sawai

ANNUAL REPORT 2007

For the year ended March 31, 2007

"Patients first"

Profile

Corporate Philosophy

1. "Working for the healthy lives of people through our heartful products."
   — SAWAI MISSION

2. "Pursuing creativity and growing with society via innovation and harmony."
   — SAWAI CHALLENGE

3. "Being a socially indispensable presence through contributing to our stakeholders."
   — SAWAI DESIRE

established in April 2007

Since 1965, Sawai has consistently supplied ethical drugs for 42 years. At present, Sawai is highly acclaimed as a leading generic drug manufacturer in Japan. Sawai's products are adopted and dispensed in about 81% of hospitals, 38% of dispensaries and 73% of health insurance pharmacies nationwide. Sawai now has five production factories in Japan and produces a wide range of generic drugs at these factories as well as at two consolidated subsidiaries for supply in the Japanese market.

Given a business environment where generic drugs will likely be disseminated rapidly, we focus much effort on establishing the Sawai brand through routine activities to be a generic drug company that is trusted and preferred by patients and medical experts.

Sawai recently formulated the Sawai Code of Conduct to ensure that all employees understand the Corporate Philosophy and properly relay its meaning to customers and medical experts. As a result, employees at Sawai endeavor to perform their respective social duties with a sense of mission and pride while increasing the Company's centripetal force by deepening everyone's awareness of the Code of Conduct.

"Patients first" is the primary corporate mission of Sawai.

Contents

A CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements regarding the Company's plans, outlook, strategies and results for the future. All forward-looking statements are based on judgments derived from the information available to the Company at the time of publication.

Certain risks and uncertainties could cause the Company's actual results to differ materially from any projections presented in this report. These risks and uncertainties include, but are not limited to, the economic circumstances surrounding the Company's businesses, competitive pressures, changes in related laws and regulations, status of product development programs, and changes in exchange rates.

Sawai Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Financial Highlights

For the Years ended March 31, 2007, 2006 and 2005

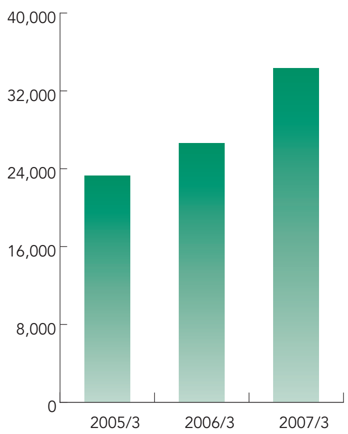
	Millions of yen			Thousands of U.S. dollars
Year ended March 31	**2007**	2006	2005	**2007**
Net sales	**¥34,317**	¥26,616	¥23,277	**$290,600**
Operating income	**4,693**	4,299	1,944	**39,741**
Net income (loss)	**2,260**	3,010	(349)	**19,138**
Net assets	**39,321**	27,543	24,969	**332,975**
Total assets	**67,827**	51,997	42,009	**574,367**
Research and development (R&D) expenses	**3,085**	2,241	2,524	**26,124**
Capital expenditures	**6,887**	5,359	2,764	**58,320**
Depreciation and amortization	**1,964**	1,640	1,329	**16,631**
	%			
Ratio of R&D expenses to sales	**9.0**	8.4	10.8	
Return on equity	**6.9**	11.5	(1.4)	
Shareholders' equity to total assets	**55.8**	53.0	59.4	
Amounts per common share:	Yen			U.S. dollars
Net income (loss) - basic	**¥ 157.67**	¥ 217.08	¥ (27.80)	**$ 1.34**
Net income - diluted	—	—	—	—
Cash dividends applicable to period	**55.00**	50.00	40.00	**0.47**
Net assets	**2,408.42**	2,014.11	1,826.76	**20.39**

Note: 1. The U.S. dollars amounts represent translations of Japanese yen for convenience only at the rate of ¥118.09 = $1.00, the rate prevailing on March 31, 2007.

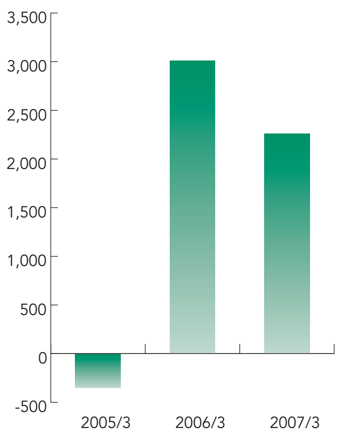
2. Diluted net income per common share is not disclosed in 2007 and 2006 because there were no potential common stock and in 2005 due to the loss.

3. Net assets as of 2007 include minority shareholders' interest due to the application of the Japanese Corporate Law.

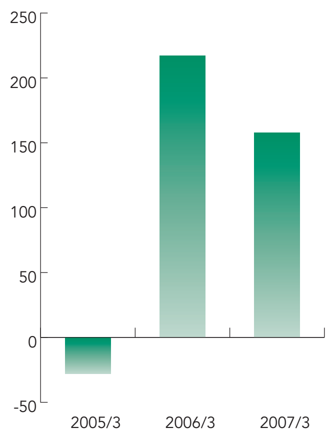
Net Sales (Millions of yen)



Net Income(Loss) (Millions of yen)



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



To Our Shareholders

Operating Results and Business Environment for the Year under Review

During the year ended March 31, 2007 (fiscal 2006), an institutional modification of the prescription forms was implemented by the Japanese government. Consequently, Sawai made proactive approaches to dispensing pharmacies and major hospitals, which often initially purchase generic drugs. As a result, net sales increased 28.9% from the previous year to ¥34,316 million, supported by efforts to engage new customers. Operating income for fiscal 2006 increased 9.2% year over year to ¥4,696 million, whereas net income decreased 24.9% to ¥2,259 million. The primary cause of the decline in net income was the recording of extraordinary profit in the preceding fiscal year in association with the transfer of a production factory from Nihon Schering K.K.

Trends in the Generic Drug Market in Japan

Holding down medical expenses and drug costs has become an urgent social issue, as the aging population has seriously tightened Japanese public finances for medical insurance. Given such circumstances, an NHI price revision in April 2006 resulted in an industry-wide average price reduction of 6.7%, whereas the modification of prescription forms was implemented in expectation of patients' preference for the increased use of generic drugs. Nevertheless, the pace of disseminating affordable generics seems stagnant, requiring the Japanese government to review new measures for the further use of generics. If separation of dispensing from prescription, which is prevalent in Western countries, is completely introduced in Japan, allowing every patient to use generic drugs routinely, the corporate performance of the overall generic drug industry might improve considerably. As the use of generic drugs not only reduces the patients' financial burden but also curtails the public funding required for medical expenses and drug costs, the Japanese government intends to increase the market share in volume from the current 17% to more than 30% by 2010. Moreover, the industry believes it is necessary to actively encourage the use of generic drugs and improve its relevant systems to that end.

The market scale of drug costs in Japan is currently about ¥7,800 billion, and the generic drug market accounts for ¥380 billion, or 5.2%, of the total drug cost market, on a value basis (Source: 2004 Japan Generic Pharmaceutical Manufacturers Association). Drug costs are expected to reach ¥8,700 billion for the year ending March 2009. Of this figure, the generic drug market is projected to account for ¥560 billion, or 6.5% of the total, and as high as 21.0% in terms of quantity (according to the Company's assumption).

Sawai's Positioning in the Japanese Generics Market

As the top brand in the industry, Sawai strives to make people aware of quality generics by providing pharmaceutical information and the stable provision of generic drugs, and conducts aggressive sales and marketing activities.

