sawai

ANNUAL REPORT 2005

For the year ended March 31, 2005

"Patients first"

Profile

“Patients first” is the first step to providing quality products and services.

Our goal is to provide the highest-quality medicines to as many people as possible. Japanese society is faced with a decreasing birth rate and increasing average age, as well as with the serious problems this has brought about in costs for medical treatment. Since long before this, however, Sawai Pharmaceutical has been developing safe and effective generic drugs that aim to hold down medical expenses for individual patients. We will continue in our challenge to open new frontiers for the betterment of society, for the future of medicine, and above all, for the patient.

Contents

Sawai Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Financial Highlights

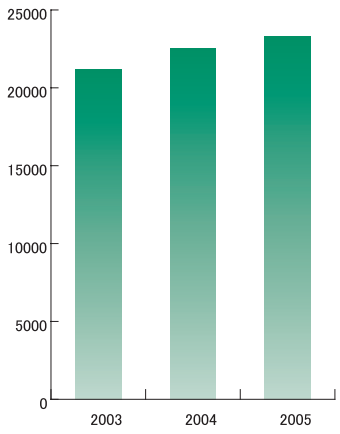
For the Years ended March 31, 2005, 2004 and 2003

	Millions of yen			Thousands of U.S. dollars
Year ended March 31	**2005**	2004	2003	**2005**
Net sales	¥ **23,277**	¥ 22,548	¥ 21,166	**$ 216,712**
Operating income	**1,944**	3,897	3,032	**18,099**
Net income (loss)	**(349)**	2,282	1,600	**(3,249)**
Total shareholders' equity	**24,969**	25,850	18,702	**232,464**
Total assets	**42,009**	38,936	33,218	**391,109**
Research and development (R&D) expenses	**2,524**	2,261	1,908	**23,499**
Capital expenditures	**2,764**	3,368	1,214	**25,733**
Depreciation and amortization	**1,329**	1,253	1,222	**12,373**
		%		
Ratio of R&D expenses to sales	**10.8**	10.0	9.0	
Return on equity	**(1.4)**	10.2	9.4	
Shareholders' equity to total assets	**59.4**	66.4	56.3	
Amounts per common share:		Yen		U.S. dollars
Net income (loss)-basic	¥ **(27.80)**	¥ 178.64	¥ 140.81	**$ (0.26)**
Net income-diluted	—	178.22	140.18	—
Cash dividends applicable to period	**40.00**	40.00	35.00	**0.37**
Shareholders' equity	**1,826.76**	1,894.00	1,568.90	**17.01**

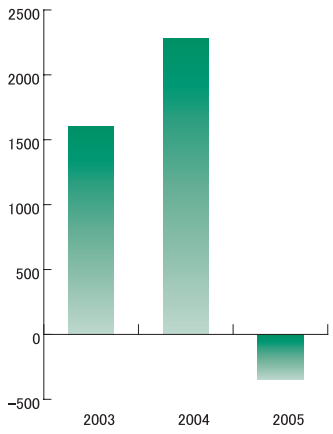
Note: 1. The U.S. dollars amounts represent translation of Japanese yen, for convenience only, at the rate of ¥ 107.41=$1, the rate prevailing on March 31, 2005.

2. Diluted net income per common share is not disclosed in 2005 due to the loss.

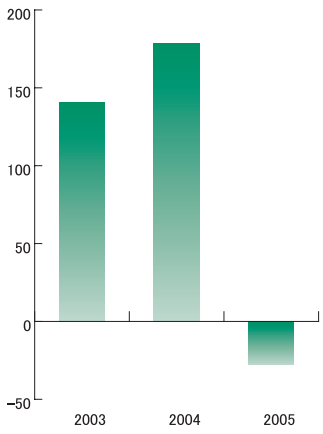
Net Sales (Millions of yen)



Net Income (Millions of yen)



Net Income Per Share (basic) (Yen)



To Our Shareholders

SURVEY

During the fiscal year ended March 31, 2005 (fiscal 2004), various measures were taken by the government in the Japanese pharmaceutical market to hold down medical expenses and drug costs given the aging society and the destitute national medical insurance budget. More specifically, prescription drug prices were cut by 4.2% on average in April 2004 in accordance with the NHI price revision. In addition, the calculation coefficient of generic drug prices was reduced from the previous "multiplying 0.8 times the price for original drugs" to "multiplying 0.7 times."

In this difficult environment, Sawai Pharmaceutical appealed to the public to encourage the use of generic drugs, which should contribute to reduced copayment and overall medical expenses in the national budget. Generic drugs are already popular in Europe and the United States. At the same time, we conducted aggressive marketing activities along with innovative PR campaigns to stress the quality, information and stable supply of our products.

Despite the use of generic drugs advancing in the market, net sales increased only 3.2% year over year to ¥23,277 million, reflecting such negative factors as a decline in unit drug prices due to the NHI price revision and the reduced drug price calculation coefficient of generic drugs. Gross profit decreased 2.4% to ¥10,960 million, but selling, general and administrative expenses increased 22.9% to ¥9,016 million, reflecting active advertising via TV commercials and the hiring of additional contract MRs especially in the first half. Operating income therefore declined 50.1% to ¥1,944 million. An extraordinary loss of ¥2,262 million was recorded owing principally to a review of the Company's corporate pension plan and a loss on sales of fixed assets from the disposal of idle properties. As a result, the Company recorded a disappointing net loss of ¥349 million.

OUTLOOK

Given Japan's harsh economic and financial conditions, the government will continue to pursue various cost-cutting measures to hold down medical expenses and drug expenditures. Accordingly, a somewhat negative impact from the biennial NHI price revision is unavoidable. On the other hand, further dissemination of affordable, high-quality, generic drugs is expected to be increasingly promoted as a state policy, thereby enhancing the substantial adoption of the DPC system by the advanced treatment hospitals.

In these circumstances, Sawai intends to exploit new high-growth markets and sell highly profitable drugs by optimizing its advantages in terms of quality, information and the stable supply of products in combination with aggressive PR and sales activities.

Specifically, our strategy will focus on strengthening information-gathering activities with upgraded MRs and increasing new customers through new original-brand drugs to ensure the top share in generic drugs delivered to major hospitals.

Everyone at the Company looks forward to the continued support and understanding of our shareholders.

H. Sawai

Hiroyuki Sawai
President

An Interview with the President
"The Future of Generic Drugs and Sawai Pharmaceutical's Intention Plans"

Generic drugs have increasingly attracted public attention as a "trump card" in restricting medical expenses. As demand for them has increased, the competition among the leading generic drug manufacturers and new entrants has intensified.

How can we win this harsh competition and continue growth?

Government Focuses on the Greater Use of Generic Drugs; a Rush of New Products Offers Opportunities

Q *Do you think that expectations for generic drugs have expanded considerably in Japan?*

A In other advanced countries such as the United States, Germany and Great Britain, the governments are committed to establishing diverse measures to encourage the use of generic drugs. As a result, generic drugs account for about 50% share in these respective national markets.

Constricting medical expenses remains a priority in Japan given the austere national budget, the high rise in medical expenses and the aging population along with a declining birthrate. The extensive use of generic drugs in Japan has the potential to reduce by half the patient-paid portion of the average per-patient medical expense. As approximately 30% of medical expenses in Japan are tax-supported, increased generic drug use would reduce medical expenses in the fiscal budget. The Koizumi Cabinet has made restructuring the medical system one of its three core reforms, and has promoted the widespread use of generic drugs. Such drugs have the potential to generate advantages in terms of public financing and household budgeting.

In June 2002, the Ministry of Health, Labor and Welfare issued a ministerial notice that encouraged the use of generic drugs at national hospitals, and in April 2003 the DPC (Diagnosis Procedure Combination) system was introduced to advanced treatment hospitals. Thereafter, in April 2004, the DPC became widely available to hospitals other than advanced treatment hospitals. In the DPC system, pharmaceuticals are considered a significant cost factor, and there is no doubt that the use of generic drugs, which are effective, reliable and low-priced, will increase remarkably. Consequently, Japan has rather belatedly caught up with the global trend.

