sawai

ANNUAL REPORT 2006

For the year ended March 31, 2006

"Patients first"

Profile

Patients First

Generic drugs can achieve many things.
Generic drugs can lighten the copayment for many patients. The use of generic drugs also contributes to holding down medical expenses at the national level, where costs have increased continuously due to the aging society of Japan.
Our motto at Sawai Pharmaceutical (“Sawai” or “we”) is “Patients first.”

To this end, we always pursue quality. We seek to ensure inexpensive drug pricing and to create original value such as the ease of taking the medication, neither of which is typically the case with original drugs. To enable the quick and timely delivery of our products, we reinforce our stable supply system in accordance with the R&D system.

Furthermore, we continue to intensify activities in providing information to medical specialists including physicians, pharmacists and to enlighten patients so that people can use generic drugs without anxiety. Toward a better society where everyone knows about and can easily access generic drugs.

— We contribute to people and society with generic drugs

Contents

Financial Highlights

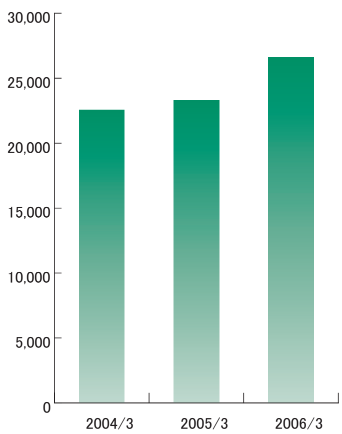
For the Years ended March 31, 2006, 2005 and 2004

Year ended March 31	Millions of yen 2006	2005	2004	Thousands of U.S. dollars 2006
Net sales	**¥26,616**	¥23,277	¥22,548	**$ 26,577**
Operating income	**4,299**	1,944	3,897	**36,597**
Net income (loss)	**3,010**	(349)	2,282	**25,624**
Total shareholders' equity	**27,543**	24,969	25,850	**234,469**
Total assets	**51,997**	42,009	38,936	**442,641**
Research and development (R&D) expenses	**2,241**	2,524	2,261	**19,077**
Capital expenditures	**5,359**	2,764	3,368	**45,620**
Depreciation and amortization	**1,640**	1,329	1,253	**13,961**
		%		
Ratio of R&D expenses to sales	**8.4**	10.8	10.0	
Return on equity	**11.5**	(1.4)	10.2	
Shareholders' equity to total assets	**53.0**	59.4	66.4	
Amounts per common share:		Yen		U.S. dollars
Net income (loss) - basic	**¥ 217.08**	¥ (27.80)	¥ 178.64	**$ 1.85**
Net income - diluted	**—**	—	178.22	**—**
Cash dividends applicable to period	**50.00**	40.00	40.00	**0.43**
Shareholders' equity	**2,014.11**	1,826.76	1,894.00	**17.15**

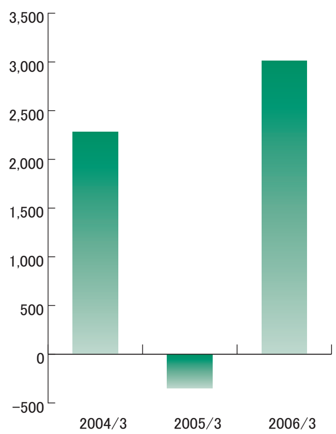
Note: 1. The U.S. dollars amounts represent translations of Japanese yen, for convenience only, at the rate of ¥117.47 = $1, the rate prevailing on March 31, 2006.

2. Diluted net income per common share is not disclosed in 2006 because there was no potential common stock and 2005 due to the loss.

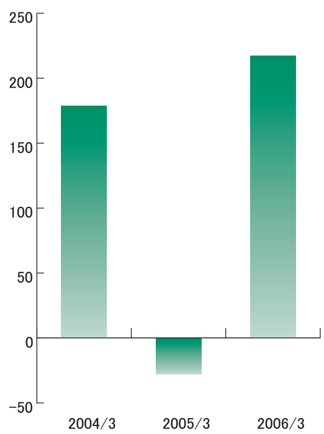
Net Sales (Millions of yen)



Net Income(Loss) (Millions of yen)



Net Income(Loss) Per Share (basic) (Yen)



To Our Shareholders

As the Top Brand in the Industry, Sawai Intends to Build on Its Recent Record Performance

We achieved record highs in net sales and profits for the year ended March 31, 2006 (fiscal 2005), sparked by the increased recognition of and demand for generic drugs and positive institutional arrangements. Since then, we intend to fortify our development, sales and production as the top brand in the forthcoming generic drug era.

Favorable conditions lead to highest net sales and profits

During the year under review, various measures were taken and promoted by the government to hold down medical expenses and drug costs, thereby gradually improving the market environment. In particular, the modification of prescription forms implemented in April 2006 is expected to spur the dissemination of affordable generic drugs.

In these circumstances, Sawai considerably increased its net sales due to 1) the custom development of major hospitals to be used in generic drugs, 2) market expansion activity taking advantage of the opportunity of indicating drugs in generic names and substitutive prescriptions introduced at several foundation hospitals, 3) the considerable growth in sales of new products released in July 2004 and 2005 and 4) the increased number of hospital clients that newly adopted our products. Furthermore, the rise in gross profit due to the improved ratio of operation and a reduction in selling, general, and administrative expenses led to record highs in our major financial indicators.

Given likely improvement in our operating environment for the year ending March 31, 2007 (fiscal 2006), Sawai intends to 1) promote its high reliability in terms of the “high quality, sufficient medical information and stable supply” of pharmaceuticals as a leading manufacturer in the generic drug industry, 2) exploit new customer and 3) sell highly profitable drugs with targets of ¥31,600 million in net sales, ¥4,840 million in ordinary income and ¥2,780 million in net income.

Playing a leadership role in the growing market for generics

The Japanese generic drug market significantly lags behind those of Western countries. Although generic drugs account for more than 50% of the drug market in the United States, the United Kingdom and Germany, they have only a 16% market share in Japan. In addition, the growth rate of generic drugs exceeds that of brand drugs in those countries, whereas the growth rate in neither category has shown a significant increase in Japan. We believe this situation is lamentable, and Japanese patients and society have suffered as a result.