A strength of Sawai is the combination of rapid development capability for new products, an abundant product lineup and high product quality. Sawai has original internal standards for quality management that are more stringent than the national statutory standards. A second strength is the number of medical experts including medical representatives (MRs) who deliver useful information and researchers. Our well-trained MRs supply the latest generics information to physicians and hospitals, and also listen to the voices on the medical frontline for internal feedback. It is no exaggeration to say that Sawai's MRs are at the highest level in the industry in terms of staff number and quality. A third strength is our stable supply system. To ensure the consistent provision of drugs, we now have five factories nationwide with state-of-the-art facilities. If measures for the enhanced use of generic drugs are implemented, a rapid demand expansion is likely. We recognize, therefore, that satisfying such a rapid rise in demand would be our responsibility as a leading company in the industry. A fourth strength is the integrated management of the three aforementioned strengths, that is, our combined capabilities for development, lineup and quality, an excellent capability for information provision and collection and a stable supply system.

Meanwhile, we believe it is necessary for all employees to share a consciousness as the top brand of the leading generic drug company. Such a common awareness is expressed as" Patients First," the Sawai Pharmaceutical motto that also appears in its corporate philosophy. This awareness means the determination to ensure the sound lives of patients, grow with society and become a trustworthy corporation in society from an innovative viewpoint through the provision of quality generic drugs. Thus, we conduct Sawai's corporate branding activities by establishing a corporate structure that implements specific measures based on a common consciousness among all employees.

View on the Status and Performance of the Medium-Term Business Plan

The Medium-Term Business Plan sets forth management policies and action plans of the Company for the three-year period from April 2006 to March 2009. We endeavor to carry out four specific targets as stated in the Plan toward the goal of achieving ¥45.0 billion in consolidated net sales for the final year ending March 2009.

Establishing the Sawai brand

Capturing hospitals that have adopted the Diagnosis Procedure Combination (DPC) system as new customers

Reinforcing our production system

Strengthening R&D systems for the development of high-quality drugs

We recognize that the rise in sales during the year under review resulted from the full demonstration of Sawai's sales capability and marketing function. We improved the production system especially for the supply of high-value-added products for hospitals by completing the construction of a syringe formulation building in the Kanto Factory. We reinforced the R&D system by integrating the R&D functions at the head office and three laboratories systematically to speed up our product development and improve management efficiency.

Perspective

In April 2008, the next NHI price revision is scheduled to be implemented. Although a short-term reluctance to make purchases before the NHI price revision is likely, we anticipate expansion in demand in view of the government's study on additional measures for the enhanced use of generic drugs.

As a leading company in the industry, Sawai intends to promote diverse enlightenment activities about generic drugs and strengthen our overall corporate system to expand our business scale.

President

Hiroyuki Sawai

Medium-Term Business Plan and Corporate Activities

The Medium-Term Business Plan sets forth management policies and action plans of the Company for the three-year period from April 2006 to March 2009. Specifically, the four following basic policies are targeted in the Plan.

1. Establishing the Sawai brand
2. Capturing hospitals that have adopted the Diagnosis Procedure Combination (DPC) system as new customers
3. Reinforcing our production system
4. Strengthening R&D systems for the development of high-quality drugs

For the final year ending March 2009, we have set a goal to achieve ¥45.0 billion in consolidated net sales, and Sawai intends to solidify its position as a leading generic drug company.

Establishing the Sawai brand

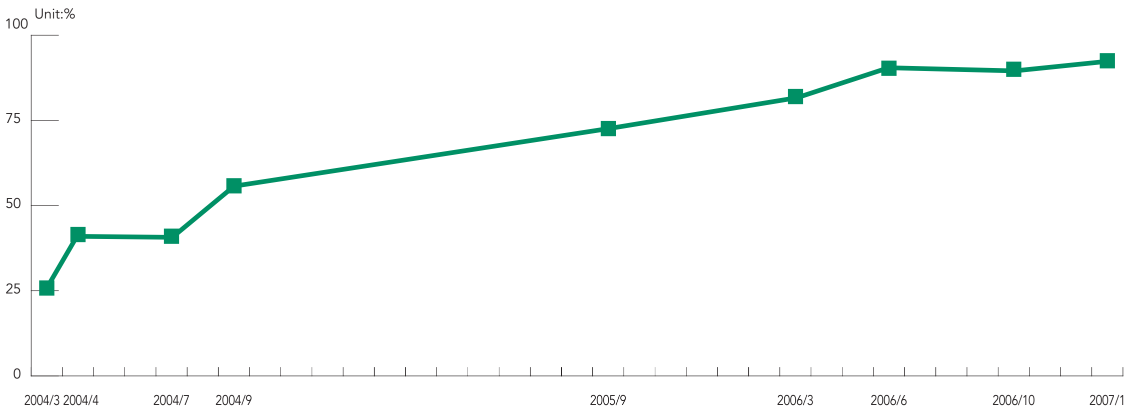
Sawai implements a variety of activities to solidify its ranking as the top brand in the generic drug industry. The dissemination of generic drugs in Japan has just begun although the recognition of such drugs is further along. A primary factor that explains these circumstances is the difference in consciousness toward generic drugs by Western countries and Japan.

In the United States, substitutive dispensing by pharmacists is authorized in almost all states. In addition, we have seen many requests for generic drug prescriptions by patients, supported by the confirmed benefits of outpatient medical agents by the Medicare public insurance system. The market share of generic drugs in the United States exceeds 50% on a volume basis and is about 10% on a value basis.

In the United Kingdom, where the history of generic drugs is long, the market share of generic drugs in the National Health Service (NHS) market has surpassed 55% on a volume basis and is about 25% on a value basis. In France and Spain, government-led activities to disseminate

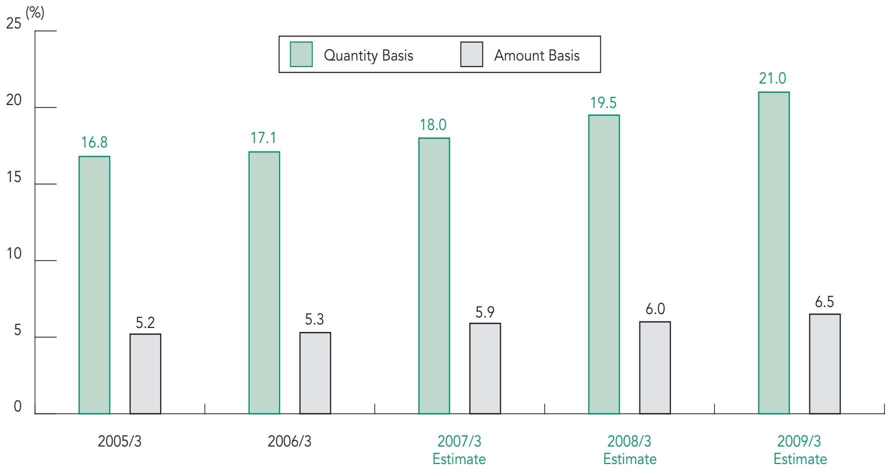
Sawai’s campaign for illuminating Generic Drugs

Acknowledgement Rate of Generic Drugs



Source: Before and after the Sawai's TV commercial broadcasting by Infoplant research

Japan's Generic Drugs Share in Quantity and Amount



generic drugs, primarily through active use promotion campaigns, have largely contributed to restricting increases in the drug costs paid from public finances.

In Japan, the dissemination of generic drugs has been limited despite the implementation of a modification of prescription forms in 2006, and governmental discussions will soon begin on whether to implement a system to completely separate dispensing from prescriptions. We believe it is Sawai's social responsibility to strive to provide patients and people with a knowledgeable appreciation of generic drugs ahead of the system improvement.

