



## Consolidated Financial Report For the Nine Months Ended September 30, 2005 (Unaudited)

**AnGes MG, Inc.** <http://www.anges-mg.com>

Listings: Mothers of the Tokyo Stock Exchange, Code 4563

Head Office: 4F, Saito Bio-Incubator, 7-7-15, Saito-Asagi, Ibaraki, Osaka, 567-0085, Japan

Adoption of the U.S.GAAP: None

### 1. Business Results for the Third Quarter 2005 (From Jan. 1, 2005 to Sep. 30, 2005)

#### (1) Results of Operations (Figures are rounded down to the nearest million yen)

	Revenues		Operating loss		Ordinary loss	
	Million yen	%	Million yen	%	Million yen	%
3Q 2005 (9 Months)	1,776	0.9	(1,508)	-	(1,407)	-
3Q 2004 (9 Months)	1,760	5.0	(1,042)	-	(1,033)	-
FY 2004 (12 Months)	2,696		(1,561)		(1,558)	

	Net loss		Net loss per share	Diluted net loss per share
	Million yen	%	yen	Yen
3Q 2005 (9 Months)	(1,437)	-	(14,462.16)	-
3Q 2004 (9 Months)	(969)	-	(10,178.24)	-
FY 2004 (12 Months)	(1,541)		(16,083.36)	-

Notes) 1. Equity in net income of unconsolidated subsidiaries and affiliates

3Q 2005: - million yen    3Q 2004: - million yen    Fiscal year 2004: - million yen

2. Average number of shares issued during the period ended (consolidated)

3Q 2005: 99,371 shares    3Q 2004: 95,293 shares    Fiscal year 2004: 95,843 shares

3. Change in accounting policies: None

4. Percentages for Revenues, Operating loss, Ordinary loss and Net loss indicate changes from the previous term.

#### (2) Financial Position

	Total assets	Shareholders' equity	Shareholders' equity ratio	Shareholders' equity per share
	Million yen	Million yen	%	Yen
Sep. 30, 2005	9,441	7,792	82.5	77,514.80
Sep. 30, 2004	11,371	9,114	80.2	93,866.17
Dec. 31, 2004	10,009	8,656	86.5	88,530.64

Notes) 1. Number of shares issued at end of period (consolidated)

Sep. 30, 2005: 100,523 shares    Sep. 30, 2004: 97,100 shares    Dec. 31, 2004: 97,780 shares

#### (3) Cash Flows

	Cash flows from operating activities	Cash flows from investing activities	Cash flows from financing activities	Cash and cash equivalents, at end
	Million yen	Million yen	Million yen	Million yen
3Q 2005 (9 Months)	(1,299)	(1,365)	565	4,909
3Q 2004 (9 Months)	(1,128)	(94)	781	4,139
FY 2004 (12 Months)	(1,433)	2,962	899	7,003

#### (4) Scope of consolidation and application of the equity method

Number of consolidated subsidiaries: 3

Number of non-consolidated subsidiaries accounted for under the equity method: N/A

Number of affiliates accounted for under the equity method: N/A

#### (5) Changes in the scope of consolidation and application of the equity method

Number of consolidated subsidiaries: Increase N/A    Decrease N/A

Number of affiliates accounted for under the equity method: Increase N/A    Decrease N/A

### 2. Earnings Forecast for the Fiscal Year 2005 (From Jan. 1, 2005 to Dec. 31, 2005)

	Revenues	Ordinary loss	Net loss
	Million yen	Million yen	Million yen
Full-year	2,200-3,200	(1,900)-(900)	(1,900)-(900)

*\*Since descriptions about future events, for instance, earnings forecast for FY 2005, are estimation, results may differ from this estimation due to changes of several economic conditions.*

*\*\*This financial report has been translated from Japanese 3Q Report which has been prepared in accordance with generally accepted accounting principles in Japan, for reference purposes only. Also some changes are added to this report in order to present in a form more familiar to the readers outside Japan.*

## AnGes MG, Inc.

### Operational and financial results for the nine months ended September 30, 2005

#### 1. Overview

For the nine months ended September 30, 2005, AnGes has made steady progress in product development and negotiated to establish new alliances and partnerships.