The modification of prescription forms, which was implemented in April 2006, should have a considerable impact on the further dissemination of generic drugs by granting the right of selection to patients and allowing the government to conduct effective educational activities. Indeed, the awareness of generic drugs improved considerably via special TV and radio programs and due to educational advertisement sponsored by Sawai and the industry. Nevertheless, we believe these measures were insufficient from the viewpoint of reducing the economic burdens of patients and society. As an industry leader, Sawai believes that its social mission is to ensure a "stable supply of generic drugs to patients" through the stable provision of its products to medical institutions by popularizing quality and affordable generic drugs and expanding the market.

Stable supply of products, upgrading MRs and strengthening development capability are the issues to be addressed as a leading company

With the new market environment in place, the responsibility of the generic drug industry has expanded to include the need 1) for a full lineup with the all strength of original drugs (e.g., formulations, dose) and 2) to establish a stable supply system nationwide.

At dispensing pharmacies, the followings are the principal criteria for the selection of generic drugs: 1) stable supply (reinforcement of wholesale channels), 2) delivery results to regional foundation hospitals, 3) quality and quantity of information supplied by MRs, 4) reliability achieved through the stock exchange listing and 5) public exposure via TV advertising. Meeting these requirements is indispensable to being a chosen brand.

In recognition of the above advantages, Sawai endeavors to fortify its top brand position.

1) **Ensuring a stable supply system and reinforcing the production system:**
   Streamline the distribution system and reorganize the companywide production system in response to the anticipated demand and to achieve a rise in our market share.
2) **Exploitation of new customers among foundation hospitals and dispensing pharmacies by increasing the number of Medical Representatives (MRs):**
   Establish a strong sales system to quickly respond to emerging markets such as foundation hospitals.
3) **Enhancement of our Medical Information department via an improved MR supporting system:**
   Establish an advanced information provision function that can meet demanding needs principally required by foundation hospitals.
4) **Acceleration of decision-making on drug development:**
   Improve research and development functionality through the integration of headquarters and laboratories which will be newly completed.
5) **Increased awareness of Sawai and build up our corporate brand to become the most requested generic drugs:**
   Strengthen proactive educational activities and branding strategy to consumers.

Furthermore, we intend to raise our profit-creating capability and strengthen our financial structure with measures such as proper human resources, raised productivity and improved development efficiency in the pursuit of industry-leading, sustainable growth. Our specific initiatives are introduced in the following pages from the viewpoints of 1) Quality Management, 2) Provision of Information, 3) Development/Production/ Distribution System and 4) Enlightenment Activities.

We look forward to the continued support and encouragement of our shareholders.

H. Sawai

Hiroyuki Sawai
President

Quality Management

Sawai's high-quality pharmaceutical products are produced at its leading-edge production facilities and sophisticated production environment in compliance with quality standards.

High quality and safety equivalent to those of original drugs

Pharmaceuticals are subject to a variety of restrictions under the Pharmaceutical Affairs Law to strictly ensure their efficacy and safety. Generic drugs and original drugs must similarly comply with the same standards at different stages such as manufacturing control and quality management, and similar regulations are applicable to their development, manufacturing and sales processes.

For the period until the patent term of original drugs expires, these active ingredients are also administered and used for many patients with efficacy and safety conducted for each. As a result, safety can be proven regarding generic drugs that contain the same active ingredients as the corresponding original drugs.

Sawai's original standards for quality management

We has not only met the requirements under the above statutory standards but also set additional quality standards to improve the evaluation of generic drugs.

Strict acceptance standards and tests for ingredients

We collect a variety of high-quality raw materials from around the world to develop a pharmaceutical product. The molecular structure and crystalline form of the medical properties are thoroughly analyzed to ensure that they are exactly the same as those of the brand drug and/or that the purity level is sufficiently high to isolate the best ingredient for the pharmaceutical.

Stringent product shipment standards

In addition to the self-checks conducted in accordance with the management standards for the respective manufacturing processes, the Quality Control Department, which is independent of the manufacturing departments, checks the control status and quality level for products. We also have stringent shipment standards.

Follow-up tests after shipment

We carefully check stored samples of the shipped products at predetermined intervals. Maximum safety is always pursued by confirming time over quality changes through careful checks after shipment.

State-of-the-art production equipment and environment for high-quality products

Sawai endeavors to create one of the highest-quality production environments among pharmaceutical manufacturers by implementing state-of-the-art equipment.

1. High Speed/High Containment Tablet Press machine
With the introduction of a state-of-the-art tableting machine, Japan's first, Sawai is a step ahead of other drug manufacturers.

2. Fully automatic PTP packaging machine
Our PTP packaging machine for sealing tablets in PTP sheets is a fully automatic system.

3. Corridor in the Sanda factory
A clean manufacturing environment is maintained via thorough air-conditioning control.

Provision of Information

As the top generic drug manufacturer, Sawai intends to supply quality and sufficient medical information faster than its competitors.

Supply of information entrusted by medical experts

An important issue for the further dissemination of generic drugs is the supply of necessary information by manufacturers. Sawai conducts information provision activities under the motto "Faster than others and in better quality and higher quantity" and intends to firmly establish trust as a leader in the industry.

40 pharmacists and 250 MRs provide medical information

Medical information is controlled by about 40 pharmacists at the Medical Information Department in the head office, seven branches and 11 sales offices nationwide. The 250 well-trained MRs deliver useful information precisely and quickly that is indispensable for the proper usage of pharmaceuticals to gain higher confidence among medical experts. Our 24-hour immediate response system addresses any emergencies. Moreover, Sawai's dedicated Web site for medical experts discloses detailed product information .

Reinforced evidence

We have built a solid marketing system that allows our MRs to provide a wide range of pharmaceutical information including a "Product information," an "Interview form," "Dear Dr. Letter," a "Compatibility reaction table," "Biological equivalence data" and "Purity and other quality data." Our "Sawai, the trustworthy brand" approach is ongoing with the preparation of dissolution test data and clinical data.