Under its" Patients first" corporate philosophy, Sawai actively holds seminars about medication and health nationwide, and regularly offers commercials, advertisements and publicity to enhance the awareness of generic drugs using national newspapers. Moreover, we proactively enhance the awareness of the Sawai brand via TV commercials.

MRs, who directly supply the latest generics information to physicians and hospitals, listen to the voices on the medical frontline for internal feedback. Sawai's MRs are highly evaluated among medical experts in terms of staff number and professional capability. Our well-trained MRs have contributed much to establishing the Sawai brand.

Sawai continues to conduct aggressive corporate activities by gaining a 30% share of the market for generic drugs.

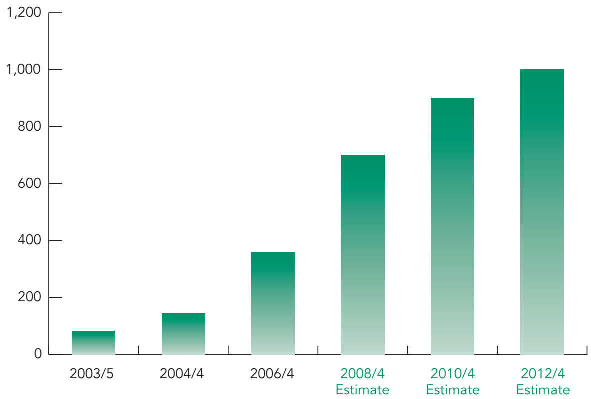
Capturing hospitals that have adopted the DPC system as new customers

Through a review of the medical treatment fee, a fixed in-patient payment system based on a comprehensive evaluation of medical services per day was implemented. This fixed payment system is known as Diagnosis Procedure Combination (DPC).

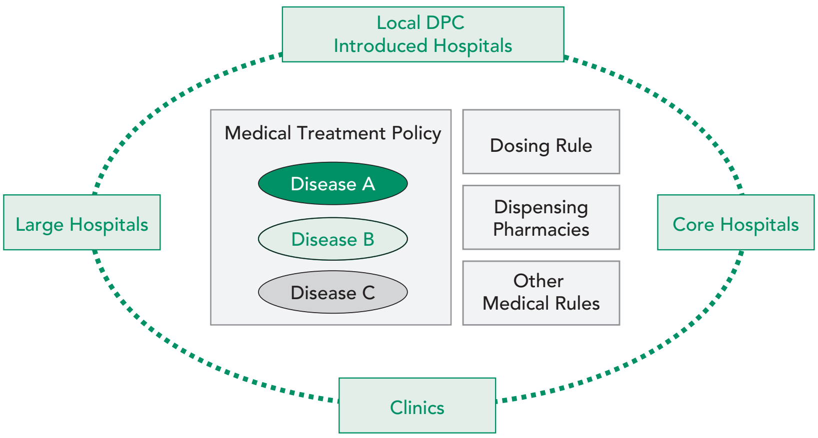
Using the increasing adoption of the DPC as an opportunity to extend the use of generic drugs at large hospitals, Sawai established the" Hospital Section" in April 2007 and increased the number of MRs to actively approach hospitals having implemented the DPC.

The implementation of the DPC has extended to 360 hospitals and is expected to increase to 1,000 by 2012. We intend to continuously secure good relations with such DPC hospitals through the disclosure of sufficient information about quality, safety and the stable supply system of our pharmaceutical products.

DPC Adoption in Hospitals



Japan's Local Medical Relationship



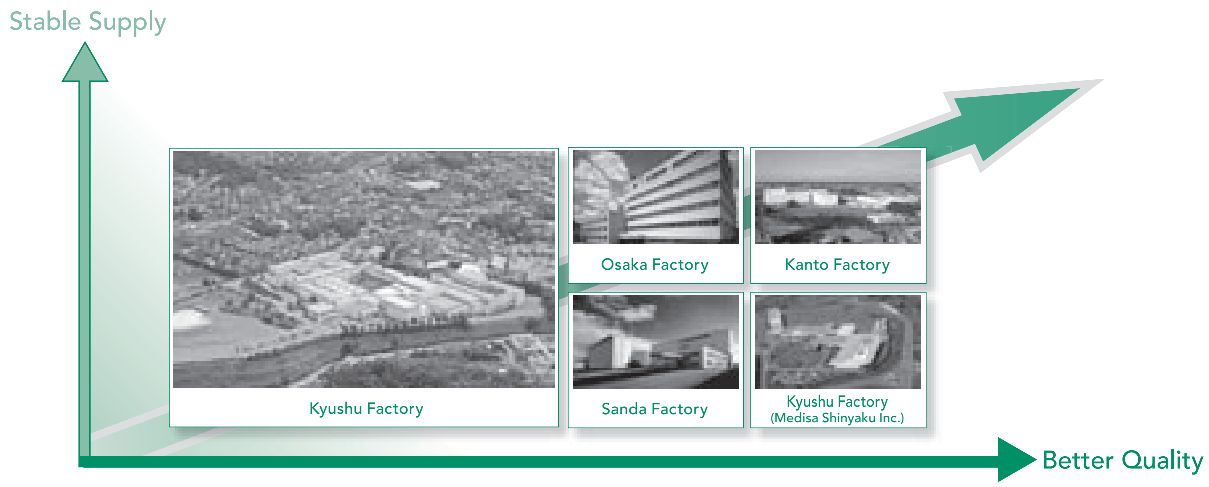
Reinforcing our production system

Sawai recognizes that its corporate mission is to ensure a stable supply of quality drugs to patients through medical institutions. To solidify its top position as a generic drug manufacturer, Sawai recognizes that it is important to provide a wide assortment of medicines in diverse medical fields and to ensure the stable provision of its quality pharmaceutical products.

We now have five factories nationwide with state-of-the-art facilities. We are reinforcing production facilities at each factory to prepare for future increases in production. In fiscal 2007, the third-stage extension of the Sanda Factory and the sixth-stage extension of the Medisa Shinyaku Factory are scheduled. In addition, we started full-fledged operation of syringe formulation building at the Kanto Factory in May 2007 to supply new dosage forms of syringes. This innovative line features the production of pre-filled syringe formulations, in which drug formulation and a filler are integrated. The pre-filled syringe formulations are highly desired by medical institutions.

Sawai recognizes that its corporate mission is to ensure a stable supply of quality drugs to patients as a leading generic drug company. We believe it is necessary to ensure and raise the sense of safety of medical institutions toward generics, without simply reinforcing production facilities to allow for supply-demand balance adjustments. We intend to always supply medical institutions and patients with high-quality pharmaceuticals in a wide variety of fields, through thorough quality management and reinforced production equipment.

■ **Sawai's Production Facilities**



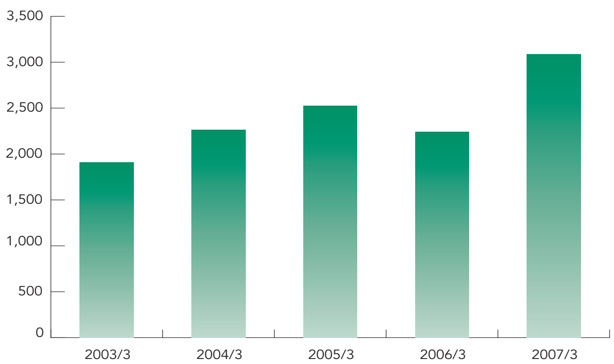
Strengthening R&D systems for the development of high-quality drugs

In October 2006, the Head Office and Laboratories building was completed. This integration of the head office and three laboratories not only improves efficiency in R&D operations but also speeds up managerial decision making, thereby increasing companywide management efficiency.