The generic drug industry will also benefit

from the patent terms of several mega-sized brand drugs expiring from 2005 to 2010. This will result in a rush of new generic drug products. Converting brand drugs with expired patents to generic drugs will lead to savings of more than ¥1 trillion in medical expenses, which would have a huge impact on the national budget.

Measures to Improve Operating Performance

Q *In the face of such a golden opportunity, what decisive actions should Sawai undertake?*

A Our priorities for the next fiscal term are as follows:

[Highly educated MRs]

As the supply and collection of medical information to and from the medical practice market are important in large and advanced treatment hospitals, we intend to nurture educated MRs. In this regard, we intend to pursue quality over quantity by ensuring that we have a sufficient level of staffing for our sales volume and that they be trained with a higher level of education relative to their peers at leading pharmaceutical manufacturers. Except for those who have recently joined the Company, all of our MRs have passed the MR qualification test. Our intent is to nurture highly educated MRs.

DPC:
This comprehensive payment method for hospitalization and medical treatment at an acute stage uses the DPC (Diagnosis Procedure Combination) system in which the disease/injury designation and the necessity of medical actions such as operations or specific treatments are combined. This payment method includes prescription drugs administered to hospitalized patients other than those used for operations. Different from the conventional piecework payment system, in which the total sum of respective medical actions is paid, the payment of a specified amount by DPC category is expected to reduce national medical expenses.

[An unprecedented rush of numerous new products]

We are proud that Sawai's product development capability is top-rated among the generic drug manufacturers. We are confident that our production technologies and the facilities at our manufacturing plants are among the best in the industry, including the Kyushu Factory.

By leveraging this outstanding technical ability, we intend to strengthen our approach to launching new drugs for all drugs with patents expiring. We plan to release 39 products during the fiscal year ending March 31, 2006, and more than 30 new products in the following two years.

[Exploitation of sales channels via a succession of new drugs]

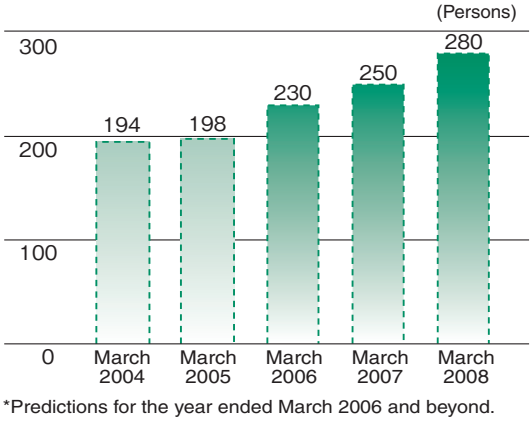
Globally, the distinction between generic drug manufacturers and new pharmaceuticals manufacturers has been vanishing. For example, Sawai has an agreement with Tanabe Seiyaku Co., Ltd., ("Tanabe") to assume the manufacture and sale of a synthetic penicillin, "DOYLE® for injection (Aspoxicilin preparation)," from Tanabe, and sales are scheduled to start in July 2005. In addition, Sawai will accept the transfer of properties and business in October 2005 from Nihon Schering K.K. Japan with regard to the Mobara Factory (Chiba) for the tool manufacturing business and succession of some original drugs. This should accelerate our effort to exploit new sales channels to national hospitals and advanced treatment hospitals with which Sawai previously has had few transactions.

Pursuit of Quality and Speed to Succeed in an Era of Volatile Fluctuation

Q *Please provide a message for your shareholders.*

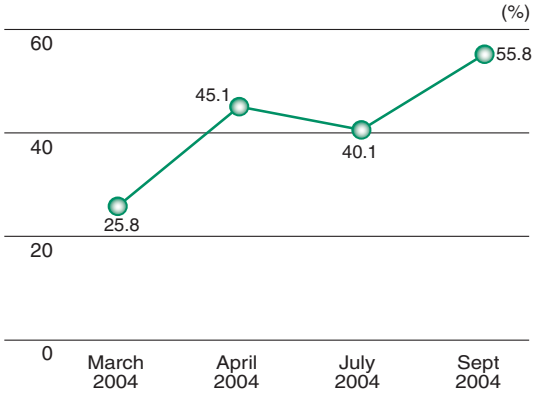
A Like other businesses, the generic drug industry is at a turning point in which only the top two or three companies will survive the industrial reorganization. Accordingly, although favorable trends are anticipated in our industry over the next few years, we face volatile fluctuations and intensifying competition. New entrants, such as foreign-affiliated corporations and brand manufacturers, are also a factor. To succeed in this severe environment, we must make companywide efforts to aggressively seek "Quality" and "Speed" in every aspect of development, manufacture, MR activity and the gathering of scientific information. At Sawai, we will persistently comply with our "Patients first" slogan.

Number of Sawai's MRs



*Predictions for the year ended March 2006 and beyond.

Awareness of Generic Drugs in Japan



Process for the Approval of Generic Drugs

The research-and-development period for generic drugs before the promotional stage is short at only about five years because various strict requirements for new drugs, including the discovery of new substances, nonclinical tests using animals and clinical studies with human trial subjects, can be omitted.

The following chart describes the processes from development to launch of a generic drug, and the mechanism for releasing a high-quality generic drug.

Application

5 years

Market and patent research

Decision on a development target

The development target drug is determined in view of such factors as the patent term and the marketability of the targeted new drug, the facilities and the investment scale for the development.

4 years

Research on raw materials to be used

Raw materials that present the same medicinal properties as those of the new drug and have equivalent or superior quality compared with the new drug are collected worldwide. Then, optimum raw materials for which the purity is highest and most suitable for formulation will be selected.

3 years

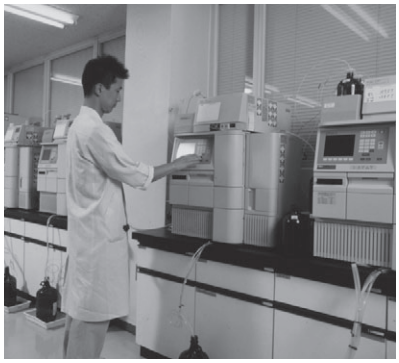
Research on formulation

Stability test, Biological equivalence test

In addition to proving the same medicinal virtues, more stable and compliance-focused formulation is pursued in the tests.

2 years

1 years



● Approval on manufacture and sales

The revised Pharmaceutical Affairs Law, in which the reinforcement of after-sales safety measures and the approval/authorization system were reviewed, was implemented in April 2005. As a result, the previous approval/authorization system was revised from “manufacturing approval” on pharmaceuticals to “manufacture and sales approval,” in which the responsibility for the market is clarified. This legal revision requires pharmaceutical manufacturers to actively gather, analyze and evaluate not only the quality of products (manufacturing) but also safety (information) and to take appropriate measures accordingly. Moreover, a company can now sell pharmaceuticals even without its own manufacturing department or factory. Therefore, fully outsourcing the manufacturing process is now possible.

● What is the NHI price listing?

The NHI (National Health Insurance) Drug Price Standard is an official document in which the Minister of Health, Labor and Welfare specifies the scope and prices of the drugs authorized for treatment that are covered by health insurance. After the manufacture and sales approval is obtained, a drug for medical care must be listed in the NHI Drug Price Standard to become applicable under the health insurance system. In principle, listings are renewed four times a year for new drugs and annually for generic drugs..