Sawai TOPICS

Information Web site for medical experts offers useful generic drug product information such as NHI price comparisons

Sawai's popular information site for medical experts is highly acclaimed among medical experts for comparing patients' costs and differences in indications with comparable original drugs. This valuable information has provided strong momentum for medical institutions to adopt Sawai's generic drugs.

http://med.sawai.co.jp/
(Japanese only)

Development/Production/Distribution System

We want to deliver generic drugs as soon as possible to those who urgently need them. Sawai wishes to deliver what is vital for patients through its well-established production and distribution systems. Being self-conscious as the top brand in the industry, we are strengthening our development capability.

Research system for earlier delivery

Our primary mission is faster delivery of inexpensive and quality generic drugs to those in need. To this end, Sawai engages in R&D activities to deliver a generic drug immediately after the patent of an original drug expires.

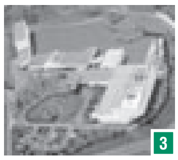
Stable supply system with five factories

Sawai's more than 350 prescription drugs cover such therapeutic areas as cardiovascular, antibiotics and anticancer agents and so on. To ensure the stable supply of these many generic drug products, we have streamlined our production system. One such effort is represented by our production factories. Our own production started at the Osaka Factory, followed by the Kyushu Factory, which was completed in 1981. The Kyushu Factory of Medisa Shinyaku Inc., a subsidiary, was completed in 1988, and the Sanda Factory was completed in 1992. We now have five factories nationwide, including the Kanto Factory, which was transferred in 2005, and boast the top production system in the industry with a total floor area of 151,666 square meters. Given the favorable environment for generic drug manufacturers, Sawai has realized "stable supply," an important requirement, to meet the critical needs of medical institutions and patients.

National sales network in collaboration with big wholesalers and regional sales agencies

Our generic drugs are delivered to 6,500 hospitals including national hospitals (coverage of 75%), 36,400 clinics (coverage of 37%) and dispensing pharmacies. To ensure the stable delivery of our products to clients that adopt our products, Sawai has established a strong network connecting several nationwide wholesalers and approximately 170 sales agencies that feature local marketing. This structure gives Sawai elaborate distribution and logistics systems for stable supply to patients and consumers.

The Kyushu Factory (70,351m^2) was awarded the Japan Greenery Research and Development Center Chairman's Prize (1999).



1. **The Kanto Factory (32,527m^2) was transferred from Nihon Schering K.K. in 2005.**
2. **The Sanda Factory (14,686m^2) is located at Sanda Techno Park in Hyogo.**
3. **The Kyushu Factory of Medisa Shinyaku Inc. (34,102 m^2).**

ISO9001 certification obtained in 2000

We want consumers to be knowledgeable about generic drugs, which can reduce the financial burden on patients and society. Sawai strives to educate about generic drugs and build up favorable branding among consumers through the use of various media including TV advertising.

Timely broadcasting of commercials and publicity

Sawai offers commercials, advertisements and publicity to enhance awareness of the Sawai brand, while shifting the focus from the economical advantages of generic drugs and their safety to the means for obtaining prescriptions in view of the recognition level and changes in relevant systems. This strategic policy aims to establish among consumers a strong association of generic drugs with Sawai while gradually deepening the general recognition of generic drugs.

From "knowing" to "choosing" stage – Third series of TV commercials aired

We started a third series of TV commercials in spring 2006. These commercials focus on how to actually have generic drugs prescribed for patients, which is a frequent request from patients.

Concurrent newspaper advertisements in 47 newspapers nationwide on April 1

On April 1, 2006, when the prescription forms were modified, Sawai ran a full-page advertisement in 47 newspapers including the national Yomiuri, Asahi and Nikkei and regional ones from Hokkaido (northern end) to Okinawa (southern end). This initiative sent a powerful message to announce the arrival of a "New era when patients themselves choose their own drugs."

Magazine advertisements to appeal to the social significance of the availability of generics

To make people understand that generic drugs are not only essential for patients but also socially meaningful to restrict medical care expenses, Sawai ran a series of article-style advertisements in Shukan Bunshun a weekly magazine that has a lot of readers among business people, from October to December 2005. The series introduced generic drugs by using examples of overseas and domestic issues.

Joint initiative with health insurance societies

For Japanese health insurance societies, a key concern is the reduction of medical expenses for their members. Accordingly, Sawai cooperates with many health insurance societies by distributing educational brochure and manga (comic)–style booklet, in which Sawai's image character Hideki Takahashi (an actor) explains various issues, and distributing the "Generic Drug Request Card," which should be submitted to medical institutions. The number of cooperative health insurance societies participating in these joint initiatives exceeds 150. We intend to increase the number of relationships with such cooperative societies.

A Generic Drug Request Card (left)

A manga (comic)–style booklet (right)
An educational brochure (center)

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 government measures, an increase in medical expenses related to the aging population has tightened Japanese public finances for medical insurance. While improving the efficiency of medicines and raising people's cost consciousness have simultaneously become national priorities, a further increase in the cost burden to individuals is feared. Accordingly, increasing the number of prescriptions for inexpensive generic drugs could be an effective countermeasure.

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. The modification of prescription forms that was implemented in April 2006 should accelerate this trend and better reflect patients' drug selection, thereby further encouraging the use of generic drugs.

The Sawai Group believes that it has a social mission to encourage the widespread use of generic drugs, which has lagged behind Western countries, and to contribute to the reduction of 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 in the operating environment and concurrently establish the company as a leading manufacturer of generic drugs by ensuring quality, good product information and stable supply 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 and intends to distribute performance-based dividends with a payout ratio of 30% as a basic criterion.

We will appropriate retained earnings to fund R&D expenditures to expand business and manufacturing facilities while solidifying our financial structure.

2. Analysis of Financial Position and Operational Results

(1) Financial Position

Total assets as of March 31, 2006 were ¥51,997 million, an increase of ¥9,988 million from the end of the previous fiscal year. Total current assets increased ¥5,801 million to ¥29,274 million, and total fixed assets rose ¥4,186 million to ¥22,722 million.

The major factors for the increase of current assets were a rise of ¥1,866 million in trade notes and accounts receivable resulting from higher sales and an increase of ¥2,589 million in inventories in anticipation of a sharp sales increase after the modification of the prescription forms.

Fixed assets rose principally due to an increase of ¥4,019 million in construction in progress related to the construction of the new head office and a laboratory.