Our innovative R&D systems allow research staff to be dedicated to development activities at an early stage, allowing for careful design and formulation to ensure high-quality drugs. Sawai endeavors 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. In addition to the self-development of generic drugs, Sawai adheres to a flexible approach toward joint development with other companies.

In conclusion, all the employees of Sawai work for the good health of patients and to create a desirable medical environment under the shared" Patients first" spirit in promoting the Medium-Term Business Plan,

■ **R&D Expenditures (Millions of yen)**



Pharmaceutical analysis

Corporate Responsibility and Corporate Governance

The Company positions corporate governance as one of the most important management tasks. The Company's basic management guidance is to raise corporate value and maximize shareholders' interests from a long-term viewpoint through consistent growth in earnings. To this end, we aim to realize fair and highly transparent corporate management by establishing a management system that allows for appropriate and swift decision making and the execution of business operations in response to external environmental changes.

1. Systems for Decision Making on Management, Corporate Governance, Internal Control and Risk Management

The Company has a relatively small number of directors (13 with no external directors) and corporate auditors (four including three external corporate auditors). The Company has conventionally adopted the corporate auditor system in view of its corporate scale, business policies and other factors in a comprehensive manner.

Management believes that the current corporate auditor system is the best way to pursue managerial efficiency and legitimacy, taking into account the corporate scale. According to the system, a relatively small number of well-acquainted directors administer duties with a high ethical sense and careful attention to every section and business unit.

Apart from the Board of Directors and the Management Conference, the Company has enhanced its organizational flexibility via the revitalization of the Conference of Head Office General Managers to share ethical norms and information as a pharmaceutical company that manufactures drugs to save human lives at the managerial level. Raising companywide awareness is consistently pursued through audits of offices and branches by the Internal Inspection Department.

The consolidated subsidiaries of the Sawai are subject to advice and instructions on routine operations by the Management Planning Department, and to visits for inspection by the Internal Inspection Department. Medisa Shinyaku Inc. receives an accounting audit by the same Independent Auditors that audit the Company, and KAKEN SHOYAKU CO., LTD., is subject to consolidated accounting auditing.

The Company receives professional advice from several lawyers and other experts, as required, with regard to the daily operation of business and affairs, as a reference for decision-making by management.

As for risk management, information channels are concentrated with the General Manager of the Management Efficient Department, who is also a member of the Board of Directors, for faster and more precise information collection and immediate treatment of issues and actions.

Four members of the Internal Inspection Department are in charge of internal audits. In close cooperation with the Board of Corporate Auditors, the Department conducts audits of other departments, consolidated subsidiaries.

Remuneration to the respective directors is determined by the President and other key officers based on internal regulations, and the remuneration to officers is managed within the upper limit amount resolved by an ordinary general meeting of shareholders.

2. Initiatives to Reinforce Corporate Governance, as well as the Basic Concept and Improvement Status of the Internal Control System

The Board of Directors met 17 times in the year under review, including regular monthly meetings and extraordinary meetings. The smaller Board endeavors to communicate more effectively and provide routine checks and balances to ensure the responsible behavior of directors.

The Company determined the basic principles of its internal control system at the Board of Directors meeting held on May 12, 2006, to raise transparency in management and achieve accountability as a corporation. A summary of the basic principles follows:

1) Executives and employees of the Sawai Group shall comply with the Sawai Code of Conduct.

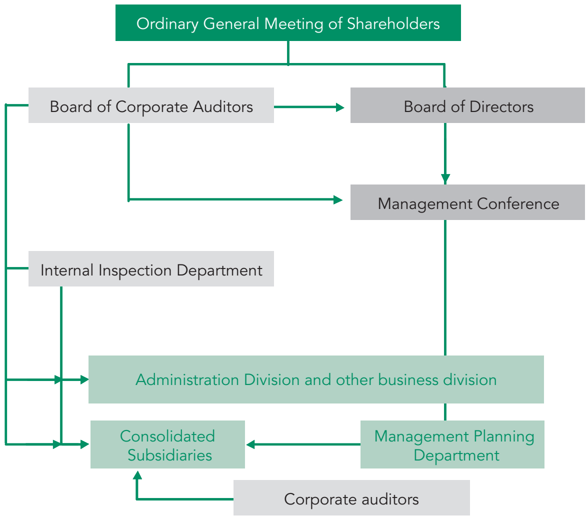
2) The Company shall improve and strengthen the supervision and verification systems while firmly adhering to the previous corporate governance system.

3) The Company shall review and respect internal regulations and establish the Compliance Committee to improve and solidify its business execution system. Moreover, the Company shall establish an enhanced risk management system to improve risk management regulations.

4) As for the streamlined operation and management of information, the Company shall maximize attention to the protection of personal information in managing internal information, with full regard to appropriate information disclosure at the proper timing both internally and externally. In addition, a whistle-blowing outlet such as the so-called Corporate Ethics Help Line shall be provided in addition to ordinary in-house communication channels.

5) The normalization of operations shall be ensured at subsidiaries by improving and implementing the Management Regulations for Subsidiaries and Affiliates. The standing corporate auditor shall contact the corporate auditors of the subsidiaries as necessary to collect information, and supervise intragroup activities to prevent the parent company from forcing a subsidiary into any transaction. An audit of subsidiaries by the Internal Inspection Department shall be conducted every two years.

A schematic drawing of the Company's corporate governance and internal control systems is summarized below.



To reinforce our audit system, the Company added one external corporate auditor in June 2007, increasing the number of corporate auditors to four (including three external corporate auditors).

Corporate Directors and Auditors

Chairman	Jiro Sawai
President	Hiroyuki Sawai
Senior Managing Director	Mitsuo Sawai
Managing Director	Takashi Iwasa, Ph.D.
Managing Director	Harumasa Toya, Ph.D.
Managing Director	Keiichi Kimura
Managing Director	Kazuichi Ishikawa
Managing Director	Shigeharu Yokohama, Ph.D.
Director	Takekiyo Sawai
Director	Shinichi Tokuyama
Director	Yoshiteru Takahashi, Ph.D.
Director	Yasuhiro Obana
Director	Minoru Kodama
Standing Statutory Auditor	Toshiaki Konishi
Statutory Auditors	Arata Mano
Statutory Auditors	Koji Ueda
Statutory Auditors	Hidefumi Sugao

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 government measures, an increase in medical expenses related to the expanding aging population has tightened Japanese public finances for medical insurance. Although 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 better reflects patients' drug selection, thereby encouraging the use of generic drugs.

The Sawai Group believes that it has a social mission to encourage the widespread use of generic drugs, for which Japan 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, 2007, were ¥67,827 million, an increase of ¥15,830 million from the end of the previous fiscal year. Total current assets increased ¥9,469 million to ¥38,744 million, and total fixed assets rose ¥6,361 million to ¥29,083 million.

The major factors for the increase in current assets were a rise of ¥4,504 million in trade notes and accounts receivable resulting from higher sales and an increase of ¥4,159 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 ¥6,258 million in property, plant and equipment related to the construction of the new Head Office/Research Laboratories and reinforcement of other manufacturing facilities.

Total liabilities as of March 31, 2007, were ¥28,506 million, an increase of ¥5,343 million from the previous year. This rise resulted mainly from an increase of ¥7,386 million in long-term debt due to the allocation of an equipment payment, a decrease of ¥1,441 million in other accounts payable related to the completion of the new Head Office/Research Laboratories and a decrease of ¥960 million in income taxes payable.

Total net assets as of March 31, 2007, rose ¥10,487 million to ¥39,321 million. Major contributors to this rise were an increase of ¥8,959 million in capital stock and capital surplus due to a public stock offering and the allocation of new shares to a third party and an increase of ¥1,326 million in retained earnings.

