kit

In the United States, focusing on the trend toward natural products, we initiated test marketing for our high-quality plant-derived natural skin care brand "boscia" (Botanical Science) from October 2002. Since then boscia has gone on to win a number of significant awards in the U.S., including the Health Beauty Award. Based on the success of our two-year test marketing period, we decided to make the first step toward a full launch of the brand in the U.S. From November 2004, a boscia Travel Kit was launched in major U.S. cities. We have secured sales space in highly prestigious locations, including Henry Bendel in New York, Nordstrom, and cosmetic retailers such as Sephora and Bath & Body Works.

Recognizing that the development and commercialization of differentiated original ingredients will prove to be the driving force of growth, FANCL believes it is important to utilize effectively our intellectual property accumulated over the years.

## RESEARCH AND DEVELOPMENT

FANCL, through its Central Research Center, carries out research and development with the main concept of inner and outer "beauty and health" to pursue beauty and health from inside and outside the body. In order to secure speedy and efficient research and development activities, we are expanding the network of joint research and development with universities, government agencies, and other companies. FANCL's Central Research Center, which has been a leading force in the popularization of nutritional supplements, is one of the best institutions in Japan in this field and has a large accumulation of research data.

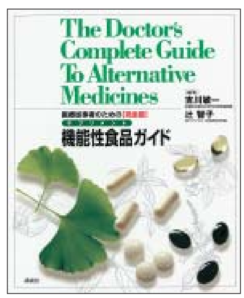
### Successive Application for Patents on Original Ingredients and Functions

Since the CC Plan declared our pursuit of a value-based appeal strategy, FANCL successively commercialized original ingredients and unique functions and also filed patent applications to protect its intellectual property rights. FANCL is consolidating its peerless position through intellectual property rights protection for the development of original ingredients and functions as well as for the in-house development of unique manufacturing technologies.

### Investing Aggressively in Verification Research

Demonstrative research is gaining importance in the process of product development. While we are not allowed to claim the effects and efficacy of nutritional supplements, it is necessary to conduct tests at the levels required by the Ministry of Health, Labour and Welfare if we plan to apply for the designation as food for specified health use. Also, it is essential to conduct verification research to prove the reliability of products at the highest possible level to offer high-quality products to customers. As we discover new ingredients and new functions, it is becoming necessary to increase our budget allocation for verification research. We intend to gradually increase the ratio of research and development expenses to sales from the current 2.2%.

### Supplement-Drug-Interaction Search Service Launched




On April 1, 2004, we launched a service using the SDI (Supplement-Drug-Interaction) search system (patent applied). The system, developed by our staff who have medical and pharmacist licenses, allows us to immediately search for possible interactions between FANCL nutritional supplements (about 100 items) and prescription and over-the-counter drugs (about 19,000 and 13,000 items, respectively). Our staff at the SDI Information Desk responds to customers' inquiries about possible interactions between supplements and drugs by making use of the this search system.

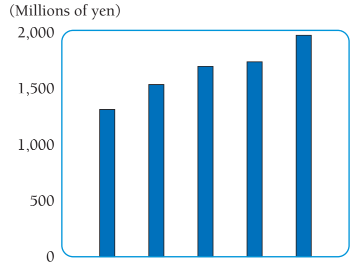
Additionally, in order to make the medical field our new sales channel, we launched the new publication, *The Doctor's Complete Guide to Alternative Medicines*, in August in a bid to make doctors, pharmacists, nutritionists, and others in the medical profession aware of the importance of nutritional supplements as part of one's diet.

R&D-Related Data

| For the years ended March 31 | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| R&D expenses (millions of yen) | 1,958 | 1,720 | 1,683 | 1,524 | 1,294 |
| Sales ratio | 2.2% | 2.0% | 1.9% | 1.8% | 2.0% |
| Researchers | 114 | 103 | 94 | 84 | 75 |
| Patent applications | 64 | 51 | 97 | 94 | 63 |

R&D Expenses

(Millions of yen)



As a good corporate citizen, FANCL naturally seeks to contribute to society through its corporate activities and is actively making efforts in a wide range of community service and environmental conservation activities.

## 1. LAUNCH OF THE CSR PROMOTION COMMITTEE

In April 2005, we launched the CSR Promotion Committee, headed by FANCL's President. In this way, we have further vitalized our CSR structure, creating a company-wide system that before had only been undertaken by the various divisions of the Company on an incremental basis. The CSR Promotion Committee is comprised of a total of six working groups: Community Service, Environmental Conservation, Information Disclosure, IT Security, Risk Management, and Corporate Ethics. We will continue to promote a structure that can easily transmit and implement a CSR strategy throughout the Company.

## 2. COMMUNITY SERVICE ACTIVITIES

**FANCL SMILE Expanding Employment Opportunities for Persons with Intellectual Disabilities**

In February 1999, FANCL established FANCL SMILE Co., Ltd., a non-consolidated special subsidiary devoted to the promotion of employment for persons with disabilities. FANCL SMILE is engaged in a variety of work for FANCL Group companies, including the layout and setup of catalogs and other documents as well as packaging work for products. In addition, persons who have forklift truck licenses also work in Group companies, strongly supporting our businesses. In this way, we are nurturing eager human resources who will support FANCL. In the mid to long-term, we aim to realize a stable and profitable company, expand the scope of FANCL SMILE's work nationwide, and employ more persons with intellectual disabilities.

## 3. ENVIRONMENTAL CONSERVATION ACTIVITIES

**Details and Results of Environment-Related Activities**

Recognizing that global environmental conservation is one of the most important common challenges facing humankind, the FANCL Group is promoting environmental conservation activities in all aspects of our business. The FANCL Group attained ISO 14001 environmental management certification in November 2002.

In fiscal 2005, we formulated the four specific action plans detailed below. In implementing these, we achieved success in each of the four categories. In addition, fiscal 2005 was the first year for the FANCL Group Community and Environmental Activities Report to be published. We will continue to enhance our activities in these areas.

**FY2005 Details and Results of Environmental Conservation Activities**

| *Item* | *FY2005 Results* |
|---|---|
| Promote resource conservation and recycling | We have achieved an 89% recycling rate of waste disposed from all our offices and plants |
| Promote a reduced environmental burden at time of delivery | Customer-designated delivery service* and the post-in delivery method now account for 35% of all deliveries |
| Green purchasing | Introduction of envelopes with smaller air-cushions (from January 2005) |
| | Improvement of purchase rate of environmentally friendly office goods to 58% |
| Environmental communications | Publication of the Community and Environmental Activities Report |

* The customer-designated delivery service was introduced in January 1997. It is a system designed to obviate the need for redelivery due to customers not being at home at the time of delivery and thereby contributes to reducing greenhouse gases that are emitted through delivery rounds.

**Environmentally Friendly Products**

At the FANCL Group, we take great care in the design and development of containers and components of all our products to ensure that they are environmentally friendly. For example, we were the first company in Japan to introduce PEN resin into the containers of our preservative-free cosmetics range. PEN resin does not emit endocrine disrupters even when burned, and given its lightweight and crack resistant properties, it is possible to use it in simple packaging. In addition, our Ecopacks are refillable containers designed from the point of view of "ecology" and "economy." Ecopacks are comprised of an airless compact film, the first such product in the cosmetics industry, and a special holder for which a patent was applied.

FANCL regards the enhancement of corporate governance and compliance as an important management issue to become a corporation trusted by shareholders and other stakeholders.

## 1. CORPORATE GOVERNANCE

We have introduced the managing officer system for the purpose of ensuring the separation of supervisory and operating functions of management. The Board of Directors, which consists of eight directors (including one outside director), makes decisions on important operating issues and other statutory matters and provides management oversight on the basis of reports regarding the operations of FANCL and its subsidiaries. The Management Conference, made up of the board directors and managing officers, considers matters to be decided by the Board of Directors in advance and deliberates on important management issues within the bounds of authority devolved by the Board of Directors. At a general shareholders meeting in June 2005, a decision was taken to shorten the term of office of board directors from two years to one year in a bid to clarify management responsibility, strengthen the management base, and flexibly build an appropriate management system in response to changes in the management environment.

Four auditors, all from outside, attend all Board of Directors meetings as well as management conferences and other meetings of importance, and have a regular exchange of views with top executives to ensure appropriate management oversight. There are no business dealings or other business interests between our company and the outside director or outside auditors, thereby ensuring the objectivity of the governance function.

The compensation for Board of Directors and Auditors in fiscal 2005 is described below:

***Board member compensation package:***

| | | |
|---|---|---|
| •*Annual total remuneration of board directors* | | |
| | 12 directors | ¥241 million |

(Covers three board members who retired during the term, but does not include an amount equivalent to the portion of employee compensation when a board member is concurrently a company employee.)

***Auditor compensation package:***

| | | |
|---|---|---|
| •*Annual total remuneration of auditors* | | |
| | 4 auditors | ¥40 million |
| •*Remuneration regarding the audit certificate based on audit contract* | | ¥20 million |
| •*Remuneration for services other than those described above* | | ¥1 million |

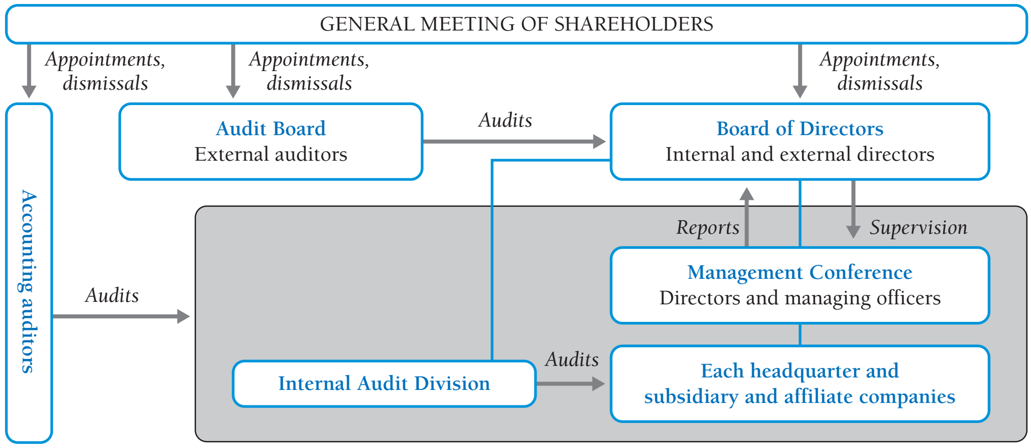
## 2. COMPLIANCE AND RISK MANAGEMENT SYSTEM

**1) Overall System**

The Internal Audit Division under the direct control of the president conducts an audit of operations for each division, while the Administrative Headquarters leads company-wide efforts to improve various office regulations and conduct educational activities to ensure that compliance is duly observed in corporate activities and that individual employees behave on the basis of solid corporate ethics. Specifically, in October 2004, the Compliance Office was assigned to the Administrative Headquarters, and the Committee for CSR Promotion was created in April 2005 to strengthen the internal control system.