Total liabilities as of March 31, 2006 were ¥23,163 million, an increase of ¥6,123 million from the previous year. This rise resulted mainly from an increase of ¥2,589 million in other accounts payable related to the construction expenses of the new head office and a laboratory, an increase of ¥1,858 million in income taxes payable reflecting the considerable increase in net income for the year and an increase of ¥1,617 million in long-term debt.

Total shareholders' equity rose ¥2,574 million to ¥27,542 million as of March 31, 2006. A major contributor to this rise was an increase of ¥2,433 million in retained earnings arising from a considerable expansion in net income. As a result, the equity ratio of the Company fell 6.4 percentage points to 53.0% as of March 31, 2006.

(2) Operational Results

During the year ended March 31, 2006, the Japanese economy gradually recovered against a backdrop of increasing personal consumption and an expansion of civil-sector investment due to improved corporate profits supported by strong demand in Japan and overseas, despite several uncertain factors such as the sharp rise in crude oil prices.

In the prescription drug industry, various measures were taken to limit medical expenses and drug expenditures given the increase in the aging population and tighter public budget for medical insurance. Meanwhile, to control costs, some administrative encouragement for the further use of affordable generic drugs was introduced. One measure was the modification of prescription forms implemented in April 2006, which should enhance the dissemination of generic drugs.

In this operating environment, the Sawai Group appealed to the public to increase the use of generic drugs, which should contribute to a reduction in patient copayment and overall medical expenses in the national budget. At the same time, we conducted aggressive marketing activities and PR campaigns to stress quality, medical information and the stable supply of our products.

Regarding operating performance for the year ended March 31, 2006 (fiscal 2005), we successfully increased the number of foundation hospital customers in a favourable business environment with the modification of the prescription forms. Net sales increased 14.3% from the previous year to ¥26,616 million, as the effect from reluctance in buying, which is often seen before an NHI price revision, was insignificant. The gross margin improved 3.1 percentage points mainly due to the increase in net sales and a decline in the cost of manufacturing relative to net sales, thanks to the improved ratio of operation.

Reflecting these circumstances, operating income for fiscal 2005 surged 121.2% to ¥4,299 million and ordinary income soared 114.5% to ¥4,040 million. As a result, the Company recorded net income of ¥3,009 million (compared with a net loss of ¥349 million for fiscal 2004), reflecting extraordinary profit of ¥1,128 million that more than offset extraordinary loss of ¥126 million, and a considerable decrease of ¥2,136 million year over year. Accordingly, net sales, operating income, ordinary income and net income, all financial indicators, resulted in record highs for the Company.

(3) Cash Flows

Cash and cash equivalents for year ended March 31, 2006 increased ¥1,593 million to ¥6,832 million compared with the previous fiscal year.

The cash flow situation and cash flow factors for fiscal 2005 were as follows:

(Cash flows from operating activities)

Net cash provided by operating activities decreased ¥234 million, or 11.1% to ¥1,885 million. This reflected an increase of ¥2,589 million in inventories in anticipation of a sharp sales increase after the modification of the prescription forms, a decline of ¥508 million in other accounts payable, resulting from the payment of ¥1,652 million as a special premium due to the disaffiliation from the Osaka Pharmaceutical Business Employees' Pension Fund paid in May 2005, and ¥49 million in income taxes paid, despite ¥5,043 million in income before income taxes (an increase of ¥5,422 million from the previous year).

(Cash flows from investing activities)

Net cash used in investing activities increased ¥510 million, or 28.3%, to ¥2,313 million.

This decrease principally reflected such factors as ¥2,515 million for the purchase of property, plant and equipment (principally owing to second-phase construction work at the Sanda Factory), ¥753 million for the purchase of intangible assets from Nihon Schering K.K. Japan (taking over the manufacture of Caprosin and two other drug items) and ¥712 million in proceeds from the sale of a real-estate-in-trust beneficial interest.

(Cash flows from financing activities)

Net cash provided by financing activities rose ¥1,571 million, or 348.6%, to ¥2,021 million.

Major contributors to this increase were ¥1,227 million in proceeds from the payment of minority shareholders due to the acceptance of an investment by Sumitomo Corporation and SUMMIT MEDI-CHEM, LTD. for Medisa Shinnyaku Inc. and an increase in proceeds from long-term and short-term bank loans. As of March 31, 2006, Sawai has participated in a commitment line syndication of ¥10 billion for which the lead manager is Sumitomo Mitsui Banking Corporation. This initiative should flexibly prepare us for a possible demand for working capital.

(4) Present Situation and Future Prospects: Our Strategy

The ongoing reforms of the medical insurance system will likely be promoted to improve the efficiencies and appropriateness of medical expenses, making our business environment more stringent. A decline in unit sales prices is also anticipated as a result of the NHI price revision conducted in April 2006. On the other hand, several stimulating measures were taken to encourage the further use of affordable and quality generic drugs. In particular, we expect a considerable increase in sales at dispensing pharmacies as a result of the modification of prescription forms implemented in April 2006.

Sawai will engage in aggressive PR and marketing activities to exploit the new market and promote highly profitable products by emphasizing quality, information and the stable supply of our products. We will strive to achieve a level of operating performance that completely offsets the increase in expenses for the consolidation and transfer of the head office and laboratories and to provide a full lineup of generic drugs with the all the strengths of the original drugs. In addition, we will continue to raise the operating performance ratio of the Kanto Factory, which was transferred to the Company from Nihon Schering K.K. Japan in October 2005.

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 their 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 to pay for health care has been increasing.

In July 2004, the calculation coefficient used to price generic drug prices was reduced from 0.8 to 0.7 times the price of original drugs, causing, together with the biennial NHI price revision, a negative effect on our sales. On the other hand, several stimulating measures were taken to encourage the further use of generic drugs, including the April 2004 transition of national hospitals and national university hospitals to independent administrative entities as a measure to improve efficiencies in medical expenses and the increasing adoption of the Diagnosis Procedure Combination (DPC) system, a fixed inpatient payment system, by advanced treatment hospitals. Furthermore, the innovative modification of prescription forms that was implemented in April 2006 is highly expected to increase patient selection of generic drugs. In addition to the revaluation of quality, the Ministry of Health, Labor and Welfare (MHLW) provided instructions to the industry with regard to the supply standards for generic drugs: 1) to get approval for a full lineup with the all strengths of the original drugs for the generic drugs stated in the NHI price listing and 2) to establish a stable supply system nationwide. We must respond to and satisfy these requirements.