For the nine months ended September 30, 2005, total revenue has increased by 0.9% to reach ¥1,776 Million. In addition to the existing license and joint R&D agreements with Daiichi Pharmaceutical Co., Ltd., and Seikagaku Corporation, AnGes and Alfresa Corporation signed a joint R&D agreement to develop the NF-κB decoy oligoneucleotide for atopic dermatitis in June 2005, from which AnGes received a one-time contract payment and R&D support payments. These payments are accounted for as operating revenues.

Regarding the reagents business, AnGes has a license agreement on HVJ-E vector with Ishihara Sangyo Kaisha, Ltd., non-exclusive license agreements with two bio-ventures, Gene Design Inc. and Hokkaido System Science Co., Ltd for using NF-κB decoy oligoneucleotide for research purposes, and a license agreement on the drug design service for siRNA with Mitsubishi Space Software Co., Ltd. AnGes is entitled to receive royalty payments from these agreements.

The following is a summary of the financial results of the AnGes group companies by business segments for the nine months ended September 30, 2005 and 2004, and for the year ended December 31, 2004.

#### <Segment information (In millions)>

Business	9 months ended September 30,				Year ended December 31,	
	2005		2004		2004	
	Revenue	(%)	Revenue	(%)	Revenue	(%)
Pharmaceuticals.....	¥ 1,699	95.7	¥ 1,672	95.0	¥ 2,600	96.4
Reagents.....	2	0.1	3	0.2	4	0.2
Other.....	74	4.2	84	4.8	90	3.4
	¥ 1,776	100.0	¥ 1,760	100.0	¥ 2,696	100.0

As a result, for the nine months ended September 30, 2005, ordinary loss was ¥1,407 Million compared to loss of ¥1,033 Million in the same period of 2004. The ordinary loss is widened mainly due to the increase in R&D expenses.

For the nine months ended September 30, 2005, net loss was ¥1,437 Million compared to loss of ¥969 Million in the same period of 2004.

## 2. Research and Development

For the nine months ended September 30, 2005, R&D expenses increased by 20.7% over the previous term to reach ¥ 2,845 Million. The ratio of R&D expenses to operating revenue reached to 160.2%.

### <Major developments>

For HGF development, clinical development programs for PAD (Peripheral Arterial Disease) and IHD (Ischemic Heart Disease) have been making progress in Japan and the US. Regarding PAD, Phase II clinical trial studies in US have completed the patient enrollment in May 2005. In the near future, data analysis and evaluation of the result will be expected to be completed after the evaluation period for each enrolled patient. In Japan, the PAD Phase III clinical studies continue making progress. Meanwhile, the US IHD Phase I clinical trial, which was started in November 2004, is also making a progress. Preparations to initiate the IHD clinical trials in Japan are in progress.

For NF-κB decoy oligoneucleotide development, Phase I clinical trial studies for atopic dermatitis in Japan, started in September 2005. The development of effective administration for NF-κB decoy oligoneucleotide using the drug delivery systems is also in progress.

### <R&D projects and its current status>

Project	Target indications	Region	Development stage	Alliance partners
HGF	PAD	Japan	Phase III clinical trials	Daiichi Pharmaceutical
		US	Phase II clinical trials	
	IHD	Japan	Preparing for clinical trials	
		US	Phase I clinical trials	
	Parkinson disease		Pre-clinical	TBD
NF-κB decoy oligoneucleotide	Atopic dermatitis		Phase I clinical trials	Alfresa Corporation
	Psoriasis		Pre-clinical	TBD
	Rheumatic arthritis		Preparing for clinical trials	Seikagaku Corporation
	Degenerative osteoarthritis		Pre-clinical	
	Prevention of restenosis		Preparing for clinical trials	Goodman

HVJ-E vector technologies have been developed by the subsidiary, GenomIdea, Inc. GenomIdea has identified new DNA candidates for drug development by using the device for

DNA-screening, which was developed in collaboration with Prof. Kaneda of University of Osaka Medical School and National Institute of Advanced Industrial Science and Technology (AIST) Kansai, and seeds search for DNA diagnostic. In collaborations with Osaka University, AIST Kansai and Mitsubishi Space Software Co., Ltd, the drug design system for next-generation nucleic acid medicines (siRNA) was established. The drug design service using this system started in April, 2005.