The Consumer Center, which gathers and analyzes public comments and requests regarding our behavior and attitude, has been placed under direct control of the president so that our customers' points of view can also serve as a checking function for us.

Corporate Governance System




### 2) Bolstering Protection of Personal Information

Most of our customers are individuals. Therefore, we have asked all employees to submit written pledges "not to leak personal information" in order to ensure the prevention of personal information leakage. With the law for the protection of personal information put into force in April 2005, we are redoubling efforts to strengthen our information management system. Specifically, we have introduced a host of security measures such as fingerprint authentication and encryption. We have also built a system that records all access logs and allows us to track any source of information leakage should this actually occur, thereby serving as a major deterrent against information leakage.

## 3. INVESTOR RELATIONS

FANCL is working to ensure information disclosure in a timely, appropriate, and speedy manner to improve management transparency.

### 1) Promotion of Speedy and Fair Disclosure

We make a timely disclosure of monthly sales data and are making efforts toward the announcement of financial results as soon as possible after the end of the term. Information on financial results is uploaded to the IR section of our website as promptly as possible after official announcements of business results. We are also striving toward a fair disclosure of information to help narrow the information disparity among stakeholders by, among other measures, offering a video recording of earning results briefings over the Internet.

Our IR activities are not limited to the domestic investor base. Top management representatives make individual calls on European and U.S. investors once a year.

### 2) Net-Based Online Execution of Voting Rights Launched

As another example of how we are utilizing the Internet to enhance shareholder convenience, online voting was made available from the June 2004 General Meeting of Shareholders as an alternative to the execution of voting rights by means of conventional posting.

*For further information, please contact:*
Investor Relations Group
Tel: 81(45)226-1470
Fax: 81(45)226-1203
http://www.fancl.co.jp
e-mail: official@fancl.co.jp


http://www.fancl.co.jp/corporate/ir/index.html

# DIRECTORS AND OFFICERS

(As of June 18, 2005)

*President and Representative Director*

Kenji Fujiwara

*Senior Executive Managing Officer*

Yasuyuki Yogoro

*Executive Managing Officers and Directors*

Kazuyoshi Miyajima
Sumiya Nakajima
Yoshinori Harigae

*Executive Managing Officer*

Toshihiro Nasuno

*Director*

Yoshifumi Narimatsu

*Managing Officers and Directors*

Kenichi Ishiwata
Yukio Ikemori

*Managing Officers*

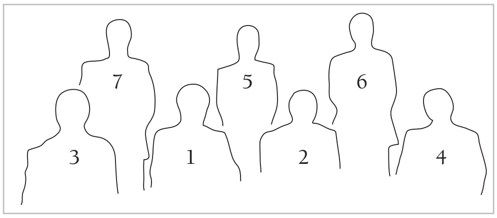
Katsumi Maruyama
Shoji Shiba
Tomoko Tsuji
Haruki Murakami
Toshinori Ryuchi
Noburou Katase
Tomochika Yamaguchi
Akira Yajima
Yutaka Hirano

*Outside Director*

Yoshiharu Hayakawa

*Statutory Auditors*

Taiji Yamada
Fumiko Ikeda
Katsunori Koseki
Akira Tobishima




1. Kenji Fujiwara
   *President and Representative Director*
2. Kazuyoshi Miyajima
   *Executive Managing Officer and Director*
3. Sumiya Nakajima
   *Executive Managing Officer and Director*
4. Yoshinori Harigae
   *Executive Managing Officer and Director*
5. Yoshifumi Narimatsu
   *Director*
6. Kenichi Ishiwata
   *Managing Officer and Director*
7. Yukio Ikemori
   *Managing Officer and Director*

# FINANCIAL SECTION

CONTENTS

# SIX-YEAR SUMMARY

FANCL CORPORATION and Consolidated Subsidiaries
For the years ended March 31

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 |
| **FOR THE YEAR:** | | | | | | |
| Net sales | ¥ 87,937 | ¥ 84,957 | ¥ 90,026 | ¥ 84,657 | ¥ 65,418 | ¥ 62,980 |
| Cosmetics | 37,098 | 34,926 | 37,155 | 36,748 | 35,669 | 38,039 |
| Nutritional supplements | 31,132 | 29,656 | 29,211 | 28,995 | 25,408 | 21,898 |
| Others | 19,707 | 20,375 | 23,660 | 18,914 | 4,341 | 3,043 |
| Net sales, by sales channel: | | | | | | |
| Mail-order sales | 54,544 | 54,439 | 59,334 | 56,821 | 43,360 | 45,942 |
| Retail store sales | 20,067 | 17,722 | 17,744 | 17,073 | 15,632 | 14,143 |
| Others | 13,326 | 12,796 | 12,948 | 10,763 | 6,426 | 2,893 |
| Gross profit | 57,905 | 55,696 | 58,982 | 56,682 | 47,034 | 44,969 |
| Gross profit margin (%) | 65.8 | 65.6 | 65.5 | 67.0 | 71.9 | 71.4 |
| Selling, general and administrative expenses | 52,477 | 47,927 | 47,456 | 45,564 | 38,402 | 33,426 |
| Selling, general and administrative expense ratio (%) | 59.7 | 56.4 | 52.7 | 53.9 | 58.7 | 53.1 |
| Operating income | 5,428 | 7,769 | 11,526 | 11,118 | 8,632 | 11,543 |
| Cosmetics | 4,745 | 6,283 | 8,099 | 8,406 | 8,320 | 10,712 |
| Nutritional supplements | 4,638 | 5,371 | 6,879 | 5,960 | 4,694 | 3,587 |
| Others | (1,967) | (1,821) | (1,646) | (1,681) | (2,532) | (641) |
| Operating income margin (%) | 6.2 | 9.1 | 12.8 | 13.1 | 13.2 | 18.3 |
| Net income | 1,710 | 3,387 | 6,429 | 5,995 | 4,867 | 6,723 |
| Net income to net sales (%) | 1.9 | 4.0 | 7.1 | 7.1 | 7.4 | 10.7 |
| ROE (%) | 2.6 | 5.1 | 9.8 | 9.7 | 8.5 | 15.3 |
| Advertising expenses | ¥ 11,105 | ¥ 9,865 | ¥ 9,262 | ¥ 10,213 | ¥ 8,896 | ¥ 6,081 |
| Sales promotion expenses | 9,475 | 7,998 | 8,615 | 8,161 | 5,810 | 5,615 |
| Research and development expenses | 1,958 | 1,720 | 1,683 | 1,524 | 1,294 | 1,302 |
| Capital expenditures | 2,257 | 4,864 | 5,397 | 3,589 | 2,727 | 7,138 |
| Depreciation | 2,463 | 2,556 | 2,268 | 2,245 | 2,379 | 2,424 |
| Net cash provided by operating activities | ¥ 4,638 | ¥ 5,861 | ¥ 9,828 | ¥ 7,426 | ¥ 6,083 | ¥ 5,681 |
| Net cash used in investing activities | (4,807) | (4,117) | (5,582) | (5,416) | (4,838) | (7,736) |
| Net cash (used in) provided by financing activities | (1,090) | (4,533) | (5,432) | (2,456) | (1,410) | 13,006 |
| Net (decrease) increase in cash and cash equivalents | (1,254) | (2,809) | (1,213) | (437) | (162) | 10,949 |

| | Yen | | | | | |
|---|---|---|---|---|---|---|
| **PER SHARE:** | | | | | | |
| Net income | ¥ 80.3 | ¥ 154.6 | ¥ 279.5 | ¥ 307.6 | ¥ 249.8 | ¥ 459.5 |
| Shareholders' equity | 3,111.2 | 3,082.4 | 2,976.3 | 3,320.2 | 3,051.4 | 3,678.9 |
| Cash dividends | 50.0 | 42.5 | 35.0 | 25.0 | 25.0 | 30.0 |

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| **AT YEAR-END:** | | | | | | |
| Total assets | ¥ 79,416 | ¥ 78,479 | ¥ 79,804 | ¥ 79,026 | ¥ 75,481 | ¥ 67,657 |
| Shareholders' equity | 66,203 | 65,613 | 66,350 | 64,719 | 59,482 | 55,146 |
| Equity ratio (%) | 83.4 | 83.6 | 83.1 | 81.9 | 78.8 | 81.5 |
| Interest-bearing debt | — | — | 350 | 1,092 | 3,086 | 2,780 |
| Working capital | 28,622 | 29,214 | 29,805 | 31,082 | 28,456 | 29,219 |
| Number of stores | 168 | 142 | 144 | 133 | 138 | 86 |
| Number of consolidated subsidiaries | 6 | 6 | 6 | 4 | 3 | 2 |

# QUARTERLY FINANCIAL AND STOCK INFORMATION / MONTHLY SALES DATA

FANCL CORPORATION and Consolidated Subsidiaries
For the years ended March 31

Millions of yen

| | 1st Quarter | | 2nd Quarter | | 3rd Quarter | | 4th Quarter | |
|---|---|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 |
| Net sales | ¥ 20,951 | ¥ 20,885 | ¥ 21,294 | ¥ 20,313 | ¥ 24,005 | ¥ 22,908 | ¥ 21,686 | ¥ 20,849 |
| Cosmetics | 8,870 | 8,854 | 8,982 | 8,099 | 10,176 | 9,389 | 9,069 | 8,581 |
| Nutritional supplements | 7,230 | 6,844 | 7,619 | 7,386 | 8,307 | 7,919 | 7,973 | 7,505 |
| Others | 4,850 | 5,186 | 4,693 | 4,826 | 5,521 | 5,599 | 4,642 | 4,762 |
| Net sales, by sales channel: | | | | | | | | |
| Mail-order sales | 13,070 | 13,465 | 12,976 | 12,715 | 15,188 | 14,929 | 13,308 | 13,327 |
| Retail store sales | 4,594 | 4,315 | 4,914 | 4,332 | 5,410 | 4,635 | 5,147 | 4,438 |
| Others | 3,286 | 3,103 | 3,403 | 3,265 | 3,406 | 3,343 | 3,229 | 3,082 |
| Operating income (loss) | 862 | 3,066 | 430 | 1,822 | 2,490 | 3,240 | 1,645 | (360) |
| Cosmetics | 1,597 | 2,168 | 457 | 1,495 | 1,569 | 2,286 | 1,120 | 332 |
| Nutritional supplements | 611 | 1,289 | 1,118 | 1,382 | 1,540 | 1,687 | 1,368 | 1,012 |
| Others | (843) | 127 | (622) | (534) | (78) | (189) | (423) | (1,223) |
| Net income (loss) | ¥ 212 | ¥ 1,714 | ¥ (63) | ¥ 517 | ¥ 1,285 | ¥ 1,825 | ¥ 275 | ¥ (669) |