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

The Sawai Group endeavours to flexibly cope with these industry 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) Continue educational activities for generic drugs, which will help reduce medical expenses and decrease prescription costs to patients, and raise our R&D capability and production capacity for an increasing market share and expanding demand for our high-quality and cost-effective generic drug products.
(2) Establish a sales system to quickly respond to new demands for generic drugs and the sophisticated needs of 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, and fully satisfy the supply standard guidelines.
(4) Build and operate a collaborative manufacturing-sales system that is directly linked to market needs and work to reduce production lead times to cope with providing a wide range of products and the expected increase in future demand.
(5) Reinforce our profitability by promoting rationalization measures, such as proper staffing, and improving productivity and efficiency in developmental operations.
(6) Nurture human resources and steadily promote the personnel system, including the implementation of a performance-based evaluation system.
(7) Rebuild a companywide production system to raise the operating performance ratio of the Kanto Factory, which was transferred to the Company from Nihon Schering K.K. Japan in October 2005.

4. Operational and Other Risks

(1) Restrictions from the revised Pharmaceutical Affairs Law

The Sawai Group manufactures and sells pharmaceuticals. Accordingly, our manufacturing and sales activities are subject to the necessary authorizations, licenses, registrations and designations by the director of the Regional Bureau of Health and Welfare and the governors and other authorities of related prefectures, mainly under the relevant provisions of the Pharmaceutical Affairs Law. Should the Company fail to comply with or violate such legal provisions, the

Company's business performance could be affected by the suspension of its business activities or the withdrawal of licenses or other authorizations 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 of 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, or "supplementary listing" for generic drugs, is required.

To ensure that the market price of drugs reflects the reasonable streamlining of medical expenses, the MHLW conducts investigations of drug pricing and makes periodic revisions (every two years since 1988) to the NHI Drug Price Standard, resulting in reduced prices for most drugs. Other drug prices in the market tend to decrease along with the reduced NHI drug prices. In particular, price competition tends to intensify with generic drugs because several manufacturers often make supplementary listings of new products when the patent 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 increased after the April 2002 revision when the GE Rule stating that the lowest price for generic drugs shall be maintained at 40% of the price for the original branded drugs was abolished.

The NHI price revision on April 1, 2006 resulted in an average price reduction of 6.7% in the pharmaceutical industry, whereas the Company's average price reduction for generic drugs was 9.6%.

For generic drugs, the calculation coefficient has been reduced from 0.8 to 0.7 times the price of original drugs. 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 law suits can be filed against the Sawai Group by any original drug manufacturers. Although we endeavour to develop new products with our original technology and unique image to conduct thorough investigations of the industry in view of the Unfair Competition Prevention Law, the Company could face litigation 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 for 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 employees 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 our relationships with large hospitals.

(c) Effects of market competition and others

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

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

5. Research and Development Activities

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

During fiscal 2005, the Company obtained approval to manufacture 47 drugs, mainly for digestive and circulatory organs, and completed applications to manufacture and sell 55 drug products. R&D expenditures for the year totalled ¥2,241 million.

Consolidated Balance Sheets

March 31, 2006 and 2005

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Current Assets:			
Cash and time deposits (Note 10)	**¥ 6,832**	¥ 5,239	**$ 58,160**
Trade notes and accounts receivable	**12,080**	10,213	**102,834**
Allowance for doubtful receivables	**(18)**	(34)	**(153)**
	18,894	15,418	**160,841**
Inventories (Note 4)	**9,609**	7,019	**81,800**
Deferred income taxes (Note 8)	**532**	326	**4,529**
Other current assets	**240**	710	**2,043**
Total current assets	**29,275**	23,473	**249,213**
Investments and Long-term Receivables:			
Investment securities (Note 3)	**880**	913	**7,491**
Long-term loans	**256**	82	**2,179**
Long-term prepaid expenses	**111**	115	945
Real-estate-in-trust beneficial interest	**—**	656	**—**
Other investments and long-term receivables	**108**	118	**920**
	1,355	1,884	**11,535**
Allowance for doubtful receivables	**(31)**	(22)	**(264)**
Net investments and long-term receivables	1,324	1,862	11,271
Property, Plant and Equipment (Note 5) **:**			
Land	**4,444**	4,070	**37,831**
Buildings and structures	**15,361**	14,723	**130,765**
Machinery and equipment	**10,100**	9,579	**85,979**
Construction in progress	**4,050**	30	**34,477**
Other	**2,554**	2,277	**21,742**
	36,509	30,679	**310,794**
Accumulated depreciation	**(15,906)**	(14,609)	**(135,405)**
Net property, plant and equipment	**20,603**	16,070	**175,389**
Intangible Assets	**791**	229	**6,734**
Deferred Income Taxes (Note 8)	**4**	375	**34**
	¥51,997	¥42,009	**$442,641**

The accompanying notes to consolidated financial statements are an integral part of these statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Current Liabilities:			
Bank loans (Note 5)	**¥ 2,300**	¥ 3,470	**$ 19,579**
Current portion of long-term debt (Note 5)	**2,128**	1,235	**18,115**
Trade notes and accounts payable	**4,855**	4,046	**41,330**
Other accounts payable	**6,376**	3,787	**54,278**
Accrued bonuses	**564**	463	**4,801**
Accrued expenses	**104**	336	**885**
Income taxes payable	**1,919**	61	**16,336**
Reserve for sales returns	**54**	41	**460**
Other current liabilities	**52**	22	**443**
Total current liabilities	**18,352**	13,461	**156,227**
Long-term Liabilities:			
Long-term debt (Note 5)	**3,837**	2,219	**32,664**
Employees' retirement benefits (Note 6)	**—**	595	**—**
Directors and corporate auditors' retirement benefits	**362**	351	**3,082**
Long-term deferred tax liabilities (Note 8)	**135**	—	**1,149**
Other long-term liabilities	**477**	414	**4,060**
Total long-term liabilities	**4,811**	3,579	**40,955**
Minority Interest	**1,291**	—	**10,990**
Shareholders' Equity (Note 7):			
Common stock			
Authorized -38,800,000 shares			
Issued and outstanding			
-13,652,000 shares in 2006 and 2005	**7,022**	7,022	**59,777**
Capital surplus	**7,346**	7,346	**62,536**
Retained earnings	**12,868**	10,434	**109,543**
Net unrealized holding gains on securities	**307**	167	**2,614**
Treasury stock-48 shares in 2006 and 2005	**(0)**	(0)	**(1)**
Total shareholders' equity	**27,543**	24,969	**234,469**
	¥51,997	¥42,009	**$442,641**

