

A Message from the President

We will reinforce management to ensure our position as the trusted top brand in the new generic drugs era.



Coming to an era when generic drugs will be the de facto choice

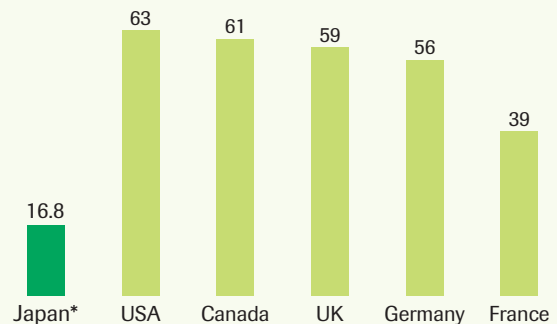
Although the dissemination of generic drugs has been a social priority in Japan for some time, the rate of dissemination of generics among all ethical drugs has remained low. Examination of the share of generics (on a volume basis) in major countries around the world reveals ratios above 50% in the U.S., Canada, the U.K., Germany and other countries. In the U.S. and Canada in particular, it is said that 80% to 90% of the volume of originator drugs whose patent periods have expired is replaced by generics within a year. However, in Japan the share of generics in 2006 at long last reached 17%.

In this market environment, as the company with the top brand in generics, Sawai has set forth the mission "Patients first." It expresses the mindset behind our activities to give people access with confidence and peace of mind to inexpensive, high-quality generics—as we implement quality assurance, assure stable supply, disseminate information to medical practitioners and the healthcare industry and engage in public information and education campaigns.

Today Japan is making a major change of course from an era in which new drugs play the central role to one in which generics will be the de facto choice. The backdrop to this transformation is the national government's move to target a 30% share for generics on a volume basis by 2012, for which it has undertaken a nationwide effort to promote the use of generics. In particular, as a result of the latest revision of the prescription form and the revision to the Regulations for NHI Pharmacies' and NHI Pharmacists' Responsibilities in

Dispensing, introduced in April 2008, the dissemination of generics is expected to accelerate due to factors such as the obligation of NHI pharmacies and pharmacists to explain to patients the option of selecting a generic drug and bonus dispensing fees for NHI pharmacies that have generic dispensing rates of 30% or higher. In addition, the market environment is beginning to favor generics: for instance, this year the number of hospitals that have introduced the Diagnosis Procedure Combination (DPC) system, which offers high incentives for the use (or prescription) of generics, will nearly double to 718. As a result, 2008 can be considered the dawning of the generics era in Japan, and we can look forward to the full-scale expansion of the market for generics.

Percent Share of Generic Drugs in Major Countries (volume)



Source: IMS Health, MIDAS, New Market Segmentation, RX only, MAT Dec. 2006 IMS Strategic Management Review 2006 "PERSPECTIVE ON THE GLOBAL PHARMACEUTICAL MARKET" Copyright IMS 2007
Japan*: Japan Generic Medicines Association FY2005

Set to prevail in an industry shakeout

While the full-scale dissemination of generics will be good for patients, society and, ultimately Sawai, at the same time, we must recognize that our social responsibility as a manufacturer also increases. It is imperative that we increase public trust in Sawai as a corporation—for instance, by making sure we have met the challenge to further enhance quality assurance and post-market safety measures that is contained in the revision of the Pharmaceutical Law, which went into force in 2005. The Ministry of Health, Labour and Welfare has mandated three items concerning supply standards for generics in 2006: 1) meeting all of the standards applicable to originator drugs in the NHI price listing, 2) developing and maintaining a system for stable supply nationwide and 3) enhancing information provision. Quality, stable supply and information provision on the part of manufacturers are also stipulated in the government's Action Program for Promoting Comfort Use of Generics.

Sawai recognizes the risk that any manufacturer that cannot meet these social requirements may be shaken out of the industry or become a victim of industry realignment. Also, we are certain that market expansion will attract full-scale market entry by medium-sized new drug manufacturers and foreign companies, which is sure to intensify competition.