Yen

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Stock Price Range | | | | | | | | |
| High | ¥ 3,880 | ¥ 4,020 | ¥ 4,000 | ¥ 3,760 | ¥ 4,050 | ¥ 3,480 | ¥ 4,450 | ¥ 3,600 |
| Low | 3,270 | 3,420 | 3,340 | 3,300 | 3,600 | 2,755 | 3,860 | 2,870 |

## MONTHLY SALES

Millions of yen

| | 2004 | | | | | | | | | 2005 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Apr. | May | Jun. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec. | Jan. | Feb. | Mar. |
| Cosmetics | ¥2,855 | ¥3,094 | ¥2,920 | ¥3,110 | ¥2,811 | ¥3,060 | ¥2,883 | ¥3,516 | ¥3,775 | ¥2,860 | ¥2,984 | ¥3,224 |
| YoY increase (decrease) | 0.9% | 1.2% | (1.5%) | 9.2% | 14.1% | 9.8% | (4.5%) | 11.6% | 17.4% | 8.4% | 3.9% | 5.0% |
| Nutritional Supplements | 2,394 | 2,467 | 2,368 | 2,506 | 2,261 | 2,851 | 2,541 | 2,702 | 3,063 | 2,478 | 2,515 | 2,980 |
| YoY increase (decrease) | 10.0% | 6.9% | 0.4% | (2.3%) | 3.5% | 8.2% | (4.6%) | 17.2% | 3.8% | 5.0% | 10.6% | 3.8% |
| Others | 1,376 | 1,710 | 1,763 | 1,731 | 1,346 | 1,615 | 1,643 | 1,907 | 1,969 | 1,447 | 1,637 | 1,557 |
| YoY increase (decrease) | (19.4%) | (6.6%) | 7.0% | (2.5%) | (6.1%) | (0.1%) | (10.4%) | 5.4% | 0.7% | (16.2%) | 14.0% | (2.6%) |
| Total | 6,626 | 7,273 | 7,051 | 7,348 | 6,419 | 7,527 | 7,068 | 8,127 | 8,809 | 6,786 | 7,137 | 7,762 |
| YoY increase (decrease) | (1.3%) | 1.0% | 1.1% | 2.2% | 5.5% | 6.9% | (6.0%) | 11.8% | 8.5% | 0.9% | 8.4% | 2.9% |

FANCL CORPORATION and Consolidated Subsidiaries
For the years ended March 31

## NET SALES

Net sales rose 3.5% year-on-year to ¥87,937 million due to a sales increase in our core Cosmetics Business and Nutritional Supplements Business.

Cosmetics Business sales rose 6.2% year-on-year to ¥37,098 million, boosted by increases in income from FANCL and ATTENIR cosmetics.

Sales of FANCL cosmetics rose 5.3% year-on-year to ¥27,759 million. Increases in MILD CLEANSING OIL and the FENATTY series sales, which underwent a renewal in the first half, were supported by firm growth in other make-up products and seasonal products. By channel, sales at existing stores also turned upward as a result of such active measures as improved training for staff, revisions to benefits, improvements in retail store operations, and store refurbishments. Retail store sales turned upward in fine form following new store openings. Sales to Hong Kong were also robust and sales through all channels posted an increase there.

In the ATTENIR cosmetics brand, effective advertising campaigns and sales promotion activities attracted a record number of customers as of the fiscal year-end. Thanks to strong performance by new products and renewed products, sales reached a record high.

Nutritional Supplements Business sales grew 5.0% year-on-year to ¥31,132 million.

This was thanks to increased sales in the mineral products containing the new compound TWINTOSE, jointly developed with Hokkaido University and Nippon Beet Sugar Manufacturing Co., Ltd., and co-enzyme $Q_{10}$, which has received coverage on television health programs. Sales increased in all sales channels, but most noticeable was the upswing in sales at retail stores.

Other Businesses sales fell 3.3% year-on-year to ¥19,707 million yen, due to sales reductions in the Germinated Brown Rice Business and IIMONO OHKOKU Mail-Order Business, although sales in the Kale Juice Business increased.

Germinated brown rice sales decreased 6.6% year-on-year to ¥5,026 million. Although a new germinated brown rice with improved taste, smell, and texture thanks to new production methods was launched, mail-order customer numbers continued to decline and supermarket sales failed to make a full recovery.

Kale Juice Business sales increased 18.1% year-on-year to ¥3,524 million, due to solid sales of frozen type products and robust sales of TWINTOSE-incorporated powder type products.

IIMONO OHKOKU Mail-Order Business sales fell 13.5% year-on-year to ¥7,153 million due to a stagnation in catalog sales, after a thorough revision of catalog contents.

Sales at other related businesses grew 7.1% year-on-year to ¥4,002 million, buoyed by strong underwear and sundries sales.

## GROSS PROFIT

The gross profit margin increased 0.2 percentage points year-on-year to 65.8%. This result was due to improvements in the gross profit margin in nutritional supplements.

In the Cosmetics Business, the gross profit margin dropped 1.2 percentage points year-on-year to 74.4%. This was due to additional expenses stemming from the start-up of the Shiga Factory.

In the Nutritional Supplements Business, the gross profit margin rose 2.0 percentage points to 66.2%, owing to revisions in the purchasing costs of raw materials.

In Other Businesses, the gross profit margin decreased 1.1 percentage points year-on-year to 49.2%, due to a drop in the gross profit margin in the Germinated Brown Rice Business caused by an appreciation in raw material costs.

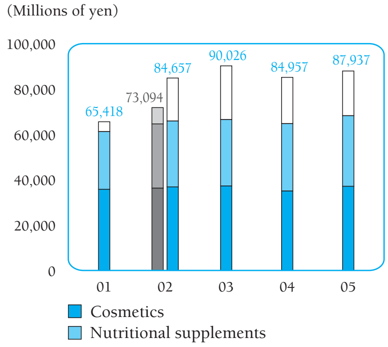
## SG&A EXPENSES

The ratio of selling, general, and administrative (SG&A) expenses to net sales rose 3.3 percentage points year-on-year to 59.7%, reflecting a significant increase over the previous year in advertising and sales promotion costs amounting to ¥2,700 million.

Given the active efforts in advertising and sales promotion expenses towards the goal of bolstering the customer base as stipulated in the CC Plan, the ratio of marketing costs (advertising and sales promotion expenses) to net sales rose 2.4 percentage points to 23.4%.

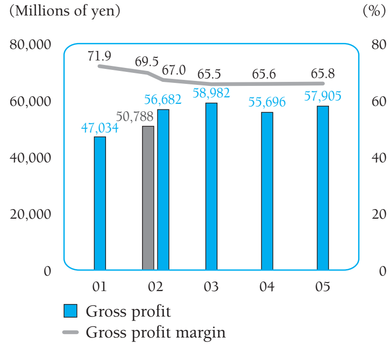
Given that staffing numbers were increased at retail stores in line with the expansion to a 300-store retail network in two years' time, the ratio of personnel costs to sales rose by 0.6 percentage points to 12.2%.

Net Sales, by Business Segment
(Millions of yen)



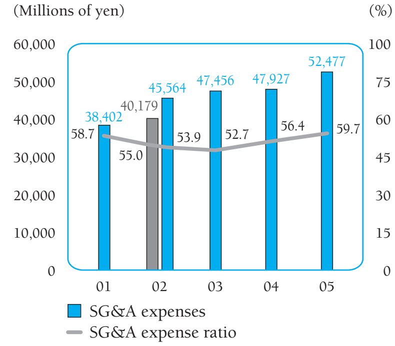

* Gray column: Excluding the results of newly consolidated IIMONO OHKOKU and FHG.

Gross Profit and Gross Profit Margin
(Millions of yen) (%)




* Gray column: Excluding the results of newly consolidated IIMONO OHKOKU and FHG.

SG&A Expenses and SG&A Expense Ratio
(Millions of yen) (%)




* Gray column: Excluding the results of newly consolidated IIMONO OHKOKU and FHG.

## OPERATING INCOME

Reflecting the aforementioned factors, operating income decreased 30.1% year-on-year to ¥5,428 million, and the operating income margin declined 2.9 percentage points to 6.2%.

In the Cosmetics Business, operating income fell 24.5% year-on-year to ¥4,745 million, and the operating income margin shrank 5.2 percentage points to 12.8%, due mainly to the increase in advertising and sales promotion expenses in accordance with product renewals.

In the Nutritional Supplements Business, operating income decreased 13.6% year-on-year to ¥4,638 million, and the operating income margin slipped 3.2 percentage points to 14.9%. Although revisions to costs for raw materials resulted in an improvement in the costs of goods sold ratio, this was offset by significant increases in advertising costs to raise awareness about the new compound TWINTOSE.

Other Businesses posted an operating loss of ¥1,967 million, which was ¥146 million larger than the previous fiscal year's result, reflecting the further expansion of losses in the IIMONO OHKOKU Mail-Order Business.

## OTHER INCOME (EXPENSES)

Loss on retirements of inventories deteriorated ¥277 million from ¥404 million in the previous fiscal year to stand at ¥681 million, as old products were disposed of in line with renewal activities.

Introduction of a new production method for germinated brown rice resulted in a loss on cancellation of leasing contacts amounting to ¥434 million.

Other, net expenses improved by ¥1,181 million year-on-year to stand at ¥332 million. This was due to the fact that provisions for reserves for retirement allowances for directors were made in the previous fiscal year. No such provisions were required this year, leading to improvement in other, net expenses.

## INCOME BEFORE INCOME TAXES

Income before income taxes decreased 29.7% year-on-year to ¥4,367 million. Income before income taxes as a percentage of net sales was 5.0%, down 2.3 percentage points compared with the previous fiscal year.

## NET INCOME

As a result of the liquidation of deferred tax assets for consolidated subsidiaries posting a loss, net income fell 49.5% year-on-year to ¥1,710 million, and the ratio of net income to net sales fell 2.1 percentage points to 1.9%.

Net income per share was ¥80.29. As of the end of the fiscal year under review, FANCL had no outstanding unexercised convertible bonds or equity warrants.

ROE fell 2.5 percentage points compared with the previous fiscal year to 2.6%, due to a reduction in net income by half.

## ASSETS

### *Current Assets*

Current assets remained almost unchanged from the previous fiscal year at ¥39,080 million. Although cash and cash equivalents decreased, notes and accounts receivable rose.

Cash and cash equivalents decreased by ¥1,254 million due to a ¥1,500 million transfer to long-term deposits. Meanwhile notes and accounts receivable and inventories rose by ¥932 million and ¥192 million respectively, due to higher sales.

### *Property, Plant and Equipment*

Property, plant and equipment remained almost unchanged from the previous fiscal year at ¥26,534 million, and while the opening of new stores and refurbishment of existing stores was undertaken actively, this was offset by an absence of large-scale investment.