Consolidated Statements of Operations

For the Years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Net Sales	**¥26,616**	¥23,277	¥22,548	**$226,577**
Cost of Sales	**13,265**	12,317	11,313	**112,922**
Gross Profit	**13,351**	10,960	11,235	**113,655**
Selling, General and Administrative Expenses	**9,052**	9,016	7,338	**77,058**
Operating Income	**4,299**	1,944	3,897	**36,597**
Other Income (Expenses):				
Interest and dividend income	**10**	7	8	**85**
Interest expense	**(68)**	(67)	(94)	**(579)**
Gain on sale of securities, net	**35**	23	10	**298**
Gain on real-estate-in-trust beneficial interest	**48**	48	—	**409**
Gain on sale of real-estate-in-trust beneficial interest	**57**	—	—	**485**
Loss on disposal of inventories	**(218)**	(119)	(140)	**(1,856)**
Expense for commitment line setup	**(77)**	—	—	**(655)**
Gain on receipt of fixed assets (Note 11)	**675**	—	—	**5,746**
Gain on reversal of provision for employees' retirement benefits	**297**	—	—	**2,528**
Gain on transfer of product's approval	**100**	—	—	**851**
Gain on sale of investments in securities, net	**—**	—	90	**—**
Loss on transfer of shareholders' interest (Note 12)	**(63)**	—	—	**(536)**
Loss due to impairment of fixed assets (Note 13)	**(27)**	—	—	**(230)**
Loss on disposal of buildings and structures	**(36)**	(359)	—	**(306)**
Loss on sale of fixed assets	**—**	(251)	10	**—**
Special premium payment on separation from the composite pension fund	**—**	(1,653)	—	**—**
Other, net	**11**	48	(22)	**93**
	744	(2,323)	(138)	**6,333**
Income (Loss) before Income Taxes	**5,043**	(379)	3,759	**42,930**
Provision for Income Taxes:				
Current	**(1,830)**	(65)	(1,539)	**(15,578)**
Reversal of provision for income taxes (current)	**—**	66	—	**—**
Deferred	**(203)**	29	62	**(1,728)**
Net Income (Loss)	**¥ 3,010**	¥ (349)	¥ 2,282	**$ 25,624**

Per Share of Common Stock:

	Yen			U.S. dollars (Note 1)
Net income (loss) – basic	**¥217.08**	¥(27.80)	¥178.64	**$1.85**
Net income – diluted	**—**	—	178.22	**—**
Dividends	**50.00**	40.00	40.00	**0.43**

The accompanying notes to consolidated financial statements are an integral part of these statements.

Consolidated Statements of Shareholders' Equity

For the Years ended March 31, 2006, 2005 and 2004

		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, 2003	11,898,500	4,411	4,708	9,601	(18)	—
Exercise of stock purchase warrants	150,000	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	13,652,000	¥7,022	¥7,346	¥10,434	¥167	¥ (0)
Net income for the year				3,010		
Cash dividends paid at ¥50.00 per share				(546)		
Bonuses to directors and corporate auditors				(30)		
Net unrealized holding gains on securities					140	
Balance at March 31, 2006 (Note 7)	**13,652,000**	**¥7,022**	**¥7,346**	**¥12,868**	**¥307**	**¥ (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, 2005	$59,777	$62,536	$88,822	$1,422	$ (1)
Net income for the year			25,624		
Cash dividends paid at $0.43 per share			(4,648)		
Bonuses to directors and corporate auditors			(255)		
Net unrealized holding gains on securities				1,192	
Balance at March 31, 2006	**$59,777**	**$62,536**	**$109,543**	**$2,614**	**$ (1)**

The accompanying notes to consolidated financial statements are an integral part of these statements.

Consolidated Statements of Cash Flows

For the Years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Cash Flows from Operating Activities:				
Income (loss) before income taxes	**¥5,043**	¥ (379)	¥3,759	**$42,930**
Adjustments to reconcile income before income taxes to net cash provided by operating activities:				
Depreciation and amortization	**1,640**	1,329	1,253	**13,961**
Loss due to impairment of fixed assets	**27**	—	—	**230**
Interest and dividend income	**(10)**	(7)	(8)	**(85)**
Interest expense	**68**	67	94	**579**
Loss on disposal of buildings and structures	**36**	321	—	**306**
Loss on sale of fixed assets	**8**	251	10	**68**
Increase in trade notes and accounts receivable	**(1,867)**	(1,026)	(675)	**(15,893)**
Decrease (increase) in inventories	**(2,589)**	63	(787)	**(22,040)**
Increase (decrease) in trade notes and accounts payable	**1,039**	914	(191)	**8,845**
Payment of bonuses to directors and corporate auditors	**(30)**	(40)	(35)	**(255)**
Increase in employees' retirement benefits	**(595)**	100	108	**(5,065)**
Increase in other accounts payable	**(509)**	1,529	365	**(4,333)**
Gain on receipt of fixed assets	**(675)**	—	—	**(5,746)**
Loss on transfer of shareholders' interest	**63**	—	—	**536**
Other	**337**	(16)	(12)	**2,868**
Sub-total	**1,986**	3,106	3,881	**16,906**
Interest and dividends received	**9**	8	5	**77**
Interest paid	**(62)**	(65)	(99)	**(528)**
Income taxes paid	**(49)**	(929)	(1,635)	**(417)**
Net cash provided by operating activities	**1,884**	2,120	2,152	**16,038**
Cash Flows from Investing Activities:				
Proceeds from time deposits	**—**	—	430	**—**
Payments for purchase of property, plant and equipment	**(2,515)**	(2,036)	(3,411)	**(21,410)**
Proceeds from sale of property, plant and equipment	**8**	786	—	**68**
Payments for purchase of securities	**(74)**	(523)	(129)	**(630)**
Proceeds from sale of securities	**379**	183	376	**3,226**
Payments for purchase of real-estate-in-trust beneficial interest	**—**	—	(656)	**—**
Proceeds from sale of real-estate-in-trust beneficial interest	**712**	—	—	**6,061**
Proceeds from transfer of product's approval	**100**	—	—	**851**
Payments for long-term loan	**(180)**	(82)	(64)	**(1,532)**
Proceeds from collection of long-term loan	**6**	62	—	**51**
Payments for purchase of intangible assets	**(754)**	(193)	(59)	**(6,419)**
Other	**5**	—	6	**44**
Net cash used in investing activities	**(2,313)**	(1,803)	(3,507)	**(19,690)**
Cash Flows from Financing Activities:				
Net increase in bank loans	**(1,170)**	1,270	200	**(9,960)**
Proceeds from long-term debt	**4,500**	2,100	430	**38,308**
Repayment of long-term debt	**(1,989)**	(2,410)	(2,408)	**(16,932)**
Proceeds from issuance of stock	**—**	37	5,184	**—**
Payments for purchase of treasury stock	**—**	(0)	—	**—**
Proceeds from payment of minority shareholders	**1,227**	—	—	**10,445**
Cash dividends paid	**(546)**	(546)	(479)	**(4,648)**
Net cash provided by financing activities	**2,022**	451	2,927	**17,213**
Net increase in cash and cash equivalents	**1,593**	768	1,572	**13,561**
Cash and cash equivalents at beginning of year	**5,239**	4,471	2,899	**44,599**
Cash and cash equivalents at end of year (Note 10)	**¥6,832**	¥5,239	¥4,471	**$58,160**