The GMP Master Cell Bank and Master Virus Bank have been successfully established, and the final releases are completed. The GMP Master Cell Bank can be used widely for manufacturing of the biopharmaceuticals and vaccine so that new bio-business including license-out of HVJ-E is developing.

The pre-clinical studies including efficacy and toxicology of using HVJ-E as the delivery vehicle of NF-kB decoy oligoneucleotide for the treatment of Inflammatory Bowl Disease (IBD), have been conducted to verify safety and characterizations of the HVJ-E vector for the therapeutical application.

#### **<New Pipeline>**

To strengthen AnGes' product pipeline, AnGes has executed a cross license agreement with a German biotech, Avontec GmbH, which is engaged in Signal Transducer and Activator of Transcription (STAT) decoy oligoneucleotide based product development. Through this alliance, AnGes obtains a license from Avontec of using STAT-1 decoy oligoneucleotide in respiratory and dermatology indications in Asia, while Avontec has the right of using NFkB Decoy oligoneucleotide in psoriasis indication in Europe.

At the same time of executing this cross license agreement, "Bio Sight Innovation 1st Investment Limited Partnership", which was established by Bio-Sight Capital Co., Ltd., has invested to Avontec. AnGes and Nikko Principal Investments Japan Ltd. have also invested to this fund.

#### **<Patent>**

The basic patent which widely covers HGF gene therapy was granted in Europe (EP0847757B1). This European patent was granted following the US and Japanese HGF patents. Japan, US and Europe are leading pharmaceutical markets. Therefore, now AnGes has the exclusive right to undertake HGF gene therapy business in these major countries.

AnGes has executed a license agreement with Vical Inc. (USA) having patents for Non-viral Gene Delivery. Through this agreement, AnGes obtained an exclusive right to use this delivery technology in HGF in Japan, North America and Europe.

The medical-use patent for HGF (VEGF) gene against cerebral vascular disorders, which is

buoyant indication as a future development candidate, has been granted in the U.S., with the official patent gazette (U.S.6,936,594) published. AnGes is securing the necessary intellectual property rights to widen the scope of indications using HGF gene.

With regard to HVJ-E, the basic patent which covers an exogenous gene transfer vector has also been granted in the U.S. (U.S.6,913,923B2). AnGes aims to form a network of intellectual property rights including various use patent applications and process patent applications.

### 3. Financials and Cash flows

#### (1) Asset and Liability/Equity (In millions, except per share data)

	September 30,		December 31,
	2005	2004	2004
Total asset.....	¥ 9,441	¥ 11,371	¥ 10,009
Stockholders' equity.....	¥ 7,792	¥ 9,114	¥ 8,656
Stockholders' equity per share.....	¥ 77,514.80	¥ 93,866.17	¥ 88,530.64
Stockholders' equity ratio.....	82.5%	80.2%	86.5%

Stockholders' equity has decreased owing to the net loss of ¥1,437 Million while it has increased ¥571 Million because of the exercising of employee stock options.

#### (2) Cash flows (In millions)

	9 months ended September 30,		Year ended December 31,
	2005	2004	2004
Cash flows from operating activities.....	¥ (1,299)	¥ (1,128)	¥ (1,433)
Cash flows from investing activities.....	(1,365)	(94)	2,962
Cash flows from financing activities.....	565	781	899
Changes in cash and cash equivalents.....	(2,094)	(432)	2,431
Cash and cash equivalents at end of period.....	¥ 4,909	¥ 4,139	¥ 7,003

For the nine months ended September 30, 2005, cash and cash equivalents decreased by ¥2,094 Million, as a result, as of September 30, 2005, cash and cash equivalents was ¥ 4,909 Million.

