

Management Discussion and Analysis

Business Environment

In fiscal 2007 (year ended March 31, 2008) business conditions in Japan turned increasingly sluggish. Prospects for the corporate sector, which has heretofore driven economic activity, have become uncertain owing to the impact of a number of factors, including instability in the world's financial markets due to deceleration of the U.S. economy and the subprime loan problem, foreign exchange market fluctuations, and rising prices, notably the soaring price of crude oil. At the same time, personal consumption has followed a course of advances and retreats.

In the ethical drugs industry, possible purchasing restraint on the part of medical institutions from January to March 2008, due to the revision to the drug price reimbursement system implemented in April 2008 was a source of concern. Nevertheless, market needs for generic drugs, centered on NHI pharmacies, have continued to increase owing to the implementation of healthcare system changes including measures to promote the use of generic drugs such as the remodification of the prescription form, the revision to the Regulations for NHI pharmacies' and NHI pharmacists' Responsibilities in Dispensing', and the addition of points to medical service fees for the dispensing of generic drugs resulting from medical fee revision.

Also, consideration of use of low-cost generic drugs in drug selection for inpatient treatment is expected to increase as the number of hospitals that have introduced the Diagnosis Procedure Combination (DPC) system increases. On the other side of the coin, however, competition between manufacturers of originator drugs and competitors has increasingly intensified.

In these circumstances, in accordance with the Medium-term Business Plan for 2007-2009, in fiscal 2007 Sawai Group undertook to establish the Sawai brand as the top generic drug brand in Japan with the aim of solidifying our position as Japan's preferred generic drugs manufacturer. We implemented a strategy targeting DPC hospitals and NHI pharmacies, augmented the production system to prepare for a sharp increase in demand, and focused effort on information

provision, stable supply, and the establishment of internal control systems in order to further increase reliability.

Income and Expenses

Net sales in the year under review rose by 9.7% from the previous year to ¥37,631 million. Cost of sales increased by 16.0% to ¥20,130 million. Although gross profit increased by 3.2% to ¥17,501 million, the ratio of gross profit to sales fell by 2.9 percentage points to 46.5%. The decrease is attributable to an increase in the cost of sales ratio due to inventory reduction efforts aimed at achieving an appropriate inventory level amid first-half sales growth that fell short of the initial forecast.

Selling, general and administrative expenses increased by 9.6% year on year to ¥13,453 million, as a result of factors including personnel increases and the expansion and upgrading of business sites in preparation for increased demand, which offset a decrease of ¥586 million in advertising and promotion expenses. R&D expenses increased by 4.4% to ¥3,222 million, and the ratio of R&D expenses to sales slipped by 0.4 percentage points to 8.6%.

Operating income decreased by 13.7% year on year to ¥4,048 million, and the ratio of operating income to sales decreased by 2.9 percentage points to 10.8%.

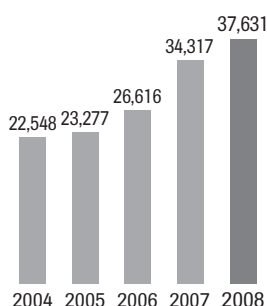
In the year under review, the Company recorded a ¥508 million loss on disposal of inventories of owing to the disposal of products whose names had changed for the purpose of preventing medical error and a ¥207 million reserve for sales rebates for the previous period attendant on a change in accounting policy.

As a result, net income for fiscal 2007 decreased by 23.1% from the previous year to ¥1,739 million. Net income per share (basic) decreased by ¥46.94 from the previous year to ¥110.73.

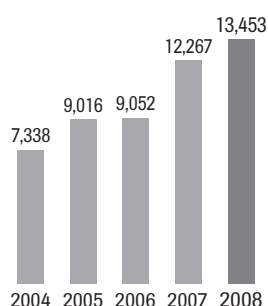
Financial Position

Total assets as of March 31, 2008 were ¥66,295 million, a decrease of ¥1,532 million, or 2.3%, from the end of the previous fiscal year.

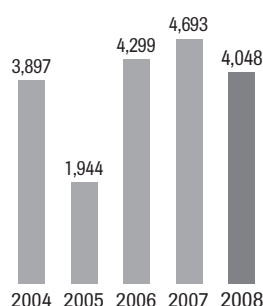
Net Sales
(Millions of yen)



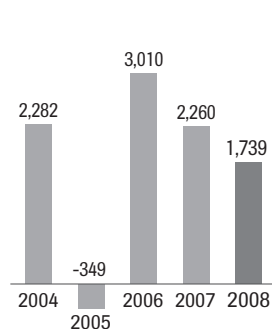
Selling, General and Administrative Expenses
(Millions of yen)



Operating Income
(Millions of yen)



Net Income
(Millions of yen)



Current assets decreased by ¥3,402 million to ¥35,341 million. The change is principally attributable to a decrease of ¥1,971 million in cash and cash equivalents and a decrease of ¥1,271 million in trade notes and accounts receivable due to the securitization of trade receivables. Inventories decreased by ¥267 million from the end of the previous fiscal year to ¥13,500 million.