As a result, the equity ratio of the Company as of March 31, 2007, rose 2.8 percentage points to 55.8%.

(2) Operational Results

During the year ended March 31, 2007, the Japanese economy gradually expanded against a backdrop of increasing personal consumption and the expansion of civil-sector investment due to improved corporate profits.

In the prescription drug industry, various measures were taken to limit medical expenses and drug expenditures given the increase in the aging population and a 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 that was implemented in April 2006, which should enhance the dissemination of generic drugs. The modification of prescription forms as a single measure is unlikely to substantially expand the usage of generic drugs. Therefore, discussions are under way for additional measures to be introduced in 2008 and beyond.

In this operating environment, the Sawai Group has appealed to the public to increase the use of generic drugs, which should contribute to a reduction in patient copayments 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, 2007, we successfully increased the number of customers such as dispensing pharmacies and foundation hospitals in a favorable business environment with the modification of the prescription forms. Net sales increased 28.9% from the previous year to ¥34,317 million.

With regard to profitability, the gross margin deteriorated 0.8 percentage point year over year mainly affected by a decline in unit drug prices due to the NHI price revision and a significant rise in SG&A expenses from increasing the number of developed products as anticipated at the beginning of the year, aggressive advertising and an increase in business consignment expenses.

Reflecting these circumstances, operating income for the year ended March 31, 2007, increased 9.2% year over year to ¥4,693 million.

(3) Cash Flows

Cash and cash equivalents for the year ended March 31, 2007, increased ¥528 million to ¥7,360 million compared with the previous fiscal year.

The cash flow situation and cash flow factors for the year ended March 31, 2007, were as follows:

(Cash flows from operating activities)

Net cash provided by operating activities decreased ¥6,254 million to ¥4,370 million.

This result mainly reflected an increase of ¥4,156 million in trade notes and accounts receivables, an increase of ¥3,931 million in inventories due to the increased stock of products and raw materials in anticipation of a sharp sales increase after the modification of the prescription forms and ¥2,798 million in income taxes paid regarding net profit for the previous fiscal year. Income taxes paid increased dramatically given the net loss for the year ended March 31, 2005, despite ¥4,166 million in income before income taxes and ¥1,964 million in depreciation and amortization.

(Cash flows from investing activities)

Net cash used in investing activities decreased ¥8,238 million, or 356.1%, to ¥10,551 million.

This decrease principally reflected such factors as ¥9,719 million for the purchase of property, plant and equipment principally owing to the completion of the new Head Office/Research Laboratories and the reinforcement of manufacturing facilities.

(Cash flows from financing activities)

Net cash provided by financing activities rose ¥13,427 million, or 664.0%, to ¥15,449 million.

Major contributors to this increase were ¥8,959 million in stock issued, ¥7,386 million in proceeds from long- and short-term bank loans and ¥887 million in cash dividends paid.

(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 2008.

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 sales rise at dispensing pharmacies as a result of the modification of prescription forms implemented in April 2006. Furthermore, the introduction of additional measures to encourage the use of generic drugs in 2008 and beyond is under consideration as the Japanese government intends to increase the share of generic drugs from 17% to 30% by 2010.

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 integration of the head office and laboratories, and provide a full lineup of generic drugs with the all strengths of original drugs. In addition, we will continue to raise the operating performance ratio of the Kanto Factory, which was transferred to the Company 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. Then, the patient-paid portion of medical expenses in health care insurance was raised for salaried workers in April 2003 and for elderly patients with a high regular income in October 2006. Furthermore, the introduction of a new medical system for the oldest elderly patients specifically is scheduled in April 2008. Accordingly, the burden on individuals to pay for health care has been increasing.

In July 2004, the calculation coefficient of generic drug prices was reduced from the previous 0.8 to 0.7 times the price of original drugs, which causing, together with the biennial NHI price revision, negatively affected our sales results. On the other hand, several stimulating measures were taken to encourage the further use of generic drugs, including the April 2004 the 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 modification of prescription forms that was implemented in April 2006 is expected to increase patient selection of generic drugs. The modification of prescription forms as a single measure is unlikely to substantially expand the usage of generic drugs. Therefore, discussions are under way for additional measures to be introduced in 2008 and beyond.

In addition to the reevaluation 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 of a full lineup with the all strengths of 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 our post-marketing surveillance system for safety measures and prevent the occurrence of drug-induced disease.

The Sawai Group endeavors 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 for patients, and raise 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 dispensing pharmacies and 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 provide a wide range of products and meet 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 based on newly enacted "corporate philosophies" and "behavioral criteria," and maintenance of the corporate environment to optimize the abilities of each employee.

(7) Rebuild a companywide production system to raise the operating performance ratio of the Kanto Factory, which was transferred to the Company 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 authorization 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 release new products when the patent term for 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 April 2002 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 lawsuits can 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 and 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 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 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 endeavors to sell its products at reasonable prices to ensure profitability so that products will not become unprofitable 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, the 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 the R&D Department at its Medisa Shinyaku Inc. subsidiary. With its "Patients-first" spirit, Sawai endeavors 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 the year ended March 31, 2007, the Company obtained approval to manufacture 46 drugs, and R&D expenditures for the year under review totaled ¥3,085 million.

Consolidated Balance Sheets

March 31, 2007 and 2006

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Current Assets:			
Cash and cash equivalents	¥ 7,360	¥ 6,832	$ 62,325
Trade notes and accounts receivable	16,584	12,080	140,435
Allowance for doubtful receivables	(47)	(18)	(398)
	23,897	18,894	202,362
Inventories (Note 4)	13,768	9,609	116,589
Deferred income taxes (Note 8)	555	532	4,700
Other current assets	524	240	4,438
Total current assets	38,744	29,275	328,089
Property, Plant and Equipment (Note 5):			
Land	4,862	4,444	41,172
Buildings and structures	22,583	15,361	191,235
Machinery and equipment	12,807	10,100	108,451
Construction in progress	1,570	4,050	13,295
Other	3,243	2,554	27,463
	45,065	36,509	381,616
Accumulated depreciation	(18,204)	(15,906)	(154,154)
Net property, plant and equipment	26,861	20,603	227,462
Intangible Assets	742	791	6,283
Investments and Other Assets:			
Investment securities (Note 3)	971	880	8,223
Long-term loans	236	256	1,998
Long-term prepaid expenses	55	111	466
Other investments and long-term receivables	270	108	2,286
	1,532	1,355	12,973
Allowance for doubtful receivables	(52)	(31)	(440)
Net investments and other assets	1,480	1,324	12,533
Deferred Income Taxes (Note 8)	—	4	—
	¥ 67,827	¥ 51,997	$ 574,367

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

LIABILITIES AND NET ASSETS

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Current Liabilities:			
Bank loans (Note 5)	¥ 4,000	¥ 2,300	$ 33,872
Current portion of long-term debt (Note 5)	3,117	2,128	26,395
Trade notes and accounts payable	4,460	4,855	37,768
Other accounts payable	4,935	6,376	41,790
Accrued bonuses to employees	708	564	5,995
Accrued bonuses to directors and corporate auditors	48	—	406
Income taxes payable	959	1,919	8,121
Reserve for sales returns	77	54	652
Other current liabilities	221	156	1,873
Total current liabilities	18,525	18,352	156,872
Long-Term Liabilities:			
Long-term debt, due after one year (Note 5)	8,534	3,837	72,267
Employees' retirement benefits (Note 6)	186	—	1,575
Directors' and corporate auditors' retirement benefits	381	362	3,226
Deferred tax liabilities (Note 8)	254	135	2,151
Negative goodwill	50	—	423
Other long-term liabilities	576	477	4,878
Total long-term liabilities	9,981	4,811	84,520
Net Assets:			
Shareholders' Equity (Note 7):			
Common stock			
Authorized 38,800,000 shares			
Issued and outstanding			
15,702,000 shares in 2007	11,502	7,022	97,400
13,652,000 shares in 2006			
Capital surplus	11,825	7,346	100,136
Retained earnings	14,194	12,868	120,196
Treasury stock 225 shares in 2007, 48 shares in 2006	(1)	(0)	(8)
Valuation and translation adjustments			
Net Unrealized Holding Gains on Securities	297	307	2,515
Minority Interests	1,504	1,291	12,736
Net assets	39,321	28,834	332,975
	¥67,827	¥51,997	$574,367