#### (Cash flows from operating activities)

For the nine months ended September 30, 2005, net cash used in operating activities decreased by ¥171 Million compared with the same period of 2004. This change was mainly due to loss before income taxes.

(Cash flows from investing activities)

For the nine months ended September 30, 2005, net cash used in investing activities decreased by ¥1,270 Million compared to the same period of 2004. This change was mainly due to the purchases of marketable securities and investments in securities. AnGes has invested the amounts of ¥603 Million earmarked for future R&D investment in terms of corporate bonds, which are safer and less risky investment instruments. AnGes has also invested to Bio Sight Innovation 1st Investment Limited Partnership.

(Cash flows from financing activities)

For the nine months ended September 30, 2005, net cash provided by financing activities decreased by ¥216 Million compared with the same period of 2004. Net proceeds from issuance of common stock of ¥565 Million were recorded due to the exercising of employee stock options.

#### 4. Outlook for 2005

We aim to make further progress in the current major projects and establish an alliance with new partners to increase revenues including license payments. The financial outlook depends upon uncertain factors such as progress of the current R&D project proceeds and the contract negotiations with new partnering companies. The projected revenue and income for the year ending December 31, 2005 are as follows;

< Consolidated basis >

Revenue.....	¥ 2,200 ~ ¥ 3,200 Million
Ordinary income/ (loss).....	¥ (1,900) ~ ¥ (900) Million
Net income / (loss).....	¥ (1,900) ~ ¥ (900) Million

***\*Since descriptions about future events, for instance, earnings forecast for FY 2005, are estimation, results may differ from this estimation due to changes of several economic conditions.***

**AnGes MG, Inc**  
**Consolidated Balance Sheets**  
(In thousands)  
(Unaudited)

	September 30,		December 31,
	2005	2004	2004
<b>Assets</b>			
Current assets:			
Cash and bank deposits.....	¥ 4,409,144	¥ 5,639,637	¥ 7,003,451
Marketable securities.....	1,500,965	2,600,321	499,100
Beneficial interest in trust.....	500,000	500,000	500,000
Accounts receivable.....	294,576	154,822	82,122
Inventories.....	480,657	494,610	544,684
Advances.....	934,763	1,261,735	656,659
Other current assets.....	86,638	145,821	202,354
Total current assets.....	8,206,745	10,796,947	9,488,373
Property and equipment, net.....	199,501	277,360	219,492
Goodwill, net.....	10,206	13,608	12,773
Other intangible assets, net.....	370,391	224,949	235,940
Other assets.....	654,614	59,023	52,786
Total assets.....	¥ 9,441,459	¥ 11,371,890	¥ 10,009,364
<b>Liabilities and Stockholders' equity</b>			
Current liabilities:			
Accounts payable.....	131,130	150,586	117,289
Accrued liabilities.....	143,392	568,130	137,661
Customer advances.....	1,303,856	1,414,561	978,379
Other current liabilities.....	6,752	7,759	6,982
Total current liabilities.....	1,585,131	2,141,038	1,240,312
Minority interest.....	64,307	116,446	112,526
Stockholders' equity:			
Common stock.....	5,441,922	5,096,806	5,156,314
Capital surplus.....	3,752,665	6,394,199	6,453,707
Accumulated deficit.....	(1,391,072)	(2,369,053)	(2,940,607)
Unrealized gains (losses) on securities.....	(5,405)	233	(900)
Foreign currency translation adjustments.....	(6,090)	(7,781)	(11,989)
Total stockholders' equity.....	7,792,020	9,114,405	8,656,525
Total liabilities and stockholders' equity.....	¥ 9,441,459	¥ 11,371,890	¥ 10,009,364

\*See accompanying notes.