Measures for Promoting Generic Drug Usage

(April 2008)

A. New "Prescription Form"

- Change of prescription form basically promote to use of generic drugs

B. Revision of the medical care regulations

- NHI physicians: Make effort to consider the use of GE
- NHI pharmacies: Make effort to stock GE, etc.
- NHI pharmacists: Explain on GE to the patients appropriately when GE substitution is permitted by doctors and make effort to dispense GE

C. Strengthen incentives for GE dispensary

- Pharmacies which GE prescriptions share is more than 30% are awarded with an additional fee

D. Generics promotion poster sponsored by MHLW

Based on this recognition, Sawai is proactively reinforcing management capacity to cope with change in the market environment and firmly establishing Sawai as the top name in the industry. With regard to human resources, for instance, recent investment has enhanced our systems in three areas: 1) the recruitment, retention, and augmentation of Medical Representatives (MRs) in anticipation of market expansion, 2) a staff increase for the Medical Information Department to augment information and reinforce our response to inquires and 3) the enhancement and reinforcement of the Reliability Assurance Department in order to further increase quality. Furthermore, we will make continuous capital investment to augment production capacity and plan to realize by the end of fiscal 2008 a production structure that can cope with sales of more than ¥70.0 billion.

Aiming for net sales of ¥45.0 billion and operating income of ¥5,000 million

Growing recognition of Sawai as the top generic drugs brand has followed TV and newspaper advertising in combination with vigorous net sales activities. It was driven, too by the enhancement of our management structure as I have previously described. In fiscal 2007, we increased net sales by 9.7% year on year to ¥37.6 billion. Operating income fell by 13.7% owing to personnel increases in

Requirements for Generic Drug Manufacturers

in Action Program for Promoting Comfortable Use of Generics

1. Stable supply

- Development of a delivery system
- Reduction of time to delivery
- Sufficient inventory

2. Quality assurance

- Implementation of quality testing and publication of results
- Examination of relevant literature, etc.

3. Information provision by manufacturers

- Enhancement of information in drug package inserts
- Provision of information to medical practitioners, etc.

4. Preparation of an environment to promote use

- Distribution of generic drugs Q&A literature
- Newspaper advertising

preparation for market expansion and rising R&D expenses as we increased the number of products under development. Nevertheless, we were able to earn operating income of ¥4,048 million.

In fiscal 2008, the final year of the medium-term business plan, we aim to achieve net sales of ¥45.0 billion as announced in the plan by implementing a strategy targeting DPC hospitals and NHI dispensing pharmacies, accelerating R&D, and focusing on new product development and sales expansion. However, we now forecast operating income of ¥5,000 million, ¥2,200 million below the target of the medium-term business plan, due to continuation of business system development and up-front investment.

The market environment is undergoing a transformation that will bring rapid market expansion accompanied by intensification of competition. In these circumstances, to increase corporate value and shareholder value in the medium to long term, it is prudent to more aggressively invest in the future to earn the trust of customers and society and increase our competitive strength. We request your support and understanding in the coming years.

Mitsuo Sawai, President



Consolidated Earnings
(¥ Billion)



Medium-term Business Plan for 2007–2009

Basic Policy “Patients First”

1. Reinforce “Top Brand” in GE
2. Target DPC hospitals
3. Strengthen manufacturing system
4. Beef up R&D to develop high-quality GE drugs

Management Issues

1. Improved Reliability

- Response to “Action Program for Promoting Comfort Use of Generic Drugs”
- Compliance with Higher level of quality by our own standards

2. Enhance Cost Competitiveness

- “Selection & Focusing”, in R&D
- Streamlining of manufacturing costs
- Cost reduction by rationalization measures enforcement

3. Enhance the Function of Marketing

4. Strengthening MIS (Management Information System)

5. Speed in Decision Makings and Actions