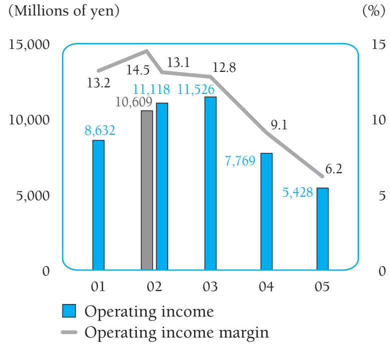
### *Intangible Assets*

Mainly due to the consolidation of IIMONO OHKOKU Co., Ltd., the Company posted additional goodwill, which is being amortized on a straight-line method over a period of five years.

### *Investments and Other Assets*

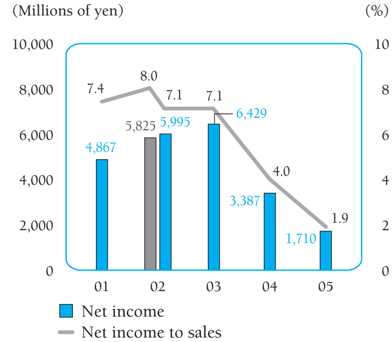
Investments and other assets increased ¥1,599 million to ¥13,503 million, reflecting increases in long-term deposits. Investment securities rose ¥1,035 million through the acquisition of unlisted bonds. Other assets rose ¥1,216 million due to increases in long-term deposits. Meanwhile, long-term loans receivable decreased ¥347 million.

Operating Income and Operating Income Margin



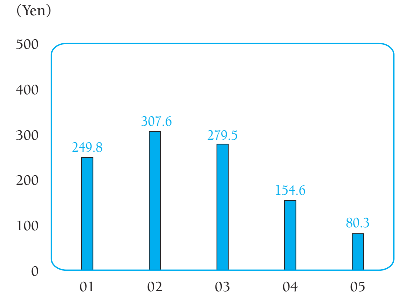

* Gray column: Excluding the results of newly consolidated IIMONO OHKOKU and FHG.

Net Income and Net Income to Sales




* Gray column: Excluding the results of newly consolidated IIMONO OHKOKU and FHG.

Net Income per Share



## LIABILITIES

### *Current Liabilities*

Current liabilities were almost unchanged from the previous fiscal year at ¥10,458 million. Although outstanding corporate taxes increased, this was offset by a decrease in notes and accounts payable.

### *Non-Current Liabilities*

Non-current liabilities remained basically unchanged from the previous fiscal year at ¥2,755 million.

## SHAREHOLDERS' EQUITY

### *Total Shareholders' Equity*

Total shareholders' equity was ¥66,203 million, up ¥590 million compared with the previous year, reflecting net income of ¥1,710 million.

### *Capital Investment*

Capital investment during the fiscal year under review totaled ¥2,257 million including investment in new stores and store refurbishment, increases in production equipment and software.

By business segment, capital investment in the Cosmetics Business and Nutritional Supplements Business totaled ¥1,008 million and ¥498 million, respectively, focusing on investment in retail stores. In Other Businesses, ¥749 million was invested in the acquisition of production equipment for the Germinated Brown Rice Business at the Kagawa Factory (land, buildings and equipment, etc.). No major equipment was disposed of or sold during the period.

## CASH FLOWS

Cash and cash equivalents ("net cash") at the end of the consolidated fiscal year totaled ¥22,307 million, down by ¥1,254 million year-on-year. The cash flow situations and their operative factors were as follows.

### *Cash Flows from Operating Activities*

Net cash provided by operating activities increased to ¥4,638 million, mainly broken down as ¥4,367 million in income before income taxes and ¥2,737 million in depreciation and amortization, while ¥1,510 million in income taxes paid represented a decline.

### *Cash Flows from Investing Activities*

Net cash used in investing activities declined to ¥4,807 million, due mainly to expenditures of ¥1,941 million for the acquisition of new and revamped shop facilities.

### *Cash Flows from Financial Activities*

Net cash used in financial activities declined to ¥1,090 million, due mainly to cash dividends paid of ¥1,064 million.

In the year ending March 31, 2006, expectations are that cash used in investing and financial activities will be undertaken within the scope of the increase in cash flows from operating activities.

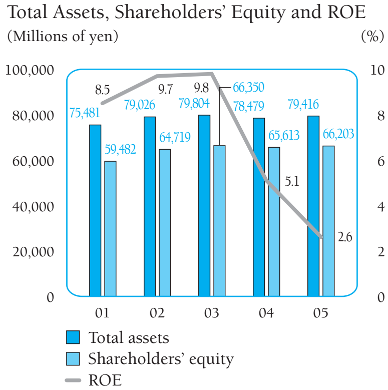
## CASH FLOW INDICATORS

| Years ended March 31 | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Shareholders' equity ratio (%) | 83.4 | 83.6 | 83.1 | 81.9 | 78.8 |
| Shareholders' equity ratio on market-value basis (%) | 110.9 | 95.7 | 114.3 | 113.5 | 163.5 |
| Debt repayment period (years) | — | — | 0.04 | 0.15 | 0.51 |
| Interest coverage ratio | — | 2,930.5 | 756.0 | 200.7 | 152.1 |

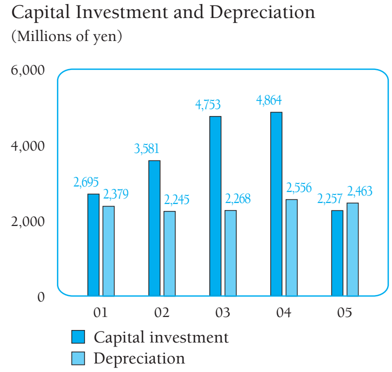
Shareholders' equity ratio: Shareholders' equity/Total assets
Shareholders' equity ratio on market-value basis: Total market value of stock/Total assets
Debt repayment period: Interest-bearing liabilities/Cash flows from operating activities
Interest coverage ratio: Cash flows from operating activities/Interest expense

Notes: 1. All indicators are calculated based on consolidated financial figures.
2. Total market value of stock is calculated by multiplying the closing share price on the final day of the period by the number of shares issued and outstanding on the final day of the period, excluding treasury stock.
3. Cash flows from operating activities are as stated on the consolidated statements of cash flows. Interest-bearing liabilities include all debt stated on the consolidated balance sheets on which interest is paid. For interest expense, cash paid for interest on the consolidated statements of cash flows is used.

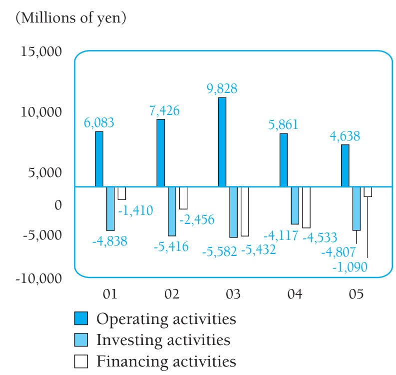
Total Assets, Shareholders' Equity and ROE




Capital Investment and Depreciation




Cash Flows



### PRODUCT DEVELOPMENT AND COMPETITIVE ENVIRONMENT

In the FANCL Group's product development, the product planning and development division is responsible for formulating and proposing product planning documents based on customer needs and market research. In collaboration with related departments such as the Central Research Center, it makes final decisions on commercialization. At present, the Group develops cosmetics and nutritional supplements using its own technology, but there is no guarantee that this will result in the successful development and new products.

Further, in light of the increasing numbers of women with sensitive skin and greater health consciousness, there are more new entrants into the markets of cosmetics for sensitive skin and nutritional supplements. The appearance of similar products could operate to reduce the relative competitiveness of the FANCL lineup and hurt our growth potential and earning capabilities.

### PRODUCT MANUFACTURING AND QUALITY ASSURANCE

The FANCL Group's cosmetics, nutritional supplements, and germinated brown rice are manufactured at five directly-managed domestic factories, while kale juice and undergarments production is outsourced to subsidiaries and affiliate companies.

Departments in charge of procurement manage all aspects of raw materials purchases and, working in cooperation with marketing departments, diversify purchases among multiple suppliers and coordinate purchases with suppliers. Nevertheless, unanticipated conditions due to external factors may make it impossible to procure planned quantities.

A quality assurance department has been established to improve product quality. At quality conferences, it verifies the quality control situation with the cognizant departments, and strives to maintain quality by conducting on-site plant inspections and other activities. Nevertheless, if a quality problem arises, it could impact negatively the Group's operating results.

### DISASTERS AND BAD WEATHER

To minimize the effects of fire and disasters on its production system, the FANCL Group conducts periodic inspections and checking on all its facilities. Diversification of its plants is intended to reduce risks. Nevertheless, there are no guarantees that the impact of fire and disaster can be fully prevented.

The harvest volumes of rice and kale, the raw materials for germinated brown rice and kale juice respectively, are subject to the vagaries of the weather. We, therefore, strive for diversification of producing areas and raw material stockpiling, but weather factors can cause shortages and higher prices that impact adversely on the Group's operating results.

### LIMITS OF INTELLECTUAL PROPERTY PROTECTION

The Group is moving forward with securing patent and other rights to its accumulated technology and other intellectual property, but this is an area in which the legal basis is not fully prepared and cannot cover all business development domains. And because it takes at least a year and a half from patent application to publication, there is the possibility that there may be development investment in technology for which other companies have already sought patents. In the future, it is possible that other companies may publish patents for technologies which the Company has already commercialized and involve it in patent infringement cases.

### LEGAL RESTRICTIONS

In the Cosmetic Businesses, there is the Pharmaceutical Affairs Law necessary to assure the quality, effectiveness and safety of pharmaceuticals, over-the-counter medicines, cosmetics, and medical equipment. It is under this legislation that the FANCL Group manufactures and sells cosmetics and related products.

The Nutritional Supplement Business is subject to the Food Sanitation Law, which prescribes food standards, additives, sanitation surveillance, and business permission. Concerning foods for sale, the Nutrition Improvement Law sets standards for the display of nutritional elements and caloric values. The Company's supplements that meet certain requirements are also subject to the regulations of the health function food system, which enables consumers to confidently select foods corresponding to their eating habits.

The Group is also governed by the Specified Commercial Transactions Law, whose objectives are the fair conduct of mail-order businesses for the protection of consumers, and by the Law for Prevention of Unfair Premiums and Unfair Labeling, intended to prevent customer inducement by those means.

The Group has established in its administrative headquarters a department responsible for compliance and more thoroughgoing observance of laws and regulations. Should violations occur, they may adversely affect the Group's operating results.

### PERSONAL INFORMATION

The Group's use of mail-order and the Internet as its main sales channels has resulted in the possession of personal information about many individuals.

The Group strictly observes the Guidelines for Personal Data Protection prescribed by the Japan Direct Marketing Association, has established an all-company committee to reinforce the information control system, and is moving toward more thoroughgoing employee education. Nevertheless, should a leakage of such information occur outside the Company, a loss of customer trust could reduce sales and subject the Company to losses from the payment of liability damages to customers.