Consolidated Statements of Operations

For the Years ended March 31, 2007, 2006 and 2005

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2007	2006	2005	**2007**
Net Sales	**¥34,317**	¥26,616	¥23,277	**$ 290,600**
Cost of Sales	**17,357**	13,265	12,317	**146,981**
Gross Profit	**16,960**	13,351	10,960	**143,619**
Selling, General and Administrative Expenses	**12,267**	9,052	9,016	**103,878**
Operating Income	**4,693**	4,299	1,944	**39,741**
Other Income (Expenses):				
Interest and dividend income	**17**	10	7	**144**
Interest expense	**(116)**	(68)	(67)	**(982)**
Gain on sale of securities, net	**—**	35	23	**—**
Gain on real-estate-in–trust beneficial interest	**—**	48	48	**—**
Gain on sale of real-estate-in–trust beneficial interest	**—**	57	—	**—**
Loss on disposal of inventories	**(236)**	(218)	(119)	**(1,998)**
Commission for commitment line setup	**—**	(77)	—	**—**
Gain on receipt of fixed assets (Note 11)	**—**	675	—	**—**
Gain on reversal of provision for employees' retirement benefits	**—**	297	—	**—**
Gain on transfer of product's approval	**—**	100	—	**—**
Gain on transfer of products' distributorship	**109**	—	—	**923**
Loss on transfer of shareholders' interest (Note 12)	**—**	(63)	—	**—**
Loss due to impairment (Note 13)	**(297)**	(27)	—	**(2,515)**
Loss on disposal of buildings and structures	**(62)**	(36)	(359)	**(525)**
Loss on sale of fixed assets	**—**	—	(251)	**—**
Special premium payment on the separation from the composite pension fund	**—**	—	(1,653)	**—**
Amortization of share issue expense	**(55)**	—	—	**(466)**
Repayment of cancellation of an insurance for directors	**85**	—	—	**720**
Other, net	**28**	11	48	**236**
	(527)	744	(2,323)	**(4,463)**
Income (Loss) before Income Taxes	**4,166**	5,043	(379)	**35,278**
Provision for Income Taxes:				
Current	**1,737**	(1,830)	(65)	**14,709**
Reversal of provision for income taxes (current)	**—**	—	66	**—**
Deferred	**(29)**	(203)	29	**(246)**
Minority Interests	**198**	—	—	**1,677**
Net Income (Loss)	**¥ 2,260**	¥ 3,010	¥ (349)	**$ 19,138**

Per Share of Common Stock:

	Yen			U.S. dollars (Note 1)
Net income (loss) – basic	**¥157.67**	¥217.08	¥(27.80)	**$1.34**
Net income – diluted	**—**	—	—	**—**
Dividends	**55.00**	50.00	40.00	**0.47**

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

Consolidated Statements of Shareholders' Equity

For the Years ended March 31, 2007, 2006 and 2005

	Millions of yen								
	Shareholders' equity					Valuation and translation adjustments			
	Common stock	Capital surplus	Retained earnings	Treasury stock	Total shareholders' equity	Net unrealized holding gains on securities	Total valuation and translation adjustments	Minority interests	Total net assets
Balance at March 31, 2004	¥ 7,003	¥ 7,325	¥11,369	—	¥25,697	¥153	¥153	—	¥25,850
Changes of items during the year									
Exercise of stock purchase warrants	19	21			40				40
Cash dividends (Note)			(341)		(341)				(341)
Cash dividends			(205)		(205)				(205)
Bonuses to directors and corporate auditors (Note)			(40)		(40)				(40)
Net loss for the year			(349)		(349)				(349)
Acquisition of treasury stock				(0)	(0)				(0)
Net changes of items other than shareholders' equity						14	14		14
Total increase/decrease during the year	19	21	(935)	(0)	(895)	14	14	—	(881)
Balance at March 31, 2005	¥ 7,022	¥ 7,346	¥10,434	¥(0)	¥24,802	¥167	¥167	—	¥24,969
Changes of items during the year									
Cash dividends (Note)			(341)		(341)				(341)
Cash dividends			(205)		(205)				(205)
Bonuses to directors and corporate auditors (Note)			(30)		(30)				(30)
Net income for the year			3,010		3,010				3,010
Net changes of items other than shareholders' equity						140	140	1,291	1,431
Total increase/decrease during the year	—	—	2,434	—	2,434	140	140	1,291	3,865
Balance at March 31, 2006	¥ 7,022	¥ 7,346	¥12,868	¥(0)	¥27,236	¥307	¥307	¥1,291	¥28,834
Changes of items during the year									
Public stock offering	4,043	4,042			8,085				8,085
Allocation of new shares to a third party	437	437			874				874
Cash dividends (Note)			(478)		(478)				(478)
Cash dividends			(410)		(410)				(410)
Bonuses to directors and corporate auditors (Note)			(46)		(46)				(46)
Net income for the year			2,260		2,260				2,260
Acquisition of treasury stock				(1)	(1)				(1)
Net changes of items other than shareholders' equity						(10)	(10)	213	203
Total increase/decrease during the year	4,480	4,479	1,326	(1)	10,284	(10)	(10)	213	10,487
Balance at March 31, 2007 (Note 7)	¥11,502	¥11,825	¥14,194	¥(1)	¥37,520	¥297	¥297	¥1,504	¥39,321

	Thousands of U.S. dollars (Note 1)								
	Shareholders' equity					Valuation and translation adjustments			
	Common stock	Capital surplus	Retained earnings	Treasury stock	Total shareholders' equity	Net unrealized holding gains on securities	Total valuation and translation adjustments	Minority interests	Total net assets
Balance at March 31, 2006	$59,463	$ 62,207	$108,968	$(0)	$230,638	$2,600	$2,600	$10,932	$244,170
Changes of items during the year									
Public stock offering	34,237	34,228			68,465				68,465
Allocation of new shares to a third party	3,700	3,701			7,401				7,401
Cash dividends (Note)			(4,048)		(4,048)				(4,048)
Cash dividends			(3,472)		(3,472)				(3,472)
Bonuses to directors and corporate auditors (Note)			(390)		(390)				(390)
Net income for the year			19,138		19,138				19,138
Acquisition of treasury stock				(8)	(8)				(8)
Net changes of items other than shareholders' equity						(85)	(85)	1,804	1,719
Total increase/decrease during the year	37,937	37,929	11,228	(8)	87,086	(85)	(85)	1,804	88,805
Balance at March 31, 2007 (Note 7)	$97,400	$100,136	$120,196	$(8)	$317,724	$2,515	$2,515	$12,736	$332,975

Note: These are items concerning the appropriation of earnings resolved at the general shareholders meeting held on June 2006, 2005 and 2004.