The accompanying notes to consolidated financial statements are an integral part of these 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, 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 from 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 Companies 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 is included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2006, which was ¥117.47 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 the 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 ("trading securities"), (b) debt securities intended to be held to maturity ("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 ("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 the 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 the fair value of an individual security to below cost 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 expenses when incurred.

(g) Impairment of fixed assets
For the year ended March 31, 2006, the Company and its consolidated subsidiaries have adopted 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 Standard Board of Japan on October 31, 2003).

As a result of adopting these new accounting standards, a loss on impairment of fixed assets in the amount of ¥27 million ($230 thousand) was recognized; income before income taxes decreased by the same amount.

(h) Accrued bonuses
The Company and its consolidated subsidiaries accrue amounts for 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, prefectural 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) Employee
The Company revised its tax qualified pension plan and implemented a new defined contribution plan.

(ii) Directors and corporate auditors
The Companies' liability for the 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 and the development of new products, including basic research and fundamental development costs, are charged to income in the period incurred and amounted to ¥ 2,241 million ($19,077 thousand), ¥ 2,524 million and ¥ 2,261 million for the years ended March 31, 2006, 2005 and 2004, 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 with the 2006 presentation.

3. Securities

(a) The following tables summarize acquisition costs and book values (fair values) of available-for-sale securities with available fair values as of March 31, 2006.

(1)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	¥794	¥519	$2,341	$6,759	$4,418

(b) Total sales of available-for-sale securities in the year ended March 31, 2006 amounted to ¥379 million ($3,226 thousand) and the related gains and losses amounted to ¥43 million ($366 thousand) and ¥8 million ($68 thousand), respectively.

(c) Book values of securities with no available fair values as of March 31, 2006 are as follows:

Unlisted equity securities ¥86 million ($732 thousand)

(d) 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.

(1) Securities with book values exceeding acquisition costs:

	Millions of yen		
	Acquisition cost	Book value	Difference
Equity securities	¥275	¥558	¥283

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

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

(e) Total sales of available-for-sale securities in the year ended March 31, 2005 amounted to ¥183 million and the related gains and losses amounted to ¥35 million and ¥12 million, respectively.

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

Unlisted equity securities ¥318 million
Other ¥28 million

4. Inventories

Inventories at March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Finished goods and merchandise	**¥5,117**	¥3,619	**$43,560**
Work-in-process	**2,248**	1,521	**19,137**
Raw materials and supplies	**2,244**	1,879	**19,103**
Total	**¥9,609**	¥7,019	**$81,800**

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

Short-term bank loans consist mainly of unsecured bank loans with weighted average interest rates of 0.459% per annum at March 31, 2006 and 0.715% per annum at March 31, 2005.

Long-term debt at March 31, 2006 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Loans from banks and other public corporations, due 2006 - 2010, interest 0.48% - 2.0%		
Secured	¥4,919	$41,875
Unsecured	1,046	8,904
	5,965	50,779
Current portion of long-term debt	2,128	18,115
	¥3,837	$32,664

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

	Millions of yen
Loans from banks and other public corporations, due 2006 - 2010, interest 0.53% - 3.3%	
Secured	¥2,008
Unsecured	1,446
	3,454
Current portion of long-term debt	1,235
	¥2,219

The aggregate annual maturities of long-term debt outstanding at March 31, 2006 were as follows:

March 31	Millions of yen	Thousands of U.S. dollars
2006	¥2,128	$18,115
2007	1,987	16,915
2008	818	6,964
2009	718	6,112
2010	314	2,673
Total	¥5,965	$50,779

At March 31, 2006, assets pledged as collateral for secured long-term debt, including current portions, were as follows:

	Millions of yen	Thousands of U.S. dollars
Property, plant and equipment, net of accumulated depreciation	¥5,153	$43,867

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

	Millions of yen
Property, plant and equipment, net of accumulated depreciation	¥5,545

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

6. Employees' Retirement Benefits

The liability for employees' retirement benefits at March 31, 2006 and 2005 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Projected retirement benefit obligation	**¥—**	¥(3,188)	**$—**
Plan assets	**—**	2,349	**—**
Unfunded retirement benefit obligation	**—**	(839)	**—**
Unrecognized actuarial differences	**—**	244	**—**
Liability for retirement benefits	**¥—**	¥ (595)	**$—**

The Company revised its tax qualified pension plan and implemented a new defined contribution plan. As a result of these changes, a settlement profit of ¥297 million ($2,528 thousand) was recognized as income for the year ended March 31, 2006.