# CONSOLIDATED BALANCE SHEETS

FANCL CORPORATION and Consolidated Subsidiaries
As of March 31, 2005 and 2004

| | Millions of yen | | Thousands of U.S. dollars (Note 2) |
|---|---|---|---|
| **ASSETS** | 2005 | 2004 | 2005 |
| **Current assets:** | | | |
| Cash and cash equivalents | ¥ 22,307 | ¥ 23,561 | $ 207,720 |
| Notes and accounts receivable – trade | 8,714 | 7,814 | 81,144 |
| Less: Allowance for doubtful accounts | (150) | (182) | (1,397) |
| | 8,564 | 7,632 | 79,747 |
| Inventories (Note 4) | 5,664 | 5,472 | 52,742 |
| Deferred taxes (Note 8) | 485 | 683 | 4,516 |
| Prepaid expenses and other current assets | 2,060 | 1,888 | 19,182 |
| Total current assets | 39,080 | 39,236 | 363,907 |
| **Property, plant and equipment, at cost:** | | | |
| Land | 10,917 | 10,848 | 101,657 |
| Buildings and structures | 19,419 | 18,463 | 180,827 |
| Machinery and equipment | 9,532 | 9,700 | 88,761 |
| Construction in progress | 4 | 62 | 37 |
| | 39,872 | 39,073 | 371,282 |
| Less: Accumulated depreciation | (13,338) | (12,306) | (124,201) |
| Property, plant and equipment, net | 26,534 | 26,767 | 247,081 |
| **Intangible assets:** | | | |
| Goodwill | 299 | 572 | 2,784 |
| **Investments and other assets:** | | | |
| Investment securities: | | | |
| Non-consolidated subsidiaries and affiliates | 898 | 762 | 8,362 |
| Other | 3,609 | 2,710 | 33,606 |
| | 4,507 | 3,472 | 41,968 |
| Guarantee deposits | 2,527 | 2,503 | 23,531 |
| Long-term loans receivable | 660 | 1,007 | 6,146 |
| Deferred taxes (Note 8) | 593 | 757 | 5,522 |
| Other assets | 5,668 | 4,452 | 52,780 |
| Less: Allowance for doubtful accounts | (452) | (287) | (4,209) |
| Total investments and other assets | 13,503 | 11,904 | 125,738 |
| Total assets | ¥ 79,416 | ¥ 78,479 | $ 739,510 |

| LIABILITIES AND SHAREHOLDERS' EQUITY | Millions of yen | | Thousands of U.S. dollars (Note 2) |
| --- | --- | --- | --- |
| | 2005 | 2004 | 2005 |
| Current liabilities: | | | |
| Notes and accounts payable – trade | ¥ 3,050 | ¥ 3,172 | $ 28,401 |
| Accrued income taxes (Note 8) | 1,914 | 1,105 | 17,823 |
| Other current liabilities | 5,494 | 5,745 | 51,159 |
| Total current liabilities | 10,458 | 10,022 | 97,383 |
| Noncurrent liabilities: | | | |
| Accrued retirement benefits (Note 9) | 2,313 | 2,406 | 21,538 |
| Other long-term liabilities | 442 | 438 | 4,116 |
| Total noncurrent liabilities | 2,755 | 2,844 | 25,654 |
| Contingent liabilities (Note 12) | | | |
| Shareholders' equity (Notes 6, 7 and 16): | | | |
| Common stock, with no par value: | | | |
| Authorized — 77,946,000 shares in 2005 and 2004 | | | |
| Issued — 23,392,200 shares in 2005 and 2004 | 10,795 | 10,795 | 100,521 |
| Additional paid-in capital | 11,706 | 11,706 | 109,005 |
| Retained earnings | 51,173 | 50,529 | 476,516 |
| Net unrealized holding gain (loss) on other securities | 27 | 54 | 252 |
| Translation adjustments | (5) | (5) | (47) |
| Less: Treasury stock | (7,493) | (7,466) | (69,774) |
| Total shareholders' equity | 66,203 | 65,613 | 616,473 |
| Total liabilities and shareholders' equity | ¥ 79,416 | ¥ 78,479 | $ 739,510 |

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF INCOME

FANCL CORPORATION and Consolidated Subsidiaries
For the years ended March 31, 2005 and 2004

| | Millions of yen | | Thousands of U.S. dollars (Note 2) |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Net sales | ¥ 87,937 | ¥ 84,957 | $ 818,857 |
| Cost of sales | 30,032 | 29,261 | 279,654 |
| Gross profit | 57,905 | 55,696 | 539,203 |
| Selling, general and administrative expenses (Note 10) | 52,477 | 47,927 | 488,658 |
| Operating income | 5,428 | 7,769 | 50,545 |
| Other income (expenses): | | | |
| Interest and dividend income | 57 | 40 | 531 |
| Interest expense | — | (3) | — |
| Loss on retirement of inventories | (681) | (404) | (6,341) |
| Loss on disposal of property, plant and equipment | (335) | (340) | (3,120) |
| Loss on cancellation of lease contracts | (434) | — | (4,041) |
| Other, net | 332 | (849) | 3,091 |
| Income before income taxes | 4,367 | 6,213 | 40,665 |
| Income taxes (Note 8): | | | |
| Current | 2,533 | 3,153 | 23,587 |
| Deferred | 124 | (327) | 1,155 |
| | 2,657 | 2,826 | 24,742 |
| Net income | ¥ 1,710 | ¥ 3,387 | $ 15,923 |

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

FANCL CORPORATION and Consolidated Subsidiaries
For the years ended March 31, 2005 and 2004

| | Millions of yen | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Common stock | | Additional paid-in capital (Note 6) | Retained earnings (Notes 6 and 16) | Net unrealized holding (loss) gain on other securities | Translation adjustments | Treasury stock | Total shareholders' equity |
| | Number of shares Thousands | Amount | | | | | | |
| March 31, 2003 | 23,392 | ¥ 10,795 | ¥ 11,706 | ¥ 48,027 | ¥ (10) | ¥ — | ¥ (4,168) | ¥ 66,350 |
| Cash dividends | — | — | — | (885) | — | — | — | (885) |
| Net income | — | — | — | 3,387 | — | — | — | 3,387 |
| Purchase of treasury stock | — | — | — | — | — | — | (3,298) | (3,298) |
| Translation adjustments | — | — | — | — | — | (5) | — | (5) |
| Net unrealized holding gain (loss) on other securities | — | — | — | — | 64 | — | — | 64 |
| March 31, 2004 | 23,392 | 10,795 | 11,706 | 50,529 | 54 | (5) | (7,466) | 65,613 |
| Cash dividends | — | — | — | (1,065) | — | — | — | (1,065) |
| Directors' bonuses | — | — | — | (1) | — | — | — | (1) |
| Net income | — | — | — | 1,710 | — | — | — | 1,710 |
| Purchase of treasury stock | — | — | — | — | — | — | (27) | (27) |
| Net unrealized holding gain (loss) on other securities | — | — | — | — | (27) | — | — | (27) |
| March 31, 2005 | 23,392 | ¥ 10,795 | ¥ 11,706 | ¥ 51,173 | ¥ 27 | ¥ (5) | ¥ (7,493) | ¥ 66,203 |

| | Thousands of U.S. dollars (Note 2) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Common stock | Additional paid-in capital (Note 6) | Retained earnings (Notes 6 and 16) | Net unrealized holding (loss) gain on other securities | Translation adjustments | Treasury stock | Total shareholders' equity |
| | Amount | | | | | | |
| March 31, 2004 | $ 100,521 | $ 109,005 | $ 470,519 | $ 503 | $ (47) | $ (69,522) | $ 610,979 |
| Cash dividends | — | — | (9,917) | — | — | — | (9,917) |
| Directors' bonuses | — | — | (9) | — | — | — | (9) |
| Net income | — | — | 15,923 | — | — | — | 15,923 |
| Purchase of treasury stock | — | — | — | — | — | (252) | (252) |
| Sale of treasury stock | — | — | — | — | — | — | — |
| Net unrealized holding gain (loss) on other securities | — | — | — | (251) | — | — | (251) |
| March 31, 2005 | $ 100,521 | $ 109,005 | $ 476,516 | $ 252 | $ (47) | $ (69,774) | $ 616,473 |

See notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

FANCL CORPORATION and Consolidated Subsidiaries
For the years ended March 31, 2005 and 2004

| | Millions of yen | | Thousands of U.S. dollars (Note 2) |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| **Cash flows from operating activities:** | | | |
| Income before income taxes | ¥ 4,367 | ¥ 6,213 | $ 40,665 |
| Adjustments to reconcile income before income taxes to net cash provided by operating activities: | | | |
| Depreciation and amortization | 2,737 | 2,828 | 25,487 |
| Increase in allowance for doubtful accounts | 132 | 8 | 1,229 |
| Accrued retirement benefits, net of payments | (1) | 916 | (9) |
| Cash surrender value of insurance policies | 439 | 296 | 4,088 |
| Income from investment in silent partnership | (160) | (150) | (1,490) |
| Loss on disposal of property, plant and equipment | 534 | 325 | 4,973 |
| Changes in operating assets and liabilities: | | | |
| Notes and accounts receivable — trade | (899) | 406 | (8,371) |
| Inventories | (192) | (369) | (1,788) |
| Other current assets | (339) | (228) | (3,157) |
| Accounts payable – trade | (123) | (168) | (1,145) |
| Other current liabilities | (342) | 811 | (3,185) |
| Other noncurrent liabilities | (67) | (142) | (624) |
| Income taxes paid | (1,510) | (4,954) | (14,061) |
| Other, net | 62 | (69) | 577 |
| Net cash provided by operating activities | 4,638 | 5,861 | 43,188 |
| **Cash flows from investing activities:** | | | |
| Increase in fixed-term deposits | (1,500) | — | (13,968) |
| Purchases of property, plant and equipment | (1,703) | (3,341) | (15,858) |
| Purchases of software | (238) | (584) | (2,216) |
| Purchases of stock of affiliates | (226) | (118) | (2,104) |
| Increase in long-term loans receivable | (185) | 48 | (1,723) |
| Purchases of investment securities | (840) | — | (7,822) |
| Disposition of investment securities | 115 | 2 | 1,071 |
| Increase in other investments and other assets | (330) | (208) | (3,073) |
| Other, net | 100 | 84 | 931 |
| Net cash used in investing activities | (4,807) | (4,117) | (44,762) |
| **Cash flows from financing activities:** | | | |
| Repayment of long-term debt | — | (350) | — |
| Purchases of treasury stock | (27) | (3,298) | (251) |
| Cash dividends paid | (1,064) | (885) | (9,908) |
| Other | 1 | — | 9 |
| Net cash used in financing activities | (1,090) | (4,533) | (10,150) |
| Effect of foreign exchange rate changes on cash and cash equivalents | 5 | (20) | 47 |
| Net decrease in cash and cash equivalents | (1,254) | (2,809) | (11,677) |
| Cash and cash equivalents at beginning of year | 23,561 | 26,370 | 219,397 |
| Cash and cash equivalents at end of year | ¥ 22,307 | ¥ 23,561 | $ 207,720 |

See notes to consolidated financial statements.