Consolidated Statements of Cash Flows

For the Years ended March 31, 2007, 2006 and 2005

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2007	2006	2005	2007
Cash Flows from Operating Activities:				
Income (loss) before income taxes	¥ 4,166	¥ 5,043	¥ (379)	$ 35,278
Adjustments to reconcile income before income taxes to net cash provided by operating activities:				
Depreciation and amortization	1,964	1,640	1,329	16,631
Amortization of negative goodwill	(5)	—	—	(42)
Loss due to impairment	297	27	—	2,515
Interest and dividend income	(17)	(10)	(7)	(144)
Interest expense	116	68	67	982
Loss on disposal of buildings and structures	62	36	321	525
Loss on sale of fixed assets	—	8	251	—
Increase in trade notes and accounts receivable	(4,156)	(1,867)	(1,026)	(35,193)
Decrease (increase) in inventories	(3,931)	(2,589)	63	(33,288)
Increase (decrease) in trade notes and accounts payable	(501)	1,039	914	(4,243)
Payment of bonuses to directors and corporate auditors	(46)	(30)	(40)	(390)
Increase in employees' retirement benefits	0	(595)	100	0
Increase in other accounts payable	442	(509)	1,529	3,743
Gain on fixed assets received	—	(675)	—	—
Loss on transfer of shareholders' interest	—	63	—	—
Increase in accrued bonuses to directors and corporate auditors	48	—	—	406
Gain on transfer of products' distributorship	(109)	—	—	(923)
Other	198	337	(16)	1,678
Sub-total	(1,472)	1,986	3,106	(12,465)
Interest and dividends received	17	9	8	144
Interest paid	(117)	(62)	(65)	(991)
Income taxes paid	(2,798)	(49)	(929)	(23,694)
Net cash provided by (used in) operating activities	(4,370)	1,884	2,120	(37,006)
Cash Flows from Investing Activities:				
Payments for purchase of property, plant and equipment	(9,719)	(2,515)	(2,036)	(82,302)
Proceeds from sale of property, plant and equipment	—	8	786	—
Payments for purchase of securities	(159)	(74)	(523)	(1,346)
Proceeds from sale of securities	61	379	183	517
Proceeds from sale of real-estate-in-trust beneficial interest	—	712	—	—
Proceeds from transfer of product's approval	—	100	—	—
Payments for long-term loan	—	(180)	(82)	—
Proceeds from collection of long-term loan	20	6	62	169
Payments for purchase of intangible assets	(158)	(754)	(193)	(1,338)
Payments for purchase of subsidiary's securities with change in scope of the consolidation	(255)	—	—	(2,159)
Payment for additional acquisition of subsidiary's securities	(343)	—	—	(2,905)
Other	2	5	—	17
Net cash used in investing activities	(10,551)	(2,313)	(1,803)	(89,347)
Cash Flows from Financing Activities:				
Net increase in bank loans	1,700	(1,170)	1,270	14,396
Proceeds from long-term debt	8,000	4,500	2,100	67,745
Repayment of long-term debt	(2,314)	(1,989)	(2,410)	(19,595)
Proceeds from issuance of stock	8,959	—	37	75,866
Payments for purchase of treasury stock	(1)	—	(0)	(9)
Proceeds from payment of minority shareholders	—	1,227	—	—
Cash dividends paid	(887)	(546)	(546)	(7,511)
Cash dividends paid to minority shareholders	(8)	—	—	(68)
Net cash provided by financing activities	15,449	2,022	451	130,824
Net increase in cash and cash equivalents	528	1,593	768	4,471
Cash and cash equivalents at beginning of year	6,832	5,239	4,471	57,854
Cash and cash equivalents at end of year	¥ 7,360	¥ 6,832	¥ 5,239	$ 62,325

The accompanying notes to the 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 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 translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2007, which was ¥118.09 to U.S.$1.00. The 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 subsidiaries, MEDISA SHINYAKU INC. and KAKEN SHOYAKU CO., LTD., that meet the control requirements for consolidation. 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.

MEDISA SHINYAKU INC. has allocated its new shares, which represent 35 percent of the total shares outstanding, to a third party since January 2006.

KAKEN SHOYAKU CO., LTD. became a subsidiary, with a large majority of its shares owned by the Company, in the latter half of the fiscal year ended March 31, 2007. Therefore, the accounts of this subsidiary were included in the scope of consolidation from the latter half of the fiscal year ended March 31, 2007.

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

(b) Cash and cash equivalents

Cash and cash equivalents 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. The allowance 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 net assets. 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 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 ¥297 million ($2,515 thousand) and ¥27 million were recognized in 2007 and 2006 respectively; income before income taxes decreased by the same amounts.

(h) Accrued bonuses

The Company and its consolidated subsidiaries accrue amounts for employees' 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) Employees

The Company and its subsidiary MEDISA SHINYAKU INC. revised its tax qualified pension plan and implemented a new defined contribution plan.

KAKEN SHOYAKU CO., LTD. maintains a lump-sum indemnity plan which is a non contributory defined benefit pension plan. The retirement benefit for employees is provided based on the company's provisions.

(ii) Directors and corporate auditors

The Companies' liability for 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 ¥3,085 million ($26,124 thousand), ¥2,241 million and ¥2,524 million for the years ended

March 31, 2007, 2006 and 2005, 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
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 the 2007 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, 2007.

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	¥278	¥785	¥507	$2,354	$6,647	$4,293

(b) Total sales of available-for-sale securities in the year ended March 31, 2007 amounted to ¥61 million ($517 thousand), and the related gains and losses amounted to ¥3 million ($25 thousand) and ¥1 million ($8 thousand), respectively.

(c) Book values of securities with no available fair values as of March 31, 2007 are as follows:
Unlisted equity securities: ¥186 million ($1,575 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, 2006.

(1) Securities with book values exceeding acquisition costs:

	Millions of yen		
	Acquisition cost	Book value	Difference
Equity securities	¥275	¥794	¥519

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

	Millions of yen		
	Acquisition cost	Book value	Difference
Other	2,341	6,759	4,418

(e) Total sales of available-for-sale securities in the year ended March 31, 2006 amounted to ¥379 million and the related gains and losses amounted to ¥43 million and ¥8 million, respectively.

(f) Book values of securities with no available fair values as of March 31, 2006 are as follows:
Unlisted equity securities ¥86 million

4. Inventories

Inventories at March 31, 2007 and 2006 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
Finished goods and merchandise	**¥ 6,917**	¥5,117	**$ 58,574**
Work-in-process	**3,014**	2,248	**25,523**
Raw materials and supplies	**3,837**	2,244	**32,492**
Total	**¥13,768**	¥9,609	**$116,589**

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 0.849% per annum at March 31, 2007 and 0.459% per annum at March 31, 2006.

Long-term debt at March 31, 2007 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Loans from banks and other public corporations, due 2007 - 2014, interest 0.48% - 2.0%		
Secured	¥ 727	$ 6,156
Unsecured	10,924	92,506
	11,651	98,662
Current portion of long-term debt	3,117	26,395
	¥ 8,534	$72,267

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

	Millions of yen
Loans from banks and other public corporations, due 2006 - 2010, interest 0.48% - 2.0%	
Secured	¥4,919
Unsecured	1,046
	5,965
Current portion of long-term debt	2,128
	¥3,837

The aggregate annual maturities of long-term debt outstanding at March 31, 2007 were as follows:

March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 3,117	$26,395
2008	1,978	16,750
2009	1,878	15,903
2010	1,474	12,482
2011	1,131	9,577
2012 - 2014	2,074	17,563
Total	¥11,651	$98,662

At March 31, 2007, 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	¥4,760	$40,308

At March 31, 2006, 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	¥5,153

6. Employees' Retirement Benefits

The Company and its subsidiary, MEDISA SHINYAKU INC., revised its tax qualified pension plan and implemented a new defined contribution plan in October 1, 2005. As a result of these changes, a settlement profit of ¥297 million was recognized as income for the year ended March 31, 2006 as follows.