Property, plant and equipment increased by ¥1,994 from the previous fiscal year to ¥28,855 million. The increase is principally attributable to investment in production-related facilities, including expansion of the Medisa Shinyaku Kyushu Factory and machinery and equipment upgrades at the Sanda Factory. Accumulated depreciation was ¥20,298 million.

Capital expenditure decreased by ¥2,551 million year on year to ¥4,336 million.

The total of intangible assets and investments and other assets decreased by ¥123 million to ¥2,099 million.

Total liabilities decreased by ¥2,416 million, or 8.5%, from the end of the previous fiscal year to ¥26,090 million. The change is mainly attributable to a decrease in current liabilities, including bank loans and other accounts payable. Interest-bearing liabilities decreased by ¥4,018 million, or 25.7%, to ¥11,634 million.

Net assets increased by ¥884 million, or 2.2%, from the end of the previous fiscal year to ¥40,205 million. The equity ratio rose 2.5 percentage points to 58.3%.

Cash Flows

Cash flows from operating activities

Net cash provided by operating activities was ¥9,549 million, an increase of ¥13,920 million in cash provided from the previous fiscal year. Principal items were ¥3,129 million in income before income taxes and minority interests, ¥2,575 million in depreciation and amortization, a ¥2,420 million increase in trade notes and accounts payable, a ¥1,271 million decrease in trade notes and accounts receivable, and ¥1,616 million in income taxes paid.

Cash flows from investing activities

Net cash used in investing activities was ¥6,562 million, a decrease of ¥3,989 million in cash used from the previous fiscal year. The principal item was payments for purchase of property, plant and equipment.

Cash flows from financing activities

Net cash used in financing activities was ¥4,958 million, an increase of ¥20,407 million in cash used from the previous fiscal year. The principal item was repayments of bank loans.

As a result, cash and cash equivalents at the end of year decreased by ¥1,971 million from the previous fiscal year to ¥5,389 million.

Dividend Policy

The Company considers the distribution of profits to shareholders an important management priority and has a basic policy of continuing to pay dividends in accordance with business performance while maintaining internal reserves necessary for future business development and reinforcement of the financial structure.

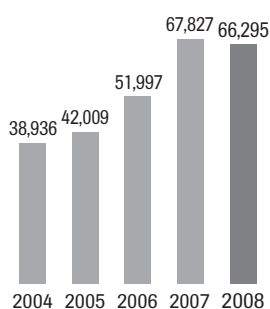
For the year under review, the Company placed importance on shareholder returns and paid an annual dividend of ¥55 per share, consisting of an interim dividend of ¥30 yen and a year-end dividend of ¥25 yen. The consolidated dividend ratio was 49.7%.

Outlook for Fiscal 2008

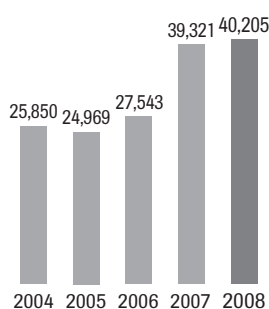
Although a drug price revision was implemented in April 2008, the Company will undertake to improve business performance by further engaging in new market development through vigorous sales activities while publicizing the excellence of our products with regard to quality, information, and stable supply. We will also continue to develop and upgrade production facilities in preparation for further dissemination of generic drugs.

We forecast net sales of ¥45,000 million and net income of ¥2,300 million for fiscal 2008, to be achieved by engaging in business operation in accordance with the above policy.

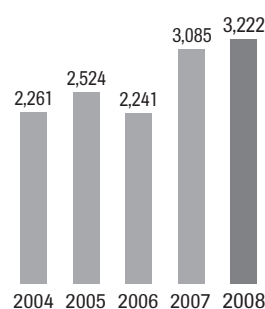
Total Assets
(Millions of yen)



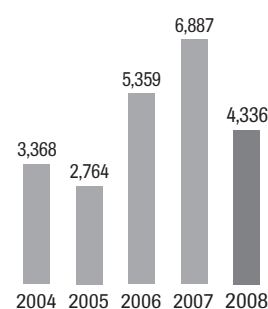
Net Assets
(Millions of yen)



Research and Development (R&D) Expenses (Millions of yen)



Capital Expenditures
(Millions of yen)



(Years ended March 31)