FANCL CORPORATION and Consolidated Subsidiaries
For the years ended March 31, 2005

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *(A) BASIS OF PREPARATION*

FANCL CORPORATION (the "Company") and its consolidated subsidiaries (collectively the "Group") maintain their books of accounts in accordance with accounting standards generally accepted in Japan, and its foreign subsidiaries maintain their books of accounts in conformity with those of their countries of domicile. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and have been compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan. Certain reclassifications have been made to present the accompanying consolidated financial statements in a format which is familiar to readers outside Japan. Certain amounts from prior years have been reclassified to conform to the current year's presentation.

### *(B) BASIS OF CONSOLIDATION*

The accompanying consolidated financial statements include the accounts of the Company and all its subsidiaries over which substantial control is exerted through either majority ownership of voting stock and/or by other means. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in non-consolidated subsidiaries and affiliates (companies over which the Company has the ability to exercise significant influence) are stated at cost because of their immateriality.

All assets and liabilities of the subsidiaries are revalued at their respective fair value upon acquisition, if applicable, and the excess of cost over underlying net assets at the date of acquisition is amortized over a period of five years on a straight-line basis.

### *(C) FOREIGN CURRENCY TRANSLATION*

All assets and liabilities denominated in foreign currencies of the Company and the domestic consolidated subsidiaries are translated at the current exchange rates in effect at each balance sheet date when not hedged by forward foreign exchange contracts, or at the contracted rates of exchange when hedged by forward foreign exchange contracts. The resulting foreign exchange gain or loss is recognized as other income or expense.

Assets and liabilities of a foreign consolidated subsidiary are translated at the current exchange rates in effect at each balance sheet date and its revenue and expense accounts are translated at the average rate of exchange in effect during the year.

Translation adjustments are presented as a component of shareholders' equity in the accompanying consolidated financial statements.

### *(D) CASH EQUIVALENTS*

All highly liquid investments, generally with a maturity of three months or less when purchased, which are readily convertible into known amounts of cash and which are so near maturity that they represent only an insignificant risk of any change in their value attributable to changes in interest rates, are considered cash equivalents.

### *(E) SECURITIES*

All securities owned by the Company and consolidated subsidiaries are available for sale and classified as "other" securities, which is one of three categories (trading, held-to-maturity and other) defined in the accounting standard for financial instruments.

Other securities with quoted market prices are carried at fair market value. The difference between the acquisition cost and the carrying value of other securities, including unrealized holding gain or loss, is recognized as a component of shareholders' equity as is reflected as "Net unrealized holding gain (loss) on other securities." The cost of other securities sold has been computed based on the average method. Other securities without quoted market prices are stated at cost based on the average method.

### *(F) INVENTORIES*

Finished goods, merchandise, work in process and raw materials are stated at cost by the average method. Supplies are stated at cost by the last purchase price method.

### *(G) DEPRECIATION AND AMORTIZATION*

Depreciation of property, plant and equipment of the

Company and consolidated subsidiaries is calculated primarily by the declining-balance method based on the estimated useful lives of the respective assets. However, buildings (excluding structures attached to the buildings) acquired on or after April 1, 1998 by the Company and the consolidated subsidiaries have been depreciated by the straight-line method. The following summarizes the estimated useful lives of property, plant and equipment by major category:

| | |
|---|---|
| Buildings and structures | 3 — 50 years |
| Machinery and equipment | 2 — 22 years |

Intangible assets are amortized by the straight-line method. The cost of software intended for internal use is amortized by the straight-line method over an estimated useful life of 5 years.

*(H) LEASES*

Finance leases other than those which transfer the ownership of the leased assets to the lessee are not capitalized, but are accounted for by a method similar to that applicable to operating leases.

*( I ) RESEARCH AND DEVELOPMENT EXPENSES*

Research and development expenses are charged to income when incurred.

*( J ) ALLOWANCE FOR DOUBTFUL ACCOUNTS*

The allowance for doubtful accounts is provided at an amount sufficient to cover possible losses on the collection of receivables, and is determined based on historical write-off experience with write-offs plus an estimated amount for probable doubtful accounts after a review of the collectibility of individual receivables.

*(K) ALLOWANCE FOR EMPLOYEES' BONUSES*

The allowance for employees' bonuses represents a provision for the future payment of employees' bonuses.

*(L) RETIREMENT BENEFITS*

Employees with three years or more of service are generally entitled to receive a lump-sum payment upon termination of employment with the Company, the amount of which is determined by reference to their basic rate of pay, length of service and the conditions under which the termination occurs.

The Company participates in a contributory defined benefit pension plan which entitles employees of the Company upon retirement at age 60 or more to either a lump-sum payment or pension annuity payments for life, or a combination of both, based on their length of service, salary at the time of retirement and number of years of participation in the plan.

Accrued retirement benefits for employees have been provided based on an estimate of the retirement benefit obligation and the pension fund assets.

Unrecognized actuarial net loss is amortized by the straight-line method over 5 years which fall within the average remaining years of service of the active participants in the plan when incurred commencing the following year.

The Company also provides an accrual for retirement allowances for directors and statutory auditors at the full amount which would be required to be paid if all directors and statutory auditors retired at the balance sheet date based on the Company's internal regulations.

*(M) STOCK ISSUANCE EXPENSES*

Stock issuance expenses are charged to income when incurred.

*(N) INCOME TAXES*

Deferred income taxes are recognized by the liability method. Under the liability method, deferred tax assets and liabilities are determined based on the difference between financial reporting and the tax bases of the assets and liabilities, and are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse.

*(O) DERIVATIVE FINANCIAL INSTRUMENTS*

Derivative financial instruments are carried at fair value with any changes in unrealized gain or loss charged or credited to operations, except for those which meet the criteria for deferral hedge accounting under which unrealized gain or loss is deferred as an asset or a liability. Forward foreign exchange contracts which meet certain criteria are accounted for by the allocation method used to hedge against risk arising from fluctuation in foreign exchange rates.

The Group does not make an assessment of the effectiveness of its hedging activities because the relationship between the anticipated cash flows fixed by hedging activities and the avoidance of market risk is so clear that there is no need to evaluate the effectiveness of each hedge against the respective underlying hedged item.

*(P) APPROPRIATION OF RETAINED EARNINGS*

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by resolution of the shareholders at a general meeting held subsequent to the close of such financial period. The accounts for that period do not, therefore, reflect such appropriations. See Note 15.

## 2. U.S. DOLLAR AMOUNTS

For the convenience of the reader, the accompanying financial statements with respect to the year ended March 31, 2005 have been presented in U.S. dollars by translating all yen amounts at ¥107.39 = US$1.00, the exchange rate prevailing on March 31, 2005. This translation should not be construed as a representation that yen have been, could have been, or could in the future be, converted into U.S. dollars at the above or any other rate.

## 3. MARKETABLE AND INVESTMENT SECURITIES

Information regarding marketable and investment securities with quoted market prices classified as other securities at March 31, 2005 and 2004 is summarized as follows:

| | Millions of yen | | | Thousands of U.S. dollars | | |
|---|---|---|---|---|---|---|
| At of March 31, 2005 | Acquisition cost | Carrying value | Unrealized gain (loss) | Acquisition cost | Carrying value | Unrealized gain (loss) |
| **Securities whose carrying value exceeds their acquisition cost:** | | | | | | |
| Stock | ¥ 66 | ¥ 111 | ¥ 45 | $ 615 | $ 1,034 | $ 419 |
| Total | ¥ 66 | ¥ 111 | ¥ 45 | $ 615 | $ 1,034 | $ 419 |

| | Millions of yen | | |
|---|---|---|---|
| At of March 31, 2004 | Acquisition cost | Carrying value | Unrealized gain (loss) |
| **Securities whose acquisition cost exceeds their carrying value:** | | | |
| Stock | ¥ 124 | ¥ 216 | ¥ 92 |
| Total | ¥ 124 | ¥ 216 | ¥ 92 |

Other securities without quoted market prices at March 31, 2005 and 2004 are summarized as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| Carrying value | 2005 | 2004 | 2005 |
| Current assets: | | | |
| Money management funds | ¥ 3,927 | ¥ 4,726 | $ 36,565 |
| Free financial funds | | ¥ 3,006 | |
| Commercial paper | 1,000 | | 9,311 |
| Noncurrent assets: | | | |
| Unlisted stocks (excluding securities traded over-the-counter) | 130 | ¥ 91 | 1,215 |
| Unlisted foreign bonds | 800 | | 7,449 |
| | ¥ 5,857 | ¥ 7,823 | $ 54,540 |

## 4. INVENTORIES

Inventories at March 31, 2005 and 2004 consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Merchandise | ¥ 556 | ¥ 478 | $ 5,183 |
| Finished goods | 1,888 | 2,051 | 17,581 |
| Raw materials | 2,306 | 2,168 | 21,472 |
| Work in process | 662 | 491 | 6,161 |
| Supplies | 252 | 284 | 2,345 |
| | ¥ 5,664 | ¥ 5,472 | $ 52,742 |

## 5. SHAREHOLDERS' EQUITY

The Commercial Code of Japan provides that an amount equal to at least 10% of the amounts to be disbursed as distributions of earnings be appropriated to the legal reserve until such reserve and additional paid-in capital equals 25% of the common stock account. The Code also stipulates that, to the extent that the sum of the additional paid-in capital account and the legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for appropriation by resolution of the shareholders.

## 6. STOCK OPTION PLANS

On June 28, 1999, the shareholders approved a stock option plan to grant warrants to purchase shares of the Company's common stock to the 4 directors and 42 employees of the Company in accordance with the Commercial Code of Japan. Under the plan, the maximum number of 166,920 shares were granted.

The price was set at ¥16,540 per stock option.

As outlined in the Company's stock option plan, this exercise price will be adjusted in accordance with a specified formula for stock splits, reverse stock splits or for other cases.

The stock options became exercisable during the period from June 29, 2001 through June 28, 2009.

On June 24, 2000, the shareholders approved a stock option plan to grant warrants to purchase shares of the Company's common stock to 225 employees in accordance with the Commercial Code of Japan. Under the plan, a maximum of 96,720 shares were granted to the employees of the Company.

The price was set at ¥13,667 per stock option.

As outlined in the Company's stock option plan, this exercise price will be adjusted in accordance with a specified formula for stock splits, reverse stock splits or for other cases.

The stock options became exercisable during the period from July 1, 2002 through June 30, 2005.