Approval — **March** — Start of production

NHI price listing — **July** — Start of sale

Start of promotional activity

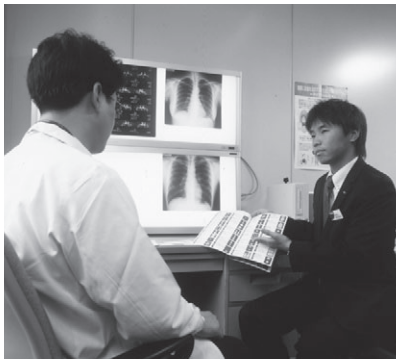
Production system

The Sawai Group has four plants in Japan to fully ensure the consistent provision of drugs. In February 2005, the second-phase construction of the Sanda Factory was completed. In addition, Sawai will acquire the Mobara Plant of Nihon Schering K.K. Japan in October 2005.

Further presence in the DPC market

The DPC* system has been introduced in 144 medical institutions and is expected to be expanded nationwide in the future. Sawai proactively commits itself to the exploitation of the DPC market by increasing the number of MRs and reinforcing its support system with enhanced functions at the Medical Information Department in the head office.

*DPC: Refer to Page 4.



Management's Discussion & Analysis

1. Management Policies

(1) Basic Management Policies

The Sawai Group's basic management policies are as follows:

- To contribute to the national medical-care system by developing effective and safe medicines and ensuring the reliable and cost-effective supply of high-quality products.
- To realize a high quality of life for our employees and to protect our shareholders' interests.

Despite restrictive government measures, an increase in medical expenses along with the expanding aging population has tightened Japanese public finances for medical insurance. A further increase in the cost burden to individuals is feared, whereas improving the efficiency of medicines and raising people's cost consciousness have become urgent national priorities.

In April 2002, an incentive measure was implemented for the "prescription, dispensation and supply of medical information on drugs including generic products," which spurred the popularity of generic drugs. Since then, the environment has become increasingly receptive to the stable provision of high-quality generic drugs accompanied by good product information.

The Sawai Group believes that it has a social mission to encourage the widespread use of generic drugs, for which dissemination has lagged behind Western countries, and to contribute to reducing the patient-paid portion of medical expenses and national medical expenses through the health insurance system. To that end, we intend to engage in aggressive sales activity while advocating further improvement of the operating environment, and concurrently establish the Company as a leading manufacturer of generic drugs by ensuring quality, good product information and stable provision through our reinforced research-and-development capability.

(2) Basic Policy on Profit Appropriation

Sawai attaches a high managerial priority to ensuring the distribution of profits to shareholders. The Company follows this basic dividend policy with due consideration to operating performance while setting aside retained earnings for future business development and strengthening its financial structure.

Based on its basic dividend policy, management decided to pay a year-end dividend of ¥25 per share despite a temporary decline in operating performance for fiscal 2004. The annual dividend of ¥40 per share includes an interim dividend of ¥15 per share. As a result, the ratio of dividends to shareholders' equity was 2.28%. The resolution concerning the interim dividend was adopted at the Board of Directors meeting held on November 12, 2004.

We intend to continuously distribute performance-based dividends with a payout ratio of approximately 30% while endeavoring to increase net income per share.

We will appropriate retained earnings to fund such requirements as R&D expenditures to expand business and manufacturing facilities.

2. Analysis on Operational Results and Financial Position

(1) Operational Results

In April 1, 2004, prescription drug prices were reduced by 4.2% on average in accordance with the NHI price revision. In addition, since July 2004, the calculation coefficient of generic drug prices was reduced from the previous "multiplying 0.8 times the price for original drugs" to "multiplying 0.7 times," causing a negative effect on our sales results.

In this difficult environment, the Sawai Group appealed to the public to increase the use of generic drugs, which should contribute to a reduction in prescription charges for patients and overall medical expenses in the national budget. Generic drugs are already popular in Europe and the United States. At the same time, we conducted aggressive marketing activities along with innovative PR campaigns to stress quality, information and the stable provision of our products.

Regarding operating performance for the year ended March 31, 2005 (fiscal 2004), we exploited the market in a favorable business environment that encouraged the increased use of generic drugs. Nevertheless, both net sales and gross profit were unfortunately affected by a decline in unit drug prices given the intensifying market competition due to the NHI price revision and the reduced drug price calculation coefficient of generic drugs.

In profits, higher expenses from hiring an increased number of contract MRs and aggressive advertising could not be fully absorbed. The Company disaffiliated from the Osaka Pharmaceutical Business Employees' Pension Fund as part of a review of its corporate

pension plan and disposed of idle properties. An ordinary loss of ¥2,263 million was recorded owing principally to the payment of a special premium along with the disaffiliation and a loss on sales of real estate.

Reflecting these circumstances, operating income for fiscal 2004 declined 50.1% year over year to ¥1,944 million and ordinary income decreased 48.2% to ¥1,883 million, although net sales increased 3.2% to ¥23,277 million. As a result, the Company recorded a disappointing net loss of ¥349 million.

(2) Financial Position

Total assets as of March 31, 2005, were ¥42,009 million, an increase of ¥3,073 million from the previous fiscal year-end. Total current assets increased ¥2,092 million to ¥23,473 million, and total fixed assets rose ¥981 million to ¥18,536 million.

The major factors for the increase in current assets were a rise of ¥768 million in cash and time deposits to pay for second-phase construction work at the Sanda Factory and an expansion of ¥1,026 million in trade notes and accounts receivable—trade resulting from higher sales of seasonal products and others (compared with a clear sales decline in the previous year for several months before the year-end pending the implementation of the NHI Drug Price Standard revision).

Fixed assets rose, principally reflecting an increase of ¥410 million in tangible fixed assets resulting from second-phase construction work at the Sanda Factory and an increase of ¥372 million in investment securities due to investments in business partners.

Total liabilities as of March 31, 2005, were ¥17,040 million, an increase of ¥3,954 million from the previous year-end. This resulted mainly from an increase of ¥2,235 million in trade notes and accounts payable due to the payment of a special premium for disaffiliation from the Osaka Pharmaceutical Business Employees' Pension Fund, payment for equipment related to second-phase construction work at the Sanda Factory and an increase of ¥958 million in long- and short-term bank loans.

Total shareholders' equity as of March 31, 2005, slipped ¥881 million to ¥24,969 million. Major contributors to this decline were a ¥895 million net loss for the year under review and the payment of dividends to shareholders.

As a result, the equity ratio of the Company as of March 31, 2005, fell 7.0 percentage points to 59.4%.

(3) Cash Flows

Cash and cash equivalents increased ¥768 million to ¥5,239 million compared with the previous fiscal year-end.

The cash flow situation and cash flow factors for fiscal 2004 were as follows:

(Cash flows from operating activities)

Net cash provided by operating activities decreased ¥32 million, or 1.5% year over year, to ¥2,120 million.

This reflected a ¥379 million loss before income taxes, which declined ¥4,138 million year over year; an increase of ¥1,164 million in accounts payable—other (including a ¥1,653 million special premium due to the disaffiliation from the Osaka Pharmaceutical Business Employees' Pension Fund, which was paid on May 2, 2005); a decrease in income taxes paid; and a decrease in inventories due to increased sales of seasonal products.

(Cash flows from investing activities)

Net cash used in investing activities decreased ¥1,704 million, or 48.6%, to ¥1,803 million.

This decrease principally reflected such factors as ¥2,035 million, or a decline of ¥1,375 million, for the purchase of property, plant and equipment owing principally to second-phase construction work at the Sanda Factory and proceeds from the sale of idle assets and other property, plant and equipment.

(Cash flows from financing activities)

Net cash provided by financing activities decreased ¥2,476 million, or 84.6%, to ¥451 million.

Major contributors were a decrease of ¥5,147 million in proceeds from the issuance of common shares relative to the previous fiscal year and an increase in proceeds from long- and short-term bank loans for appropriation to second-phase construction work at the Sanda Factory.