**AnGes MG, Inc**  
**Consolidated Statements of Operations**  
(In thousands, except per share data)  
(Unaudited)

	9 months ended September 30,		Year ended December 31,
	2005	2004	2004
<b>Operating revenues</b> .....	¥ 1,776,529	¥ 1,760,842	¥ 2,696,299
<b>Operating expenses:</b>			
Research and development.....	2,845,960	2,358,848	3,679,079
Selling, general and administrative.....	438,791	444,308	578,263
Total operating expenses.....	3,284,751	2,803,156	4,257,342
Operating loss.....	(1,508,222)	(1,042,314)	(1,561,043)
<b>Non-operating income (expenses):</b>			
Interest income.....	3,118	4,379	5,670
Grant.....	105,291	1,972	2,030
Foreign currency transaction (loss) gain, net.....	(4,055)	4,023	(4,827)
Stock issuance cost.....	(5,906)	(5,639)	(6,741)
Other items, net.....	2,111	3,740	5,920
Ordinary loss.....	(1,407,661)	(1,033,837)	(1,558,989)
<b>Extraordinary gain (loss):</b>			
Reversal of allowance for doubtful accounts, net...	—	116	116
Gain on change in holding ratio of subsidiary.....	—	62,850	62,850
Gain on sales of property and equipment.....	83	—	—
Loss on dispositions of property and equipment and intangible assets.....	(16,886)	(1,334)	(44,844)
Loss on cancellation of leases.....	(53,995)	—	—
Loss before income taxes and minority interest.....	(1,478,460)	(972,205)	(1,540,866)
Provision for Income taxes – Current.....	6,873	3,416	10,228
Minority interest loss.....	48,218	5,702	9,623
Net loss.....	¥ (1,437,115)	¥ (969,918)	¥ (1,541,472)
<b>Loss per share:</b>			
Basic.....	¥ (14,462.16)	¥ (10,178.24)	¥ (16,083.36)
Diluted.....	—	—	—
<b>Shares used in calculation of loss per share data:</b>			
Basic.....	99,371	95,293	95,843
Diluted.....	—	—	—

\*See accompanying notes.

\*\*Diluted loss per share data is not calculated because the impact was anti-dilutive.

**AnGes MG, Inc**  
**Consolidated Statements of Capital surplus and Accumulated Deficit**  
(In thousands)  
(Unaudited)

	<b>9 months ended September 30,</b>		<b>Year ended</b>
	<b>2005</b>	<b>2004</b>	<b>December 31,</b>
			<b>2004</b>
<b>Capital surplus:</b>			
Balance at beginning of period.....	¥ 6,453,707	¥ 6,081,734	¥ 6,081,734
Issuance of common stock upon exercise of stock options.....	285,608	312,465	371,973
Reduction of capital surplus.....	(2,986,650)	—	—
Balance at end of period.....	3,752,665	6,394,199	6,453,707
<b>Accumulated deficit:</b>			
Balance at beginning of period.....	(2,940,607)	(1,399,134)	(1,399,134)
Reduction of capital surplus.....	2,986,650	—	—
Net loss.....	(1,437,115)	(969,918)	(1,541,472)
Balance at end of period.....	¥ (1,391,072)	¥ (2,369,053)	¥ (2,940,607)

\*See accompanying notes.