On June 16, 2002, the shareholders of the Company approved a stock option plan to grant warrants to purchase shares of the Company's common stock to directors, statutory auditors and employees of the Company and its subsidiaries in accordance with the Commercial Code of Japan. Under the plan, a maximum of 396,100 shares were granted to the individuals referred to above.

The price was set at ¥4,100 per stock option.

As outlined in the Company's stock option plan, this exercise price will be adjusted in accordance with a specified formula for stock splits, reverse stock splits or for other cases.

The stock options became exercisable during the period from July 1, 2004 through June 29, 2007.

On June 19, 2004, the shareholders of the Company approved a stock option plan to grant warrants to purchase shares of the Company's common stock to directors and employees of the Company and its subsidiaries in accordance with the Commercial Code of Japan. Under the plan, a maximum of 623,800 shares were granted to the individuals referred to above.

The price was set at ¥3,650 per stock option.

As outlined in the Company's stock option plan, this exercise price will be adjusted in accordance with a specified formula for stock splits, reverse stock splits or for other cases.

The stock options will become exercisable during the period from July 3, 2006 through June 30, 2009.

## 7. INCOME TAXES

Income taxes applicable to the Company and consolidated subsidiaries comprise corporation tax, inhabitants' taxes and enterprise tax which, in the aggregate, resulted in a statutory tax rate of approximately 42% for 2005 and 2004. The effective tax rates reflected in the accompanying consolidated statements of income differ from the statutory tax rate primarily due to the effect of permanent nondeductible expenses for tax purposes.

The significant components of deferred tax assets and liabilities at March 31, 2005 and 2004 were as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Deferred tax assets: | | | |
| Accrued enterprise taxes | ¥ 170 | ¥ 109 | $ 1,583 |
| Accrued bonuses | 318 | 311 | 2,961 |
| Allowance for doubtful accounts | 128 | 139 | 1,192 |
| Accrued severance benefits | 915 | 927 | 8,520 |
| Depreciation | 66 | 52 | 615 |
| Net loss carried forward | 593 | 160 | 5,522 |
| Other | 205 | 343 | 1,909 |
| | 2,395 | 2,041 | 22,302 |
| Valuation allowance | (791) | (77) | (7,366) |
| | 1,604 | 1,964 | 14,936 |
| Deferred tax liabilities: | | | |
| Unrealized intercompany profit on land | 232 | 232 | 2,160 |
| Unrealized revaluation gain on land with respect to acquisition of IIMONO OHKOKU Co., Ltd. | 165 | 165 | 1,537 |
| Other | 129 | 127 | 1,201 |
| | 526 | 524 | 4,898 |
| Net deferred tax assets | ¥ 1,078 | ¥ 1,440 | $ 10,038 |

## 8. RETIREMENT BENEFITS

The Company and consolidated subsidiaries have defined benefit pension plans and lump-sum retirement payment plans which cover substantially all employees who terminate their employment. In addition to these plans, the Company and its consolidated subsidiaries (except for one consolidated subsidiary) participate in the multi-employer welfare pension fund (the "Fund") under the Welfare Pension Insurance Law of Japan.

The funded status of the defined benefit pension plans for the years ended March 31, 2005 and 2004 is summarized as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Projected benefit obligation | ¥ 1,451 | ¥ 1,566 | $ 13,509 |
| Fair value of plan assets | (530) | (492) | (4,934) |
| Funded status | 921 | 1,074 | 8,575 |
| Unrecognized actuarial net loss | 0 | (102) | 3 |
| Net retirement benefit obligation | 921 | 972 | 8,578 |
| Prepaid pension cost | 274 | 224 | 2,547 |
| Accrued retirement benefits | ¥ 1,195 | ¥ 1,196 | $ 11,125 |

The consolidated subsidiaries have adopted a simplified method permitted for the calculation of the projected benefit obligation.

Retirement allowances for directors and statutory auditors in the amount of ¥1,117 million ($10,401 thousand) and ¥1,210 million have been included in accrued retirement benefits in the consolidated balance sheets at March 31, 2005 and 2004, respectively.

Retirement benefit expenses for the years ended March 31, 2005 and 2004 were composed of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Service cost – benefits earned during the year | ¥ 179 | ¥ 185 | $ 1,670 |
| Interest cost on projected benefit obligation | 19 | 18 | 176 |
| Expected return on plan assets | (11) | (8) | (103) |
| Amortization of unrecognized actuarial net loss | 42 | 47 | 387 |
| Contributions to welfare pension fund | 193 | 175 | 1,799 |
| Special additional retirement payment | 127 | — | 1,186 |
| Retirement benefit expenses | ¥ 549 | ¥ 417 | $ 5,115 |

In the table above, retirement benefit expenses determined by a simplified method at the consolidated subsidiaries have been included in the service cost – benefits earned during each year.

The Company and consolidated subsidiaries have accounted for the contributions to the Fund as retirement benefit expenses. This accounting treatment is permitted under the accounting standard for retirement benefits because it is difficult for the Company and the consolidated subsidiaries to reasonably calculate the value of the pension plan assets based on their contributions.

The assumptions used in the actuarial calculation other than those stated above for the years ended March 31, 2005 and 2004 were principally as follows:

| | 2005 | 2004 |
|---|---|---|
| Discount rate | 1.75% | 1.75% |
| Expected rate of return | 3.00% | 3.00% |
| Actuarial cost method | Unit credit actuarial cost method | |
| Amortization period for actuarial differences | 5 years * | 5 years * |

* Amortized by the straight-line method over a period which falls within the estimated average remaining years of service of the active participants, commencing the year subsequent to the period when the actuarial difference was calculated.

## 9. RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses charged to income for the years ended March 31, 2005 and 2004 were as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Research and development expenses | ¥ 1,959 | ¥ 1,720 | $ 18,242 |

## 10. LEASES

The Group holds certain machinery and equipment under finance leases which do not transfer the ownership to the lessee. These leases are not capitalized, but are accounted for by a method similar to that applicable to operating leases. If such leases had been capitalized, the acquisition costs and accumulated depreciation of the leased assets at March 31, 2005 and 2004 would have been as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Machinery and equipment | ¥ 5,550 | ¥ 5,055 | $ 51,681 |
| Accumulated depreciation | 2,043 | 2,104 | 19,024 |
| | ¥ 3,507 | ¥ 2,951 | $ 32,657 |

The following presents the future minimum lease payments subsequent to March 31, 2005 under finance leases which do not transfer ownership:

| March 31, 2005 | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Minimum lease payments: | | |
| Due within one year | ¥ 745 | $ 6,937 |
| Due after one year | 2,790 | 25,980 |
| | ¥ 3,535 | $ 32,917 |

Lease expenses related to finance leases which do not transfer ownership for the years ended March 31, 2005 and 2004 amounted to ¥911 million ($8,483 thousand) and ¥834 million, respectively. Depreciation related to these leases for the years ended March 31, 2005 and 2004 would have been ¥840 million ($7,822 thousand) and ¥773 million, respectively, if the leases had been capitalized.

For the purpose of presentation of the above pro forma amounts, depreciation of the leased assets has been calculated by the straight-line method over the lease terms assuming a nil residual value.

## 11. CONTINGENT LIABILITIES

Contingent liabilities as of March 31, 2005 amounted to ¥2,481 million ($23,103 thousand) and represented guarantees of borrowings incurred by the nineteen industrial corporations (including the Company) which are members of the Nagareyama Industrial Cooperative Association (the "Association") for the purposes of financing their purchases of manufacturing and other facilities located in the Nagareyama City area and the land upon which such facilities are situated. The Company has guaranteed such borrowings jointly and severally with the other eighteen members of the Association.

In addition to the guarantees stated above, the land of ¥591 million ($5,503 thousand) and the plant of ¥1,809 million ($16,845 thousand) located in the Nagareyama area were pledged as collateral for the above borrowings.

## 12. AMOUNTS PER SHARE

In accordance with a new accounting standard for earnings per share which became effective April 1, 2002, basic net income per share is computed based on the net income available for distribution to shareholders of common stock and the weighted- average number of shares of common stock outstanding during each year. Diluted net income per share is computed based on the net income available for distribution to the shareholders and the weighted -average number of shares of common stock outstanding during each year assuming full dilution of common stock equivalents. Net assets per share is also computed based on the weighted -average number of shares of common stock outstanding during each year. Since there were no potentially dilutive convertible bonds or warrants outstanding as of 2004, diluted net income per share has not been presented.

| | Yen | | U.S. dollars |
|---|---|---|---|
| | 2005 | 2004 | 2005 |
| Net income | | | |
| — Basic | ¥ 80.29 | ¥ 154.57 | $ 0.75 |
| — Diluted | 80.23 | — | 0.75 |
| Net assets | ¥ 3,111.15 | ¥ 3,082.47 | $ 28.97 |

## 13. DERIVATIVE AND HEDGING ACTIVITIES

The Company utilizes derivative financial instruments such as forward foreign exchange contracts for the purpose of hedging its exposure to adverse fluctuations in foreign currency exchange rates, but does not enter into such transactions for speculative or trading purposes.

The Company may from time to time enter into forward foreign exchange contracts in order to manage certain risks arising from adverse fluctuations in the exchange transactions. The Company has implemented internal regulations under which they will so hedge any significant exchange risks.

No specific disclosure for derivatives has been made as the Company's positions principally meet the criteria for deferral hedge accounting.

## 14. SEGMENT INFORMATION

The Company and consolidated subsidiaries are primarily engaged in the manufacture and sales of products mainly in Japan in three segments: a cosmetics business in which various cosmetics are sold through wholesalers and stores and by mail, a nutritional supplements business in which various supplements are sold through wholesalers and stores and by mail, and other business which includes sales of miscellaneous goods, personal ornaments, underwear, medical and health products, housewares, germinated brown rice, kale juice and etc. This segmentation has been adopted for internal management purposes.