3. Our Tasks Ahead

The ongoing reforms of the medical insurance system are intended to improve the efficiencies and appropriateness of medical expenses. Elderly patients became liable for a fixed percentage of medical expenses in October 2002, and the patient-paid portion of medical expenses in health care insurance was raised in April 2003. Accordingly, the burden on individuals has been increasing. National hospitals and national

university hospitals became independent administrative entities as a measure to improve efficiencies in medical expenses in April 2004. In addition, advanced treatment hospitals are increasingly adopting the DPC system.

In July 2004, the calculation coefficient of generic drug prices was reduced from the previous "multiplying 0.8 times the price for original drugs" to "multiplying 0.7 times," causing a negative effect on our sales results together with the biennial NHI price revision.

On the other hand, the Ministry of Health, Labor and Welfare (MHLW) continues to reevaluate the quality of generic drugs as part of an effort to encourage their use.

In April 2005, the previous approval/authorization system was revised from "manufacturing approval" on pharmaceuticals to "manufacture and sales approval," to further reinforce after-sales safety measures to prevent the occurrence of drug-induced diseases.

The Sawai Group endeavors to flexibly cope with these environmental changes while streamlining its internal systems including enhancing R&D capabilities and establishing itself as the leading manufacturer of generic drugs, for which demand is expected to expand significantly. To that end, we intend to address the following:

(1) Promote the features and product information of our high-quality and cost-effective generic drugs, which will help reduce medical expenses and decrease prescription charges for patients, and increase our market share through aggressive sales activity.
(2) Establish a sales system to quickly respond to the new demand for generic drugs and the sophisticated needs in new markets, particularly national and public hospitals.
(3) Ensure the quality of generic drugs and reinforce after-sales safety investigations, as requested by the MHLW.
(4) Build and operate a collaborative manufacturing-sales system that is directly linked to market needs and works to reduce production lead times to cope with the requirement of providing a wide range of products and the expected rise in future demand.
(5) Reinforce our profitability by promoting rationalization measures, such as proper staffing, improvement of productivity and efficiency improvements in developmental operations.
(6) Nurture human resources and promote personnel revisions including the establishment of a performance-based personnel evaluation system.

In addition, Sawai will accept the transfer of properties and business at the Mobara Factory (Chiba) as of October 1, 2005, from Nihon Schering K.K. Japan. We will strive to quickly put in place a trusted manufacturing operation at the factory and improve productivity with adjustments of existing manufactured items in other plants.

4. Operational and Other Risks

Concerning the overview of business and accounting conditions stated in our securities report, the major underlying risk factors that could significantly affect the judgment of investors are as follows:

Forward-looking statements outlined in this document are those determined by management as of March 31, 2005.

(1) Restrictions from the revised Pharmaceutical Affairs Law

The Sawai Group engages in the manufacture and sales of pharmaceuticals. Accordingly, our manufacturing and sales activities are subject to the necessary authorizations, licenses, registrations and/or designations by the director of the Regional Bureau of Health and Welfare and the governors or other authorities of any related prefectures mainly under the relevant provisions of the Pharmaceutical Affairs Law, etc. Should the Company fail to comply with or violate such legal provisions, the Company's business performance could be affected as a result of the suspension of its business activities or the withdrawal of license/permissions by the relevant authorities.

(2) Revisions to the NHI Drug Price Standard and others

Prescription drugs, the Sawai Group's mainstay products, are subject to "drug prices," which are the basis for computing medication costs as a component in the medical treatment fees for medical care institutions, in accordance with the NHI Drug Price Standard as stipulated by the MHLW. To sell prescription drugs, an NHI price listing (the listing of NHI drug prices for generic drugs is called a "supplementary listing") is required.

To ensure that the market price of drugs reflects the reasonable streamlining of medical expenses, the MHLW conducts periodic revisions (every two years since 1988) concerning the NHI Drug Price Standard based on its investigation of drug pricing,

thereby resulting in reduced prices for most drugs. Other drug prices in the market tend to decline along with the reduced NHI drug prices. In particular, price competition tends to intensify with regard to generic drugs because several manufacturers often make the supplementary listing (release) of new products in a concentrated manner when the patent term for the branded drugs expires. As a consequence, the price reduction rate of products released by generic drug manufacturers is always higher than the average for the overall pharmaceutical industry. The gap expanded at the last revision in April 2002 when the GE Rule (which stated that the lowest price for generic drugs shall be maintained at 40% of the price for the original branded drugs with regard to the NHI price revision) was abolished.

The NHI price revision on April 1, 2004, resulted in an average price reduction of 4.2% in the pharmaceutical industry, whereas the Company's simple average revision was 14.1%.

For generic drugs, the calculation coefficient has been reduced from the previous "multiplying 0.8 times the price for original drugs" to "multiplying 0.7 times."

The Company's business performance could be affected by such revisions to the NHI Drug Price Standard and others.

(3) Cautionary notes on business deployment

(a) Patent litigation with original drug manufacturers

Patent litigations could be filed against the Sawai Group by any original drug manufacturers.

Although we endeavor to develop new products with our original technology and unique image based on thorough investigations of the industrial property and in view of the Unfair Competition Prevention Law, the Company could face lawsuits in the future. The Company's business performance therefore could be affected by the possible filing of such lawsuits.

(b) Ensuring a sufficient number of MRs

We must strengthen the provision of medical information to increase the acceptance of our products at large hospitals where demand for generic drugs is expected to rise. Although the Company strives to recruit human resources who possess flexible sales skills, securing good MRs is an immediate task. The Company's business performance could be affected if we cannot recruit and maintain talented MRs for large hospitals.

(c) Effects of market competition and others

The Company endeavors to sell its products at reasonable prices to ensure profitability so that products will not become unprofitable and thereby be eliminated due to repeated price reductions. In the generic drug market, competition has intensified generally among market players including original drug manufacturers. Given the harsh current situation, the Company could be involved in severe price competition in the future.

Moreover, the original drug manufacturers try to effectively maintain their market shares with a variety of measures even after the patent term of their branded drugs has expired. As a result, the Company's business performance could be affected if sales do not achieve targeted levels owing to the activities of original drug manufacturers.

5. Research and Development Activities

The Sawai Group has its R&D Division under Sawai Pharmaceutical and the R&D Department at its Medisa Shinyaku Inc. subsidiary. With its "Patients-first" spirit, Sawai continues to promote R&D activities by focusing its efforts on the development of safe and effective generic drugs that meet medical needs such as the development of high-value-added products through engineered drug formulation.

During fiscal 2004, the Company obtained approval to manufacture 35 drugs and completed applications to manufacture 48 more drug products. Those for which approval was obtained were mainly drugs for digestive and circulatory organs.

R&D expenditures for the year under review totaled ¥2,524 million.