**AnGes MG, Inc**  
**Consolidated Statements of Cash Flows**  
(In thousands)  
(Unaudited)

	9 months ended September 30,		Year ended December 31,
	2005	2004	2004
<b>Cash flows from operating activities:</b>			
Loss before income taxes and minority interest.....	¥ (1,478,460)	¥ (972,205)	¥ (1,540,866)
Depreciation and amortization.....	115,442	90,677	145,523
Amortization of goodwill.....	2,566	3,214	4,050
Decrease in allowance for doubtful accounts.....	—	(116)	(116)
Interest income.....	(3,118)	(4,379)	(5,670)
Foreign currency transaction gain, net.....	(102)	(6,142)	(4,379)
Gain on sales of property and equipment.....	(83)	—	—
Loss on dispositions of property and equipment and intangible assets.....	16,886	1,334	44,844
Stock issuance cost.....	5,906	5,639	6,741
Gain on change in holding ratio of subsidiary.....	—	(62,850)	(62,850)
(Increase) Decrease in accounts receivable.....	(212,453)	(70,056)	2,642
Decrease (Increase) in inventories.....	64,027	35,557	(14,517)
(Increase) Decrease in other current assets.....	(159,657)	(287,163)	253,461
Increase in accounts payable.....	13,840	42,647	9,350
Increase (Decrease) in other current liabilities.....	347,337	97,354	(274,109)
Subtotal.....	(1,287,869)	(1,126,488)	(1,435,896)
Interest income received.....	2,138	2,793	6,863
Income taxes paid.....	(13,812)	(4,627)	(4,515)
Net cash used in operating activities.....	(1,299,543)	(1,128,322)	(1,433,547)
<b>Cash flows from investing activities:</b>			
Proceeds from repayment of time deposit (over 3 months).....	—	—	1,500,000
Purchases of marketable securities.....	(200,000)	—	(500,000)
Proceeds from redemption of marketable securities..	—	200,000	2,300,000
Purchases of beneficial interest in trust.....	(500,000)	—	(1,000,000)
Proceeds from redemption of beneficial interest in trust.....	500,000	—	1,000,000
Purchases of property and equipment.....	(66,708)	(136,862)	(165,881)
Proceeds from sales of property and equipment.....	175	—	—
Purchases of intangible assets.....	(181,717)	(143,834)	(160,657)
Purchase of investments in securities.....	(816,369)	—	—
Decrease in long-term prepaid expense.....	2,062	—	—
Increase in long-term prepaid expense.....	(100,811)	(15,297)	(16,147)
Proceeds from security deposits received.....	93	1,807	5,208
Payments for security deposits.....	(1,967)	(300)	(350)
Net cash (used in) provided by investing activities	(1,365,243)	(94,487)	2,962,171
<b>Cash flows from financing activities:</b>			
Net proceeds from issuance of common stock.....	565,309	620,471	738,385
Net proceeds from issuance of common stock to minority shareholders.....	—	161,319	161,319
Net cash provided by financing activities.....	565,309	781,790	899,705
Effect of exchange rate changes on cash and cash equivalents.....	5,214	8,633	3,101
Net (decrease) increase in cash and cash equivalents.....	(2,094,263)	(432,384)	2,431,430
Cash and cash equivalents at beginning of period.....	7,003,451	4,572,021	4,572,021
Cash and cash equivalents at end of period.....	¥ 4,909,188	¥ 4,139,637	¥ 7,003,451

\*See accompanying notes.

**AnGes MG, Inc**  
**Notes to Consolidated Financial Statements (Unaudited)**  
**September 30, 2005**

**1. Basis of presenting consolidated financial statements**

The accompanying consolidated financial statements of AnGes MG, Inc ("AnGes") and its consolidated subsidiaries (collectively, the "Company") are basically an English version of those which have been prepared in accordance with generally accepted accounting principles in Japan and filed with the Tokyo Stock Exchange as "*1st Quarter financial report.*"

The accompanying consolidated financial statements incorporate certain reclassifications of figures from those included in the *1st Quarter financial report* in order to present in a form more familiar to the readers outside Japan. Certain amounts in the accompanying consolidated financial statements from prior year have been reclassified to conform to the current year presentation. In addition, the notes to consolidated financial statements included certain information which is not required under Japan GAAP but is presented herein as additional information.

The amounts presented in the consolidated financial statements are rounded down to the nearest thousand yen.

**2. Summary of Significant Accounting Policies**

***Principles of Consolidation***

The consolidated financial statements include the accounts of AnGes and its subsidiaries in which AnGes has a controlling financial interest and exercise control over its operation. All intercompany transactions and balances have been eliminated in consolidation.