	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 differences	175	1,490
Decrease in reserve for employees' retirement benefits	¥ (297)	$ (2,528)

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

The liability for employees' retirement benefits at March 31, 2007 and 2006 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Projected retirement benefit obligation	¥186	¥ —	$1,575
Liability for retirement benefits	¥186	¥ —	$1,575

KAKEN SHOYAKU CO., LTD., the Company's subsidiary, maintains a lump-sum indemnity plan which is a non contributory defined benefit pension plan and uses the simplified method to determine benefit obligations.

Retirement benefit expenses for the years ended March 31, 2007, 2006 and 2005 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	2007
Service cost	¥ 15	¥258	¥353	$ 127
Interest cost	—	32	59	—
Expected return on plan assets	—	(29)	(52)	—
Amortization of actuarial differences	—	69	139	—
Payment of contribution to defined contribution pension plan	308	—	—	2,608
Retirement benefit expenses	¥323	¥330	¥499	$2,735

Retirement expenses of KAKEN SHOYAKU CO., LTD., which adopted the simplified method to determine benefit obligations are included in both service cost and amortization of transition obligation.

The assumptions and bases used for the calculation of the retirement benefit obligation at March 31, 2005 were 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 Corporate Law of Japan (the "Law"), which was enacted in May 2006, 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.

Accordingly, 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 include consideration for warrant rights, which should be included in capital surplus, the increase in capital surplus is larger than the increase in common stock.

The Law provides that an amount equal to 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 equal to or greater than 25% of common stock, they are available for dividends by the resolution of shareholders' meeting. The Law also provides that, if the total amount of additional paid-in capital and the legal reserve exceeds 25% of the amount of common stock, the excess may be distributed to the shareholders either as a return of capital or as dividends subject to the approval of the shareholders. 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 Law.

On June 22, 2007, the Company's shareholders approved the payment of year-end cash dividends of ¥25 ($0.21) per share, totaling ¥393 million ($3,328 thousand) to the Company's shareholders of record as of March 31, 2007.

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, 2007, 2006 and 2005.

Significant components of deferred tax assets and liabilities at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Deferred tax assets:			
Unrealized gains on land	¥ 29	¥ 29	$ 246
Retirement benefits for directors and corporate auditors	156	148	1,321
Unrealized gains on inventories	133	122	1,126
Accrued bonuses to employees	286	231	2,422
Amount in excess of depreciation and amortization	154	71	1,304
Loss due to impairment of fixed assets	205	198	1,736
Loss on disposal of buildings and structures	147	147	1,245
Enterprise taxes	96	170	813
Less valuation allowance	(490)	(345)	(4,149)
Other	124	77	1,050
Total deferred tax assets	839	848	7,105
Deferred tax liabilities:			
Reserve for deferred gains on sales of fixed assets	(136)	(136)	(1,152)
Reserve for special depreciation	(61)	(99)	(517)
Net unrealized holding gains on securities	(203)	(212)	(1,719)
Unrealized gain on revaluation of land	(138)	—	(1,169)
Other	(0)	—	(0)
Total deferred tax liabilities	(538)	(447)	(4,556)
Net deferred tax assets	¥ 301	¥ 401	$ 2,549

There was no significant difference between the statutory income tax rate and the effective income tax rate for the years ended March 31, 2007 and 2006.

9. Leases

(a) Finance leases as lessee

At March 31, 2007 and 2006, 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
	2007	2006	**2007**
Original lease obligations, including finance charges	**¥1,069**	¥770	**$9,052**

Lease obligations under non-capitalized finance leases, including finance charges, remaining at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
Payments due within one year	**¥217**	¥147	**$1,838**
Payments due after one year	**330**	217	**2,794**
Total	**¥547**	¥364	**$4,632**

Leases payments under such leases for the years ended March 31, 2007, 2006 and 2005 are ¥209 million ($1,770 thousand), ¥158 million and ¥155 million, respectively.

(b) Operating leases as lessee

Lease obligations under operating leases, remaining at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
Payments due within one year	**¥ 4**	¥14	**$34**
Payments due after one year	**7**	2	**59**
Total	**¥11**	¥16	**$93**

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 Nonconsolidated Subsidiaries and Associated Companies

Medisa Shinyaku Inc. has increased its 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 certain assets have been reduced to their recoverable amounts. Accordingly, impairment losses were recognized in the year ended March 31, 2007 and 2006 as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
Land	**¥ 16**	¥22	**$ 135**
Buildings	**267**	5	**2,262**
Machinery	**14**	—	**111**
Total	**¥297**	¥27	**$2,515**

Assets are grouped in one segment, which is managed appropriately. The recoverable amounts of assets are their net realizable values calculated from appraised values.

Independent Auditors' Report

KPMG

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 consolidated subsidiaries as of March 31, 2007 and 2006, and the related consolidated statements of income, changes in net assets and cash flows for each of the three years in the period ended March 31, 2007, 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 consolidated subsidiaries as of March 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2007, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the Company and its consolidated subsidaries' adoption of the new accounting standard for impairment of fised 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, 2007 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 22, 2007

KPMG AZSA & Co.

Investor Information

Sawai Pharmaceutical Co., Ltd.

Head Office
2-30, Miyahara 5-chome, Yodogawa-ku,
Osaka 532-0003, Japan

Founded
1929

Incorporated
1948

Paid-in Capital
¥11,501million

Number of Shares Outstanding
15,702,000

Number of Shareholders
13,124

Number of Employees
737

Stock Listing
Tokyo Stock Exchange 1st Section

Fiscal Year-End
March

General Meeting of Shareholders
June

Independent Public Accountant
KPMG AZUSA & Co.

Transfer Agent
The Chuo Mitsui Trust & Banking Co., Ltd.

Major Shareholders(Top 10)

Name	Number of Shares Held (Thousands)	Percentage of Ownership Voting (%)
Japan Trustee Services Bank., Ltd.(trust account)	960	6.11
The Master Trust Bank of Japan, Ltd.(trust account)	625	3.98
Jiro Sawai	614	3.91
Hiroyuki Sawai	614	3.91
Mitsuo Sawai	484	3.08
Kenzo Sawai	484	3.08
Nomura Trust and Banking Co.,Ltd.(trust account)	303	1.93
Sumitomo Mitsui Banking Corporation	300	1.91
The Bank of New York for GCM Client Accounts EISG	273	1.74
The Bank of New York Non-Treaty JASDEC Account	215	1.37

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

Area Offices
Tokyo-Higashi, Tokyo-Nishi, Yokohama, Kita-Kanto, Jo-Shinetsu, Shizuoka, Kyoto, Kobe, Hokuriku, Takamatsu, Okayama, Kumamoto

Factories
Kyushu, Sanda, Osaka, Kanto

Consolidated Subsidiary
Medisa Shinyaku Inc.
Kaken Shoyaku Co.,Ltd.

Stock Price Information

	Stock Price	
	High	Low
From April 1, 2006 to March 31, 2007	¥ 6,300	¥ 4,250
First Quarter	5,910	4,250
Second Quarter	6,300	5,150
Third Quarter	5,660	4,620
Fourth Quarter	5,320	4,650

For further information, please contact:

Investor Relations
Tel: +81-(0)6-6105-5718
Fax: +81-(0)6-6394-7311
E-mail: ir@sawai.co.jp
URL: http://www.sawai.co.jp

sawai

Sawai Pharmaceutical Co., Ltd.

2-30, Miyahara 5-chome, Yodogawa-ku,Osaka 532-0003, Japan
URL http://www.sawai.co.jp/

Printed in Japan