Consolidated Balance Sheets

March 31, 2005 and 2004

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	**2005**
Current Assets:			
Cash and time deposits (Note 10)	**¥ 5,239**	¥ 4,471	**$ 48,776**
Trade notes and accounts receivable	**10,213**	9,187	**95,084**
Allowance for doubtful receivables	**(34)**	(59)	**(317)**
	15,418	9,128	**143,543**
Inventories (Note 4)	**7,019**	7,082	**65,348**
Deferred income taxes (Note 8)	**326**	399	**3,035**
Other current assets	**710**	301	**6,610**
Total current assets	**23,473**	21,381	**218,536**
Investments and Long-term Receivables:			
Investment securities (Note 3)	**913**	541	**8,500**
Long-term loans	**82**	62	**763**
Real-estate-in-trust beneficial interest	**656**	656	**6,107**
Long-term prepaid expense	**115**	93	**1,071**
Other investments and long-term receivables	**118**	199	**1,099**
	1,884	1,551	**17,540**
Allowance for doubtful receivables	**(22)**	(31)	**(205)**
Total investments and long-term receivables	**1,862**	1,520	**17,335**
Property, Plant and Equipment (Note 5) **:**			
Land	**4,070**	3,420	**37,892**
Buildings and structures	**14,723**	13,065	**137,073**
Machinery and equipment	**9,579**	8,387	**89,182**
Construction in progress	**30**	2,316	**279**
Other	**2,277**	2,112	**21,200**
	30,679	29,300	**285,626**
Accumulated depreciation	**(14,609)**	(13,640)	**(136,012)**
Net property, plant and equipment	**16,070**	15,660	**149,614**
Intangible assets	**229**	91	**2,132**
Deferred income taxes (Note 8)	**375**	284	**3,492**
	¥42,009	¥38,936	**$391,109**

See accompanying Notes to Consolidated Financial Statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	**2005**
Current Liabilities:			
Bank loans (Note 5)	**¥ 3,470**	¥ 2,200	**$ 32,306**
Current portion of long-term debt (Note 5)	**1,235**	1,892	**11,498**
Trade notes and accounts payable	**4,046**	2,831	**37,669**
Other accounts payable	**3,787**	1,552	**35,257**
Accrued bonuses	**463**	463	**4,311**
Accrued expenses	**336**	236	**3,128**
Income taxes payable	**61**	940	**568**
Reserve for sales return	**41**	30	**382**
Other current liabilities	**22**	27	**205**
Total current liabilities	**13,461**	10,171	**125,324**
Long-Term Liabilities:			
Long-term debt, due after one year (Note 5)	**2,219**	1,874	**20,659**
Employees' retirement benefits (Note 6)	**595**	495	**5,540**
Directors' and corporate auditors' retirement benefits	**351**	336	**3,268**
Other long-term liabilities	**414**	210	**3,854**
Total long-term liabilities	**3,579**	2,915	**33,321**
Shareholders' Equity (Note 7)			
Common stock;			
Authorized 38,800,000 shares,			
Issued and outstanding:			
-13,652,000 shares in 2005	**7,022**	7,003	**65,376**
-13,627,500 shares in 2004			
Capital surplus	**7,346**	7,325	**68,392**
Retained earnings	**10,434**	11,369	**97,142**
Net unrealized holding gains on securities	**167**	153	**1,555**
Treasury stock, 48 shares in 2005	**(0)**	—	**(1)**
Total shareholders' equity	**24,969**	25,850	**232,464**
	¥42,009	¥38,936	**$391,109**

Sawai Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Consolidated Statements of Operations

For the Years ended March 31, 2005, 2004 and 2003

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2005	2004	2003	**2005**
Net Sales	**¥23,277**	¥22,548	¥21,166	**$216,712**
Cost of Sales	**12,317**	11,313	10,997	**114,673**
Gross Profit	**10,960**	11,235	10,169	**102,039**
Selling, General and Administrative Expenses	**9,016**	7,338	7,137	**83,940**
Operating Income	**1,944**	3,897	3,032	**18,099**
Other Income (Expenses):				
Interest and dividend income	**7**	8	7	**65**
Interest expense	**(67)**	(94)	(113)	**(624)**
Gain on sale of securities, net	**23**	10	2	**214**
Compensation for damages	**—**	—	16	**—**
Loss on disposal of inventories	**(119)**	(140)	(94)	**(1,108)**
Unrealized loss on investment securities	**—**	—	(17)	**—**
Gain on real-estate-in–trust beneficial interest	**48**	—	—	**447**
Gains from grants of distributorships (Note 12)	**—**	30	30	**—**
Gain on sale of investments in securities, net	**—**	90	—	**—**
Loss on disposal of buildings and structures	**(359)**	—	—	**(3,342)**
Loss on sale of fixed assets	**(251)**	10	—	**(2,337)**
Special premium payment on the separation from the composite pension fund	**(1,653)**	—	—	**(15,390)**
Other, net	**48**	(12)	11	**447**
	(2,323)	(138)	(186)	**(21,628)**
Income (Loss) before Income Taxes	**(379)**	3,759	2,846	**(3,529)**
Provision for Income Taxes:				
Current	**(65)**	(1,539)	(1,351)	**(605)**
Reversal of provision for income taxes (current)	**66**	—	—	**615**
Deferred	**29**	62	105	**270**
Net Income (Loss)	**¥ (349)**	¥ 2,282	¥ 1,600	**$ (3,249)**

Per Share of Common Stock:

	Yen			U.S. dollars (Note 1)
Net income (loss) — basic	**¥(27.80)**	¥178.64	¥140.81	**$(0.26)**
Net income — diluted (Note)	**—**	178.22	140.18	**—**
Dividends	**40.00**	40.00	35.00	**0.37**

Note: Diluted net income per share is not disclosed in 2005 due to the loss.

See accompanying Notes to Consolidated Financial Statements.

Sawai Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Consolidated Statements of Shareholders' Equity

For the Years ended March 31, 2005, 2004 and 2003

	Millions of yen					
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Net unrealized holding gains (losses) on securities	Treasury stock
Balance at March 31, 2002	10,580,000	¥3,400	¥3,675	¥ 8,343	¥ 10	¥ —
Exercise of stock purchase warrants	218,500	175	198			
Allocation of new shares to a third party	100,000	76	76			
Public stock offering	1,000,000	760	759			
Net income for the year				1,600		
Cash dividends paid at ¥30.00 per share				(319)		
Bonuses to directors and corporate auditors				(23)		
Net unrealized holding losses on securities					(28)	
Balance at March 31, 2003	11,898,500	4,411	4,708	9,601	(18)	—
Exercise of stock purchase warrants	229,000	184	209			
Allocation of new shares to a third party	150,000	241	241			
Public stock offering	1,350,000	2,167	2,167			
Net income for the year				2,282		
Cash dividends paid at ¥40.00 per share				(479)		
Bonuses to directors and corporate auditors				(35)		
Net unrealized holding gains on securities					171	
Balance at March 31, 2004	13,627,500	7,003	7,325	11,369	153	—
Exercise of stock purchase warrants	24,500	19	21			
Net loss for the year				(349)		
Cash dividends paid at ¥40.00 per share				(546)		
Bonuses to directors and corporate auditors				(40)		
Net unrealized holding gains on securities					14	
Purchase of treasury stock						(0)
Balance at March 31, 2005 (Note 7)	**13,652,000**	**¥7,022**	**¥7,346**	**¥10,434**	**¥167**	**¥(0)**

	Thousands of U.S. dollars (Note 1)				
	Common stock	Capital surplus	Retained earnings	Net unrealized holding gains on securities	Treasury stock
Balance at March 31, 2004	$65,199	$68,197	$105,846	$1,425	$ —
Exercise of stock purchase warrants	177	195			
Net loss for the year			(3,249)		
Cash dividends paid at $0.37 per share			(5,083)		
Bonuses to directors and corporate auditors			(372)		
Net unrealized holding gains on securities				130	
Purchase of treasury stock					(1)
Balance at March 31, 2005	**$65,376**	**$68,392**	**$ 97,142**	**$1,555**	**$ (1)**

See accompanying Notes to Consolidated Financial Statements.