The list of consolidated subsidiaries as of and for the three months ended September 30, 2005 is as follows:

<u>Name of subsidiary</u>	<u>Location</u>	<u>% of ownership</u>
AnGes, Inc.	U.S.A	100.0%
AnGes Euro Limited	UK	100.0%
GenomIdea Inc.	Japan	61.6%

AnGes has no equity investment which is accounted for under the equity method.

AnGes and its subsidiaries have fiscal year-ends of December 31.

### **Cash and Cash equivalents**

For the purpose of consolidated statements of cash flows, "Cash and cash equivalents" consist of cash on hands, demand deposits, and certain investments which are readily convertible to cash, and which mature within three months or less from date of purchase with virtually no risk of loss of values.

"Cash and bank deposits" on the consolidated balance sheets and "Cash and cash equivalents" on the consolidated statements of cash flows are reconciled as follows (in thousands):

	<u>September 30,</u>		<u>December 31,</u>
	<u>2005</u>	<u>2004</u>	<u>2004</u>
Cash and bank deposits.....	¥ 4,409,144	¥ 5,639,637	¥ 7,003,451
Add: Marketable securities.....	1,500,965	—	—
Less: Time deposits with original maturities of more than three months.....	—	(1,500,000)	—
Less: Marketable securities not included in cash and cash equivalents.....	(1,000,921)	—	—
Cash and cash equivalents.....	<u>¥ 4,909,188</u>	<u>¥ 4,139,637</u>	<u>¥ 7,003,451</u>

### **Marketable securities and investments in securities**

The Company considers its marketable securities and investments in securities as available-for-sale securities which are not held for trading purposes and not held to maturity with the positive intent and ability to hold maturity. Available-for-sale securities of which the fair market values are readily determinable are recorded at fair market value. Unrealized gains and losses are reported in a separate component of stockholders' equity. Available-for-sale securities of which the fair market values are not readily determinable are recorded at cost. The cost of securities sold is based on the moving average method.

### **Inventories**

Inventories are principally stated at cost. The cost of raw materials is determined using the moving average method, the cost of work in process is determined using the specific identification method, and the cost of supplies is determined using the last purchase price method.

## **Depreciation and Amortization**

### *Property and equipment*

Depreciation of "Property and equipment" is calculated using the declining-balance method at rates based on the estimated useful lives of the assets which are prescribed by the Japanese Income Tax Laws. Useful lives by asset category are as follows:

Asset category	Years
Buildings and improvements.....	3-15
Machinery.....	3 - 4
Furniture, Laboratory and office equipment.....	3-15

Property and equipment consisted of the following (in thousands):

Asset category	September 30,		December 31,
	2005	2004	2004
Buildings and improvements.....	¥ 65,024	¥ 204,338	¥ 106,532
Machinery.....	86,344	86,344	86,344
Furniture, Laboratory and office equipment.....	328,349	270,695	269,226
	479,719	561,378	462,103
Less: Accumulated depreciation.....	(280,217)	(284,017)	(242,611)
	¥ 199,501	¥ 277,360	¥ 219,492

### *Intangible assets and goodwill*

Intangible assets and goodwill are carried at cost less accumulated amortization. Capitalized costs for software for internal use are amortized using the straight-line method over 5 years. Goodwill is amortized using the straight-line method over 5 years.

### **Deferred charges**

Stock issuance costs are expensed as incurred.

### **Allowance for doubtful accounts**

"Allowance for doubtful accounts" is maintained for the amounts deemed uncollectible based on solvency analyses and for estimated delinquency based on collection rates projected from historical credit loss experiences, and for the amounts to cover specific accounts that are estimated to be uncollectible.

### **Translation of foreign currency balances and transactions**

Foreign currency transactions are translated using foreign exchange rate prevailing at the transaction dates. Receivables and payables denominated in foreign currencies were translated at the current rate at the balance sheets date. The differences of the prevailing rate between the transaction date and balance sheets date are involved in or charged to income accordingly.

All the assets and liabilities of foreign subsidiaries are translated at current rates at the balance sheets dates. All the income and expense accounts are translated at weighted-average rate. Adjustments arising from translating financial statements of overseas subsidiaries denominated in foreign currencies into Japanese yen are reported in a separate component of stockholders' equity.