The business segment information of the Company and consolidated subsidiaries for the years ended March 31, 2005 and 2004 is summarized as follows:

### BUSINESS SEGMENTS

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| Year ended March 31, 2005 | Cosmetics business | Nutritional supplements business | Other businesses | Total | Eliminations or corporate | Consolidated |
| **I. Sales and operating income** | | | | | | |
| Sales to external customers | ¥ 37,098 | ¥ 31,132 | ¥ 19,707 | ¥ 87,937 | ¥ — | ¥ 87,937 |
| Intersegment sales or transfers | — | — | — | — | — | — |
| Total sales | 37,098 | 31,132 | 19,707 | 87,937 | — | 87,937 |
| Operating expenses | 32,353 | 26,494 | 21,674 | 80,521 | 1,988 | 82,509 |
| Operating income (loss) | ¥ 4,745 | ¥ 4,638 | ¥ (1,967) | ¥ 7,416 | ¥ (1,988) | ¥ 5,428 |
| **II. Total assets, depreciation and capital expenditures** | | | | | | |
| Total assets | ¥ 26,174 | ¥ 13,384 | ¥ 14,199 | ¥ 53,757 | ¥ 25,659 | ¥ 79,416 |
| Depreciation | 1,322 | 522 | 527 | 2,371 | 92 | 2,463 |
| Capital expenditures | 1,008 | 499 | 750 | 2,257 | — | 2,257 |

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| Year ended March 31, 2004 | Cosmetics business | Nutritional supplements business | Other businesses | Total | Eliminations or corporate | Consolidated |
| **I. Sales and operating income** | | | | | | |
| Sales to external customers | ¥ 34,926 | ¥ 29,656 | ¥ 20,375 | ¥ 84,957 | ¥ — | ¥ 84,957 |
| Intersegment sales or transfers | — | — | — | — | — | — |
| Total sales | 34,926 | 29,656 | 20,375 | 84,957 | — | 84,957 |
| Operating expenses | 28,643 | 24,285 | 22,196 | 75,124 | 2,064 | 77,188 |
| Operating income (loss) | ¥ 6,283 | ¥ 5,371 | ¥ (1,821) | ¥ 9,833 | ¥ (2,064) | ¥ 7,769 |
| **II. Total assets, depreciation and capital expenditures** | | | | | | |
| Total assets | ¥ 24,733 | ¥ 11,887 | ¥ 13,468 | ¥ 50,088 | ¥ 28,391 | ¥ 78,479 |
| Depreciation | 1,241 | 606 | 600 | 2,447 | 109 | 2,556 |
| Capital expenditures | 3,826 | 559 | 297 | 4,682 | 182 | 4,864 |

| Year ended March 31, 2005 | Thousands of U.S. dollars Cosmetics business | Nutritional supplements business | Other businesses | Total | Eliminations or corporate | Consolidated |
|---|---|---|---|---|---|---|
| **I. Sales and operating income** | | | | | | |
| Sales to external customers | $ 345,451 | $ 289,897 | $ 183,509 | $ 818,857 | $ — | $ 818,857 |
| Intersegment sales or transfers | — | — | — | — | — | — |
| Total sales | 345,451 | 289,897 | 183,509 | 818,857 | — | 818,857 |
| Operating expenses | 301,267 | 246,708 | 201,825 | 749,800 | 18,512 | 768,312 |
| Operating income (loss) | $ 44,184 | $ 43,189 | $ (18,316) | $ 69,057 | $ (18,512) | $ 50,545 |
| **II. Total assets, depreciation and capital expenditures** | | | | | | |
| Total assets | $ 243,728 | $ 124,630 | $ 132,219 | $ 500,577 | $ 238,933 | $ 739,510 |
| Depreciation | 12,310 | 4,861 | 4,907 | 22,078 | 857 | 22,935 |
| Capital expenditures | 9,386 | 4,647 | 6,984 | 21,017 | — | 21,017 |

Unallocatable operating expenses included under "Eliminations or corporate" for the years ended March 31, 2005 and 2004 amounted to ¥1,988 million ($18,512 thousand) and ¥2,065 million, respectively, and consisted of operating expenses incurred in the Administration Department of the Company. Corporate assets included under "Eliminations or corporate" for the years ended March 31, 2005 and 2004 amounted to ¥25,659 million ($238,933 thousand) and ¥28,391 million, respectively, and consisted principally of cash and cash equivalents, short-term investments, land, funds for long-term investments (investment securities and other) and the cash surrender value of certain of the Company's insurance policies.

### GEOGRAPHICAL SEGMENTS

Since sales of the Company and its domestic consolidated subsidiaries for the years ended March 31, 2005 and 2004 constituted more than 90% of consolidated sales, geographical segment information has not been presented.

### OVERSEAS SALES

Since overseas sales were less than 10% of consolidated sales for the years ended March 31, 2005 and 2004, no disclosure of overseas sales has been presented.

## 15. SUBSEQUENT EVENT

The following appropriations of retained earnings of the Company, which have not been reflected in the consolidated financial statements for the year ended March 31, 2005, were approved at a meeting of the shareholders held on June 20, 2005:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Cash dividends (¥25=U.S.$0.23 per share) | ¥ 531 | $ 4,945 |

# REPORT OF INDEPENDENT AUDITORS

**THE BOARD OF DIRECTORS**
**FANCL CORPORATION**

We have audited the accompanying consolidated balance sheets of FANCL CORPORATION and consolidated subsidiaries as of March 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of FANCL CORPORATION and consolidated subsidiaries at March 31, 2005 and 2004, 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.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2005 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2.

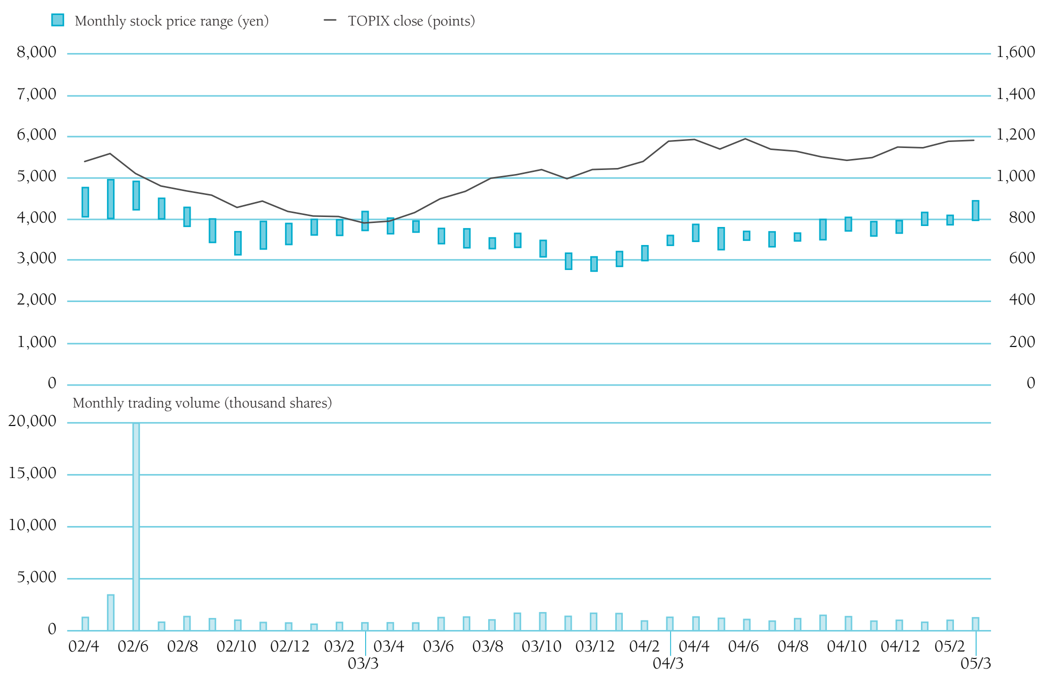
Ernst & Young ShinNihon

June 20, 2005

## MARKET PRICE RANGE PER SHARE OF COMMON STOCK, AND TRADING VOLUME

| | 2004 | | | | | | | | | 2005 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Apr. | May | Jun. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec. | Jan. | Feb. | Mar. |
| High (¥) ...................... | 3,880 | 3,800 | 3,710 | 3,700 | 3,670 | 4,000 | 4,050 | 3,950 | 3,970 | 4,170 | 4,100 | 4,450 |
| Low (¥) ....................... | 3,470 | 3,270 | 3,500 | 3,340 | 3,480 | 3,510 | 3,720 | 3,600 | 3,670 | 3,860 | 3,870 | 3,980 |
| Trading volume | | | | | | | | | | | | |
| (Thousand shares) ..... | 1,339 | 1,202 | 1,094 | 930 | 1,183 | 1,472 | 1,350 | 912 | 1,000 | 824 | 996 | 1,236 |

### Monthly Stock Data

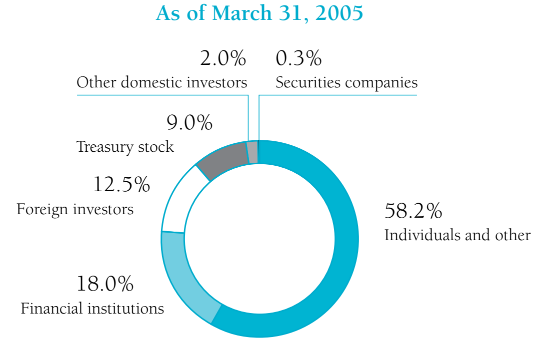



## COMPOSITION OF SHAREHOLDERS

(Percentage of ownership)

| | 2003 | | 2004 | | 2005 |
|---|---|---|---|---|---|
| | Mar. | Sep. | Mar. | Sep. | Mar. |
| Individuals and other .... | 61.6 | 62.7 | 62.4 | 59.2 | 58.2 |
| Financial institutions ..... | 21.8 | 19.4 | 16.3 | 16.5 | 18.0 |
| Foreign investors ........... | 10.5 | 9.5 | 9.5 | 12.9 | 12.5 |
| Treasury stock ................ | 4.7 | 6.3 | 9.0 | 9.0 | 9.0 |
| Other domestic investors | 0.7 | 0.7 | 2.1 | 2.0 | 2.0 |
| Securities companies ..... | 0.7 | 1.4 | 0.7 | 0.4 | 0.3 |

As of March 31, 2005



# CORPORATE INFORMATION

(As of March 31, 2005)

### HEAD OFFICE

89-1 Yamashita-cho, Naka-ku, Yokohama,
Kanagawa-ken 231-8528, Japan
Tel: 81(45)226-1200

### ESTABLISHED

August 1981

### COMMON STOCK LISTING

Tokyo Stock Exchange, First Section
(Code: 4921)

### COMMON STOCK

Authorized Shares: 77,946,000
Outstanding Shares: 23,392,200

### PAID-IN CAPITAL

¥10,795,161,280

### NUMBER OF SHAREHOLDERS

20,918

### NUMBER OF FULL-TIME EMPLOYEES

642

### TRANSFER AGENT AND REGISTRAR

Mizuho Trust & Banking Co., Ltd.
1-2-1 Yaesu, Chuo-ku,
Tokyo 103-8670, Japan
http://www.mizuho-tb.co.jp/daikou/

Note: The transfer agent and registrar was changed from UFJ Trust Bank Limited to Mizuho Trust & Banking Co., Ltd. in June 21, 2005.

### ANNUAL MEETING OF SHAREHOLDERS

Held in mid-June in Kanagawa

### CONSOLIDATED SUBSIDIARIES

ATTENIR CORPORATION
NICOSTAR Co., Ltd.
IIMONO OHKOKU Co., Ltd.
FANCL Hatsuga Genmai Co., Ltd.
FANCL ASIA (PTE.,) LTD.
FANCL Biken Co., Ltd.

FANCL Corporation
89-1 Yamashita-cho, Naka-ku
Yokohama, Kanagawa-ken 231-8528, Japan
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http://www.fancl.co.jp/corporate/ir/index.html

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