Sawai Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Consolidated Statements of Cash Flows

For the Years ended March 31, 2005, 2004 and 2003

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2005	2004	2003	**2005**
Cash Flows from Operating Activities:				
Income (loss) before income taxes	**¥ (379)**	¥3,759	¥2,846	**$ (3,529)**
Adjustments to reconcile income before income taxes to net cash provided by operating activities:				
Depreciation and amortization	**1,329**	1,253	1,221	**12,373**
Interest and dividend income	**(7)**	(8)	(7)	**(65)**
Interest expense	**67**	94	113	**624**
Loss on disposal of buildings and structures	**321**	—	—	**2,989**
Loss on sale of fixed assets	**251**	10	—	**2,337**
Increase in trade notes and accounts receivable	**(1,026)**	(675)	(1,656)	**(9,552)**
Decrease (increase) in inventories	**63**	(787)	(759)	**587**
Increase (decrease) in trade notes and accounts payable	**914**	(191)	587	**8,509**
Payment of bonuses to directors and corporate auditors	**(40)**	(35)	(24)	**(372)**
Increase in employees' retirement benefits	**100**	108	40	**931**
Increase in other accounts payable	**1,529**	365	330	**14,235**
Other	**(16)**	(12)	143	**(150)**
Sub—total	**3,106**	3,881	2,834	**28,917**
Interest and dividends received	**8**	5	7	**74**
Interest paid	**(65)**	(99)	(127)	**(605)**
Income taxes paid	**(929)**	(1,635)	(1,302)	**(8,649)**
Net cash provided by operating activities	**2,120**	2,152	1,412	**19,737**
Cash Flows from Investing Activities:				
Proceeds from time deposits	**—**	430	—	**—**
Payments for purchase of property, plant and equipment	**(2,036)**	(3,411)	(2,243)	**(18,956)**
Proceeds from sale of property, plant and equipment	**786**	—	—	**7,318**
Payments for purchase of securities	**(523)**	(129)	(82)	**(4,869)**
Proceeds from sale of securities	**183**	376	64	**1,704**
Payments for purchase of real-estate-in-trust beneficial interest	**—**	(656)	—	**—**
Payments for long-term loan	**(82)**	(64)	—	**(763)**
Proceeds from collection of long-term loan	**62**	—	—	**577**
Payments for purchase of intangible assets	**(193)**	(59)	(13)	**(1,797)**
Other	**—**	6	3	**—**
Net cash used in investing activities	**(1,803)**	(3,507)	(2,271)	**(16,786)**
Cash Flows from Financing Activities:				
Net increase in bank loans	**1,270**	200	300	**11,824**
Proceeds from long-term debt	**2,100**	430	1,000	**19,551**
Repayment of long-term debt	**(2,410)**	(2,408)	(1,646)	**(22,437)**
Exercise of stock purchase warrants	**—**	—	(1)	**—**
Proceeds from issuance of stock	**37**	5,184	2,021	**345**
Payments for purchase of treasury stock	**(0)**	—	—	**(1)**
Cash dividends paid	**(546)**	(479)	(319)	**(5,083)**
Net cash provided by financing activities	**451**	2,927	1,355	**4,199**
Net increase in cash and cash equivalents	**768**	1,572	496	**7,150**
Cash and cash equivalents at beginning of year	**4,471**	2,899	2,403	**41,626**
Cash and cash equivalents at end of year (Note 10)	**¥5,239**	¥4,471	¥2,899	**$48,776**

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

1. Basis of Financial Statements

SAWAI PHARMACEUTICAL CO., LTD. (the "Company") and its consolidated subsidiaries (the "Companies") maintain their official accounting records in Japanese yen and in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan ("Japanese GAAP"), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of consolidated statements of shareholders' equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation is not presented in the accompanying consolidated financial statements.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2005, which was ¥107.41 to U.S.$1. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

2. Summary of Significant Accounting Policies

(a) Consolidation

The consolidated financial statements include the accounts of the Company and its fully owned subsidiaries, MEDISA SHINYAKU INC. and ACTIVE WORK CO., LTD. that meet the control requirements for consolidation. The Company merged with ACTIVE WORK CO., LTD. on April 1, 2004. All significant intercompany transactions and accounts have been eliminated in the consolidation. In the elimination of investments in subsidiaries, the assets and liabilities of subsidiaries are evaluated using the fair value at the time the Company acquired control of respective subsidiaries.

The Company has no affiliates, meeting the significant influence requirement for application of the equity method.

(b) Cash and time deposits

Cash and time deposits in the consolidated balance sheets include cash on hand, readily-available deposits and deposits with a maturity of one year or less.

(c) Allowance for doubtful receivables

The allowance for doubtful receivables is provided in amounts sufficient to cover possible losses on collection. It is determined by adding individually estimated uncollectable amounts to an amount computed based on the actual ratio of bad debts in the past.

(d) Marketable and investment securities

The Companies classify securities into the following categories: (a) securities held for trading purposes (hereafter, "trading securities"), (b) debt securities intended to be held to maturity (hereafter, "held-to-maturity debt securities"), (c) equity securities issued by subsidiaries and affiliated companies, and (d) all other securities that are not classified in any of the above categories (hereafter, "available-for-sale securities").

The Companies have no trading securities, held-to-maturity debt securities or equity securities in unconsolidated subsidiaries and affiliates. Available-for-sale securities with available fair market values

are stated at fair market value. Unrealized gains and unrealized losses on these securities are reported, net of applicable income taxes, as a separate component of shareholders' equity. Realized gains and losses on sale of such securities are computed using moving-average cost.

Securities with no available fair market value are stated at moving-average cost. If a decline in fair value below cost of an individual security is judged to be material and other than temporary, the carrying value of the individual security is written down.

(e) Inventories

Inventories are stated at moving average cost, except for supplies, which are stated at average cost.

(f) Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation is provided on the straight-line method over estimated useful lives. Expenditures for significant renewals and betterments are capitalized, while expenditures for normal repairs and maintenance are charged to expense when incurred.

(g) Impairment of fixed assets

In the year ended March 31, 2005, the Company did not adopt early the new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003). The new accounting standard is required to be adopted in periods beginning on or after April 1, 2005, but the standard does not prohibit earlier adoption.

The Company and its consolidated subsidiaries will adopt the new standard effective April 1, 2005.

(h) Accrued bonuses

The Company and its consolidated subsidiaries accrue estimated amounts of employee's bonuses based on estimated amounts to be paid in the subsequent period.

(i) Stock issuance costs

Stock issuance costs are charged to income as incurred.

(j) Income taxes

Income taxes comprise corporation tax, prefectual and municipal inhabitants taxes and enterprise tax. The provision for income taxes is based on income for financial statement purposes. The tax effects of loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting are recognized as deferred income taxes.

(k) Retirement benefits

(i) Employees:

The Companies' non-contributory pension plans cover substantially all employees. The provision is determined actuarially and funded currently through outside trustees. The Companies also have unfunded lump-sum retirement benefit plans which cover certain employees who are not covered by the funded pension plan.

Unrecognized actuarial differences are amortized over 5 years, which is within the estimated average remaining service lives of the employees, from the next fiscal year.

(ii) Directors and corporate auditors:

The liability for the Companies' directors' and corporate auditors' retirement benefits is provided based on the Companies' internally decided criteria.

(l) Bonuses to directors and corporate auditors

Bonuses to directors and corporate auditors, which are subject to approval at the general meeting of shareholders, are accounted for as an appropriation of retained earnings.

(m) Research and development

Research and development expenses for the improvement of existing products or the development of new products, including basic research and fundamental development costs, are charged to income in the period incurred and amounted to ¥2,524 million (US$23,499 thousand), ¥2,261 million and ¥1,908 for the years ended March 31, 2005, 2004 and 2003, respectively.

(n) Software costs

The Companies include software in intangible assets and depreciate it using the straight-line method over the estimated useful life of five years.

(o) Finance leases

Finance leases which do not transfer ownership or which do not have bargain purchase option provisions are accounted for in the same manner as operating leases in accordance with Japanese GAAP.

(p) Consolidated statements of cash flows

In preparing the consolidated statements of cash flows, cash on hand, readily-available deposits and short-term highly liquid investments with maturities not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

(q) Net income per share

The computations of net income per share of common stock are based on the weighted average number of shares of common stock outstanding during each year.

(r) Reserve for sales returns

The reserve for sales returns is provided in the maximum amount (at the prescribed rate) permitted by Japanese tax laws.

(s) Reclassifications

Certain prior year amounts have been reclassified to conform to 2005 presentation.