### **Lease transactions**

Finance leases, other than those which involve transferring of ownership of the leased assets to the lessee, are accounted for in a manner similar to operating leases.

### **Consumption taxes**

Consumption taxes are excluded from the amounts in the consolidated statements of operations.

### **3. Fair value of financial instruments**

The fair values of available-for-sale securities by type of security and contractual maturity as of September 30, 2005 and 2004, and December 31, 2004 are as follows (in thousands):

<u>September 30, 2005</u>	<u>Amortized cost</u>	<u>Unrealized gains</u>	<u>Unrealized losses</u>	<u>Estimated fair value</u>
Type of security				
Corporate debt securities.....	¥ 1,602,370	¥ 58	¥ 5,463	¥ 1,596,965
	<u>¥ 1,602,370</u>	<u>¥ 58</u>	<u>¥ 5,463</u>	<u>¥ 1,596,965</u>
<u>September 30, 2004</u>	<u>Amortized cost</u>	<u>Unrealized gains</u>	<u>Unrealized losses</u>	<u>Estimated fair value</u>
Type of security				
Corporate debt securities.....	¥ 2,600,088	¥ 233	¥ —	¥ 2,600,321
	<u>¥ 2,600,088</u>	<u>¥ 233</u>	<u>¥ —</u>	<u>¥ 2,600,321</u>
<u>December 31, 2004</u>	<u>Amortized cost</u>	<u>Unrealized gains</u>	<u>Unrealized losses</u>	<u>Estimated fair value</u>
Type of security				
Corporate debt securities.....	¥ 500,000	¥ —	¥ 900	¥ 499,100
	<u>¥ 500,000</u>	<u>¥ —</u>	<u>¥ 900</u>	<u>¥ 499,100</u>

As of September 30, 2005, 2004 and December 31, 2004, carrying amounts of investments in securities which have no fair market value were ¥413,500 thousand, ¥1,000 thousand and ¥1,000 thousand, respectively. Investments in securities are classified into "other assets" of consolidated balance sheets.

#### 4. Leases

##### **Finance leases without transfer of ownership as lessee**

Pro forma data as of September 30, 2005 and 2004, and December 31, 2004 as to acquisition cost, accumulated depreciation and net book value of leased assets are summarized as follows (in thousands):

	September 30,		December 31,
	2005	2004	2004
Pro forma acquisition cost.....	¥ 213,336	¥ 229,128	¥ 230,926
Pro forma accumulated depreciation.....	163,013	121,623	137,829
Pro forma net book value.....	¥ 50,322	¥ 107,505	¥ 93,096

Future minimum lease payments under finance leases without transfer of ownership are summarized as follows (in thousands):

	September 30,		December 31,
	2005	2004	2004
Due within one year.....	¥ 41,725	¥ 57,981	¥ 54,257
Thereafter.....	10,986	52,529	41,845
	¥ 52,711	¥ 110,510	¥ 96,103

Lease expenses and pro forma data as to depreciation expenses and interest expenses are summarized as follows (in thousands):

	9 months ended September 30,		Year ended
	2005	2004	December 31,
			2004
Lease expenses.....	¥ 45,469	¥ 66,664	¥ 84,489
Pro forma depreciation expenses.....	42,613	63,919	80,867
Pro forma interest expenses.....	1,970	3,363	4,246

Depreciation is based on the straight-line method over the lease term of the leased assets with no residual value. The difference between the total lease expenses and the pro forma acquisition cost of leased assets is assumed to be pro forma interest expense and the allocation to each period is based on the interest method.

##### **Operating lease transactions as lessee**

Future minimum lease payments under operating leases are summarized as follows (in thousands):

	September 30,		December 31,
	2005	2004	2004
Due within one year.....	¥ —	¥ 769	¥ 722
Thereafter.....	—	384	180
	¥ —	¥ 1,154	¥ 903