	Millions of yen	Thousands of U.S. dollars
Decrease in projected benefit obligation	¥(3,041)	$(25,887)
Decrease in plan assets	2,569	21,869
Unrecognized actuarial loss	175	1,490
Decrease in reserve for employees' retirement benefits	¥ (297)	$ (2,528)

Assets in the amount of ¥2,569 million ($21,869 thousand) will be contributed to the defined contribution pension plan for 4 years. The unpaid amount of ¥42 million ($358 thousand) was recorded in other current liabilities and long-term liabilities in 2006.

Retirement benefit expenses for the years ended March 31, 2006, 2005 and 2004 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Service cost	**¥258**	¥353	¥330	**$2,196**
Interest cost	**32**	59	65	**273**
Expected return on plan assets	**(29)**	(52)	(40)	**(247)**
Amortization of actuarial differences	**69**	139	153	**587**
Retirement benefit expenses	**¥330**	¥499	¥508	**$2,809**

The assumptions and bases used for the calculation of the retirement benefit obligation at March 31, 2005 was 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 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 the exercise of warrants includes consideration for warrant rights, which should be included in capital surplus, the increase in the capital surplus is larger than the increase in the common stock.

The Commercial Code of Japan 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 shareholders' 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 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 23, 2006, the Company's shareholders approved the payment of year-end cash dividends of ¥35 ($0.30) per share totaling ¥478 million ($4,069 thousand) to the Company's shareholders of record as of March 31, 2006 and the payment of bonuses totaling ¥46 million ($392 thousand) to the Company's directors.

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, 2006, 2005 and 2004.

Significant components of deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Unrealized gains on land	**¥ 29**	¥ 219	**$ 247**
Retirement benefits for employees	**—**	243	**—**
Retirement benefits for directors and corporate auditors	**148**	143	**1,260**
Unrealized gains on inventories	**122**	83	**1,039**
Accrued bonuses to employees	**231**	189	**1,966**
Amount in excess of depreciation and amortization	**71**	—	**604**
Operating loss carryforwards	**—**	32	**—**
Loss due to impairment of fixed assets	**198**	—	**1,686**
Loss on sales of land	**—**	51	**—**
Loss on disposal of buildings and structures	**147**	147	**1,251**
Enterprise taxes	**170**	9	**1,447**
Less valuation allowance	**(345)**	(146)	**(2,937)**
Other	**77**	81	**656**
Total deferred tax assets	**848**	1,051	**7,219**
Deferred tax liabilities:			
Reserve for deferred gains on sales of fixed assets	**(136)**	(136)	**(1,158)**
Reserve for special depreciation	**(99)**	(99)	**(843)**
Net unrealized holding gains on securities	**(212)**	(115)	**(1,804)**
Total deferred tax liabilities	**(447)**	(350)	**(3,805)**
Net deferred tax assets	**¥401**	¥ 701	**$3,414**

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 year ended March 31, 2005. There was no significant difference between the statutory income tax rate and the effective income tax rate for the years ended March 31, 2006 and 2004.

	2005
Statutory income tax rate	40.87 %
Non-deductible expenses	(6.87)
Per capita inhabitant tax	(8.33)
Special tax credits	2.87
Valuation allowance	(38.74)
Reversal of provision for income tax (current)	17.43
Other	0.53
Effective income tax rate	7.76 %

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, and operating income and income before income taxes each decreased by the same amount.

9. Leases

(a) Finance leases as lessee

At March 31, 2006 and 2005, original lease obligations for machinery and equipment and other assets under non-capitalized finance leases were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Original lease obligations, including finance charges	**¥770**	¥736	**$6,555**

Lease obligations under non-capitalized finance leases, including finance charges, remaining at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Payments due within one year	**¥147**	¥153	**$1,251**
Payments due after one year	**217**	295	**1,847**
Total	**¥364**	¥448	**$3,098**

Leases payments under such leases for the years ended March 31, 2006, 2005 and 2004 are ¥158 million ($1,345 thousand), ¥155 million and ¥102 million, respectively.

(b) Operating leases as lessee

Lease obligations under operating leases, remaining at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Payments due within one year	**¥14**	¥20	**$119**
Payments due after one year	**2**	16	**17**
Total	**¥16**	¥36	**$136**

10. Segment Information

The Companies operate primarily in the pharmaceutical supplies industry in Japan. Accordingly, there is no presentation of information by business segment.

11. Gains on receipt of fixed assets

On October 1, 2006, the Company will take over the Mobara factory from Nihon Schering K.K. ("Nihon Schering").

12. Equity in earnings of non-consolidated subsidiaries and associated companies

Medisa Shinyaku Inc. increased allocation of new stocks to a third party.

13. Loss on Impairment of fixed assets

Due to the recent decline in land prices and the sluggish rental market, the carrying values of the certain assets have been reduced to their recoverable amounts. Accordingly, an impairment loss of ¥27 million ($230 thousand), which consisted of ¥5 million ($43 thousand) on buildings and ¥22 million ($187 thousand) on land, was recognized in the year ended March 31, 2006. Assets are grouped by one segment, which is managed appropriately. The recoverable amounts of assets are their net realized values calculated from appraised values.

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, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended March 31, 2006, 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, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the Company and its consolidated subsidiaries' adoption of the new accounting standard for impairment of fixed assets, effective April 1,2005, discussed in Note 2 of the notes to the consolidated financial statements.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 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 23, 2006

KPMG AZSA & Co.

Board of Directors / Corporate Data

Board of Directors (As of June 23, 2006)

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, 2006)

Head Office

4-25, Akagawa 1-chome, Asahi-ku,
Osaka 535-0005, Japan
(From December 1, 2006)
2-30, Miyahara 5-chome, Yodogawa-ku,
Osaka 532-0003, Japan

Established

1929

Stated Capital

¥7,022 million

Number of Shares Outstanding

13,652,000

Number of Shareholders

9,113

Number of Employees

626

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, Kanto

Laboratories

Osaka Laboratory
Research and Development Center
Pharmaceutical Research Center

Consolidated Subsidiary

Medisa Shinyaku Inc.

URL

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

Sawai Pharmaceutical Co., Ltd.
4-25, Akagawa 1-chome, Asahi-ku, Osaka 535-0005, Japan
URL http://www.sawai.co.jp/

Printed in Japan