3. Securities

(1) The following tables summarize acquisition costs and book values (fair values) of available-for-sale securities with available fair values as of March 31, 2005:

(a) Securities with book values exceeding acquisition costs:

	Millions of yen			Thousands of U.S. dollars		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥275	¥558	¥283	$2,560	$5,195	$2,635

(b) Securities with book values not exceeding acquisition costs:

	Millions of yen			Thousands of U.S. dollars		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Other	10	10	(0)	93	93	(0)

(2) Total sales of available-for-sale securities in the year ended March 31, 2005 amounted to ¥183 million (US$1,704 thousand) and the related gains and losses amounted to ¥35 million (US$326 thousand) and ¥12 million (US$112 thousand), respectively.

(3) Book values of securities with no available fair values as of March 31, 2005 are as follows:

Unlisted equity securities	¥318 million (US$2,961 thousand)
Other	¥ 28 million (US$261 thousand)

(4) The following tables summarize acquisition costs and book values (fair values) of available-for-sale securities with available fair values as of March 31, 2004:

(a) Securities with book values exceeding acquisition costs:

	Millions of yen		
	Acquisition cost	Book value	Difference
Equity securities	¥228	¥487	¥259
Other	10	10	0
Total	¥238	¥497	¥259

(b) Securities with book values not exceeding acquisition costs:

	Millions of yen		
	Acquisition cost	Book value	Difference
Other	10	10	(0)

(5) Total sales of available-for-sale securities in the year ended March 31, 2004 amounted to ¥376 million and the related gains and losses amounted to ¥102 million and ¥2 million, respectively.

(6) Book values of securities with no available fair values as of March 31, 2004 are as follows:

Unlisted equity securities ¥34 million

(7) Total sales of available-for-sale securities in the year ended March 31, 2003 amounted to ¥64 million and the related gains and losses amounted to ¥3 million and ¥1 million, respectively.

4. Inventories

Inventories at March 31, 2005 and 2004, are as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Finished goods and merchandise	**¥3,619**	¥4,262	**$33,693**
Work-in-process	**1,521**	1,317	**14,161**
Raw materials and supplies	**1,879**	1,503	**17,494**
Total	**¥7,019**	¥7,082	**$65,348**

5. Short-term Bank Loans and Long-term Debt

Short-term bank loans consist mainly of unsecured bank loans with a weighted average interest rates of 0.715% per annum at March 31, 2005, and 0.771% per annum at March 31, 2004.

Long-term debt at March 31, 2005, consists of the following:

	Millions of yen	Thousands of U.S. dollars
Loans from banks and other public corporations, due 2006-2010, interest 0.53%-3.3%		
Secured	¥2,008	$18,695
Unsecured	1,446	13,462
	3,454	32,157
Current portion of long-term debt	1,235	11,498
	¥2,219	$20,659

Long-term debt at March 31, 2004, consists of the following:

	Millions of yen
Loans from banks and other public corporations, due 2004-2010, interest 0.6%-3.3%	
Secured	¥2,773
Unsecured	993
	3,766
Current portion of long-term debt	1,892
	¥1,874

The aggregate annual maturities of long-term debt outstanding at March 31, 2005, are as follows:

March 31	Millions of yen	Thousands of U.S. dollars
2005	¥1,235	$11,498
2006	1,061	9,878
2007	688	6,405
2008	256	2,383
2009	214	1,993
Total	¥3,454	$32,157

At March 31, 2005, assets pledged as collateral for secured long-term debt, including current portion are as follows:

	Millions of yen	Thousands of U.S. dollars
Property, plant and equipment, net of accumulated depreciation	¥5,545	$51,625

At March 31, 2004, assets pledged as collateral for secured long-term debt, including current portion are as follows:

	Millions of yen	Thousands of U.S. dollars
Property, plant and equipment, net of accumulated depreciation	¥5,810	$51,625

The real-estate-in trust investment of ¥656 million is pledged as security to the Shinsei Bank at March 31, 2005 and 2004.

6. Employees' Retirement Benefits

The liability for employees' retirement benefits at March 31, 2005 and 2004 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Projected retirement benefit obligation	**¥(3,188)**	¥(2,963)	**$(29,681)**
Plan assets	**2,349**	2,080	**21,870**
Unfunded retirement benefit obligation	**(839)**	(883)	**(7,811)**
Unrecognized actuarial differences	**244**	388	**2,271**
Liability for retirement benefits	**¥ (595)**	¥ (495)	**$ (5,540)**

Retirement benefit expenses for the years ended March 31, 2005, 2004 and 2003 are as follows:

	Millions of yen			Thousands of U.S. dollars
	2005	2004	2003	**2005**
Service cost	**¥353**	¥330	¥306	**$3,287**
Interest cost	**59**	65	72	**549**
Expected return on plan assets	**(52)**	(40)	(42)	**(484)**
Amortization of actuarial differences	**139**	153	91	**1,294**
Retirement benefit expenses	**¥499**	¥508	¥427	**$4,646**

The assumptions and bases used for the calculation of the retirement benefit obligation are as follows:

Discount rate	2.0%
Expected return rate for plan assets	2.5%
Amortization period for actuarial differences	5 years

The estimated amount of all retirement benefits to be paid at future retirement dates is allocated equally to each service year using the estimated number of total service years.

7. Shareholders' Equity

Under the Commercial Code of Japan, the entire amount of the issue price of shares is required to be accounted for as capital, although a company may, by resolution of its board of directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital which is included in capital surplus. In conformity therewith, the Company has divided the amount received from the issuance of common stock, including the exercise of warrants, between common stock and additional paid-in capital by resolution of the Board of Directors.

Because the proceeds from exercise of warrants includes the consideration for the warrant rights which should be included in capital surplus, the increase of the capital surplus is larger than the increase of the common stock.

The Japanese Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal reserve until the total amount of legal reserve and additional paid-in capital equals 25% of common stock. The legal reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the stockholders' meeting or may be capitalized by resolution of the Board of Directors. On condition that the total amount of legal reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for dividends by the resolution of shareholders' meeting. Legal reserve is included in retained earnings in the accompanying financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the unconsolidated financial statements of the Company in accordance with the Commercial Code of Japan.

On June 24, 2005, the Company's shareholders approved the payment of year-end cash dividends of ¥25 (U.S.$0.23) per share totaling ¥341 million (US$3,175 thousand) to the Company's shareholders of record as of March 31, 2005 and the payment of bonuses to the Company's directors totaling ¥30 million (US$279 thousand).

8. Income Taxes

The Companies are subject to a number of taxes based on income, which, in the aggregate, indicate a statutory income tax rate in Japan of approximately 40.87% for the years ended March 31, 2005, 2004 and 2003.

Significant components of deferred tax assets and liabilities at March 31, 2005 and 2004 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Deferred tax assets:			
Unrealized gains on land	**¥ 219**	¥ 219	**$2,039**
Retirement benefits for employees	**243**	202	**2,262**
Retirement benefits for directors and corporate auditors	**143**	137	**1,331**
Unrealized gains on inventories	**83**	118	**773**
Accrued bonuses to employees	**189**	189	**1,760**
Operating loss carryforwards	**32**	—	**298**
Loss on sales of land	**51**	—	**475**
Loss on disposal of buildings and structures	**147**	—	**1,369**
Enterprise taxes	**9**	85	**84**
Less valuation allowance	**(146)**	—	**(1,359)**
Other	**81**	87	**753**
Total deferred tax assets	**1,051**	1,037	**9,785**
Deferred tax liabilities:			
Reserve for deferred gains on sales of fixed assets	**(136)**	(164)	**(1,266)**
Reserve for special depreciation	**(99)**	(83)	**(922)**
Net unrealized holding gains on securities	**(115)**	(106)	**(1,071)**
Other	**(—)**	(1)	**(—)**
Total deferred tax liabilities	**(350)**	(354)	**(3,259)**
Net deferred tax assets	**¥ 701**	¥ 683	**$6,526**

The following table summarizes the significant differences between the statutory income tax rates and the effective income tax rates for financial statement purposes for the years ended March 31, 2005 and 2003. There was no significant difference between the statutory income tax rate and the effective income tax rate for the year ended March 31, 2004.

	2005	2004	2003
Statutory income tax rate	**40.87%**	— %	**40.87%**
Non-deductible expenses	**(6.87)**	—	**0.57**
Per capita inhabitant tax	**(8.33)**	—	**1.12**
Special tax credits	**2.87**	—	**0.25**
Valuation allowance	**(38.74)**	—	**—**
Reversal of provision for income tax (current)	**17.43**	—	**—**
Other	**0.53**	—	**0.96**
Effective income tax rate	**7.76%**	— %	**43.77%**

With the enactment of the "Revision of the Local Tax Law" (Legislation No. 9, 2003) on March 31, 2003, the tax bases for assessing enterprise taxes comprises "amount of income", "amount of added value" and "amount of capital" commencing April 1, 2004.

Enterprise taxes based on "amount of added value" and "amount of capital" are included in "Selling, general and administrative expenses" commencing this fiscal year pursuant to "Practical Solutions on Presentation for Size-Based Components of Corporate Enterprise Tax on the Income Statement "(Accounting Standards Board ,Practical Solution Report No. 12 issued on February 13, 2004).

As a result of this change, selling, general and administrative expenses increased by ¥51 million ($475 thousand), and operating income and income before income taxes each decreased by the same amount.

9. Leases

(a) Finance leases as lessee

At March 31, 2005 and 2004, original lease obligations for machinery and equipment and other assets under non-capitalized finance leases are as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Original lease obligations, including finance charges	**¥736**	¥632	**$6,852**

Lease obligations under non-capitalized finance leases, including finance charges, remaining at March 31, 2005 and 2004, are as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Payments due within one year	**¥153**	¥130	**$1,424**
Payments due after one year	**295**	324	**2,747**
Total	**¥448**	¥454	**$4,171**

Leases payments under such leases for the years ended March 31, 2005, 2004 and 2003 are ¥155 million (US$1,443 thousand), ¥102 million, and ¥54 million, respectively.

(b) Operating leases as lessee

Lease obligations under operating leases, remaining at March 31, 2005 and 2004, are as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Payments due within one year	**¥20**	¥31	**$186**
Payments due after one year	**16**	36	**149**
Total	**¥36**	¥67	**$335**

10. Cash Flow Information

The reconciliation of cash and time deposits in the consolidated balance sheets and cash and cash equivalents in the consolidated statements of cash flows is as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	**2005**
Cash and time deposits	**¥5,239**	¥4,471	**$48,776**
Deposits placed with banks with maturities of over three months	**(—)**	(—)	**(—)**
Cash and cash equivalents	**¥5,239**	¥4,471	**$48,776**

11. Segment Information

The Companies operate primarily in the pharmaceutical supplies industry in Japan. Accordingly, segment information is not disclosed.

12. Gains from Grants of Distributorships

In 2004 gains from grants of distributorships are gains from the grant of distributorship rights for anti-inflammatory agents, etc. which the Company manufactures and had sold formerly to Asahi Kasei Corporation.

In 2003 gains from grants of distributorships are gains from the grant of distributorship rights for anti-inflammatory agents, etc. which Medisa Shinyaku Inc., a consolidated subsidiary, manufactures and had sold formerly to Asahi Kasei Corporation.

13. Research and Development Expenses

Research and development expenses included in selling, general and administrative expenses and cost of sales for the years ended March 31, 2005, 2004 and 2003 amounted to ¥2,524 million (US$23,499 thousand), ¥2,261 million and ¥1,908 million, respectively.

14. Subsequent event

On April 13, 2005, the Company and Nihon Schering K.K. ("Nihon Schering") entered into an agreement for the transfer of certain of Nihon Schering's operations to the Company. There will a special gain generated by this transfer of approximately ¥890 million in the year ended March 31, 2006.

Main provisions are as follows:

(1) Information of Nihon Schering

(a) Company name	Nihon Schering K.K.
(b) Location of headquarters	2-6-64, Nishimiyahara, Yodogawa-ku, Osaka, Japan
(c) Representative Director	JOSE E.MARTINO ALBA
(d) Capital	¥10,000 million (As of December 31, 2004)
(e) Major business	Import, production and distribution of pharmaceuticals

(2) Summary of agreement

(a) The Company will receive the tangible assets of the Mobara plant of Nihon Schering.

(b) The Company will maintain the employment of all the regular employees of the Mobara plant.

(c) The Company will be commissioned to manufacture pharmaceuticals over the next three years.

(3) Purpose of agreement

The Company intends to expand the commissioned manufacturing business and considers this agreement will meet the Company's needs.

(4) Nature of transferred assets

(a) Date of transfer	October 1, 2005
(b) Nature of transferred assets	Land, buildings, machinery, equipment (IT equipment inclusive) and other assets of the Mobara plant of Nihon Schering.

Independent Auditors' Report

To the Shareholders and Board of Directors of
SAWAI PHARMACEUTICAL CO., LTD.:

We have audited the accompanying consolidated balance sheets of SAWAI PHARMACEUTICAL CO., LTD. and subsidiaries as of March 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 31, 2005, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SAWAI PHARMACEUTICAL CO., LTD. and subsidiaries as of March 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2005, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following.

As described in Note 14 "Subsequent events", on April 13, 2005, the Company and Nihon Schering K.K. ("Nihon Schering") entered into an agreement for the transfer of certain of Nihon Schering's operations to the Company.

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 1 to the consolidated financial statements.

Osaka, Japan
June 24, 2005

KPMG AZSA & Co.

Board of Directors / Corporate Data

Board of Directors (As of June 24, 2005)

Chairman

Jiro Sawai*

President

Hiroyuki Sawai*

Senior Managing Director

Mitsuo Sawai

Managing Directors

Hiroyuki Sato
Takashi Iwasa, Ph.D.
Harumasa Toya, Ph.D.
Keiichi Kimura
Kazuichi Ishikawa

Directors

Takekiyo Sawai
Shinichi Tokuyama
Yoshiteru Takahashi, Ph.D.

Standing Statutory Auditor

Toshiaki Konishi

Statutory Auditors

Kazuo Ohishi, Attorney at Law
Arata Mano, Tax Accountant
Koji Ueda, Tax Accountant

*Representative Director

Corporate Data (As of March 31, 2005)

Head Office

4-25, Akagawa 1-chome, Asahi-ku,
Osaka 535-0005, Japan

Established

1929

Stated Capital

¥7,022 million

Number of Shares Outstanding

13,652,000

Number of Shareholders

6,485

Number of Employees

495

Independent Public Accountants

KPMG AZSA & Co.
3-6-5 Kawara-machi, Chuo-ku,
Osaka 541-0048, Japan

Transfer Agent*

The Mizuho Trust & Banking Co., Ltd.

Branches

Sapporo, Sendai, Tokyo, Nagoya, Osaka,
Hiroshima, Fukuoka

Area Offices

Jo shinetsu, Kita-kanto, Tokyo-nishi, Tokyo-higashi,
Yokohama, Hokuriku, Shizuoka, Kyoto,
Kobe, Takamatsu, Matsuyama

Factories

Osaka, Sanda, Kyushu

Laboratories

Osaka Laboratory
Research and Development Center
Pharmaceutical Research Center

Consolidated Subsidiary

Medisa Shinyaku Inc.

URL

http://www.sawai.co.jp/

*The Company changed its transfer agent to The Chuo Mitsui Trust and Banking Company, Limited as of June 25, 2005.

sawai

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URL http://www.sawai.co.jp/

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