

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Sawai Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2008 and 2007

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 Financial Instruments 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 Financial Instruments 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, 2008, which was ¥100.20 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 mainly calculated by the straight-line method over estimated useful life of the asset. The Company and its consolidated subsidiaries have changed their method of depreciation for all tangible fixed assets acquired on or after April 1, 2007 to reflect the revisions to the Japanese Corporate Tax Law. As a result of this change, gross profit was ¥21 million (\$210 thousand) less, operating income and income before income taxes and minority interests were ¥24 million (\$240 thousand) less for the year ended March 31, 2008 compared with the corresponding amounts which would have been recorded under the previous method.

Pursuant to an amendment to the Japanese Corporate Tax Law, after having fully depreciated tangible fixed assets acquired on or before 31 March 2007 up to 5% of the acquisition cost, based on the prior Japanese Corporate Tax Law, the Company and its consolidated subsidiaries have depreciated the difference between 5% of the acquisition cost and the memorandum price using a straight-line method over 5 years and expensed the amounts as "Depreciation and amortization." The straight-line depreciation starts from the next year, when the book value of tangible assets acquired on or before 31 March 2007 reaches 5% of the acquisition cost. As a result, for the year ended 31 March 2008, gross profit was ¥78 million (\$778 thousand) less, operating income and income before income taxes and minority interests were each ¥89 million (\$888 thousand) less than they would have been using the previous method.

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 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. Retirement benefits for employees are 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 ¥3,222 million (\$32,156 thousand), ¥3,085 million and ¥2,241 million for the years ended March 31, 2008, 2007 and 2006, 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

For the year ended March 31, 2008, the Company changed the accounting standards for the reserve for sales returns, which is based on estimated projections in order to prepare for loss incurred from the return of products. It was previously provided in the maximum amount (at the prescribed rate) permitted by the Corporation Tax Law. Compared with previous standards, the reserve for sales returns increased in the amount of ¥87 million (\$868 thousand), gross profit, operating income and income before income taxes and minority interests each decreased by ¥87 million (\$868 thousand), respectively.

(s) Reserve for sales rebates

For the year ended March 31, 2008, the Company added up the reserve for sales rebates which multiplied accounts receivable by the estimated rebate rates at the end of the fiscal year in order to prepare for sales rebates in the future. With this change, net sales and operating income are ¥57 million (\$569 thousand) less and income before income taxes and minority interests is ¥263 million (\$2,625 thousand) less, respectively.

(t) Reclassifications

Certain prior year amounts have been reclassified to conform to the 2008 presentation.

3. Inventories

Inventories at March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Finished goods and merchandise	¥ 6,647	¥ 6,917	\$ 66,338
Work-in-process	2,743	3,014	27,375
Raw materials and supplies	4,110	3,837	41,018
Total	¥13,500	¥13,768	\$134,731

4. 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, 2008.

(1) Securities with book values exceeding acquisition costs:

	Millions of yen			Thousands of U.S. dollars		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥234	¥660	¥426	\$2,335	\$6,587	\$4,252

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

	Millions of yen			Thousands of U.S. dollars		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥45	¥25	¥(20)	\$449	\$250	\$(199)

(b) Total sales of available-for-sale securities in the year ended March 31, 2008 amounted to ¥7 million (\$70 thousand), and the related gains and losses amounted to ¥1 million (\$10 thousand) and ¥0 million (\$0 thousand), respectively.

(c) Book values of securities with no available fair values as of March 31, 2008 are as follows:

Unlisted equity securities: ¥136 million (\$1,357 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, 2007.

Securities with book values exceeding acquisition costs:

	Millions of yen		
	Acquisition cost	Book value	Difference
Equity securities	¥278	¥785	¥507

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

(f) Book values of securities with no available fair values as of March 31, 2007 are as follows:

Unlisted equity securities: ¥186 million

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

Short-term bank loans consisted mainly of unsecured bank loans with weighted average interest rates of 1.059% per annum at March 31, 2008 and 0.849% per annum at March 31, 2007.

Long-term debt at March 31, 2008 consisted of the following:

	Millions of yen	Thousands of U.S. dollars (Note 1)
Loans from banks and other public corporations, due 2008–2015, interest 0.54%–2.0%		
Secured	¥ 471	\$ 4,700
Unsecured	9,163	91,447
	9,634	96,147
Current portion of long-term debt	2,144	21,397
Total	¥7,490	\$74,750

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

	Millions of yen
Loans from banks and other public corporations, due 2007–2014, interest 0.48%–2.0%	
Secured	¥ 727
Unsecured	10,924
	11,651
Current portion of long-term debt	3,117
Total	¥8,534

The aggregate annual maturities of long-term debt outstanding at March 31, 2008 are as follows:

March 31,	Millions of yen	Thousands of U.S. dollars
2009	¥2,144	\$21,397
2010	2,043	20,389
2011	1,639	16,357
2012	1,296	12,934
2013	1,325	13,224
2014–2015	1,187	11,846
Total	¥9,634	\$96,147

At March 31, 2008, assets pledged as collateral for secured long-term debt, including current portions, are as follows:

	Millions of yen	Thousands of U.S. dollars
Property, plant and equipment, net of accumulated depreciation	¥4,372	\$43,633

At March 31, 2007, assets pledged as collateral for secured long-term debt, including current portions, are as follows:

	Millions of yen
Property, plant and equipment, net of accumulated depreciation	¥4,760

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 on 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
Decrease in projected benefit obligation	¥(3,041)
Decrease in plan assets	2,569
Unrecognized actuarial loss	175
Decrease in reserve for employees' retirement benefits	¥ (297)

Assets in the amount of ¥2,569 million will be contributed to the defined contribution pension plan over 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, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Projected retirement benefit obligation	¥169	¥186	\$1,687
Liability for retirement benefits	¥169	¥186	\$1,687

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, 2008, 2007 and 2006 are as follows:

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
Service cost	¥ 12	¥ 15	¥258	\$ 120
Interest cost	-	-	32	-
Expected return on plan assets	-	-	(29)	-
Amortization of actuarial differences	-	-	69	-
Payment of contribution to defined contribution pension plan	348	308	-	3,473
Retirement benefit expenses	¥360	¥323	¥330	\$3,593

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.

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 included 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 24, 2008, the Company's shareholders approved the payment of year-end cash dividends of ¥25 (\$0.25) per share, totaling ¥393 million (\$3,922 thousand) to the Company's shareholders of record as of March 31, 2008.

8. Deferred 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, 2008, 2007 and 2006.

Significant components of deferred tax assets and liabilities at March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Deferred tax assets:			
Unrealized gains on land	¥ 29	¥ 29	\$ 289
Retirement benefits for directors and corporate auditors	158	156	1,577
Unrealized gains on inventories	130	133	1,297
Accrued bonuses to employees	326	286	3,253
Reserve for sales rebates	108	—	1,078
Amount in excess of depreciation and amortization	142	154	1,417
Loss due to impairment of fixed assets	205	205	2,046
Loss on disposal of buildings and structures	147	147	1,467
Enterprise taxes	81	96	808
Less valuation allowance	(520)	(490)	(5,190)
Other	161	124	1,609
Total deferred tax assets	967	839	9,651
Deferred tax liabilities:			
Reserve for deferred gains on sales of fixed assets	(136)	(136)	(1,357)
Reserve for special depreciation	(25)	(61)	(250)
Net unrealized holding gains on securities	(165)	(203)	(1,647)
Unrealized gain on revaluation of land	(138)	(138)	(1,377)
Other	(0)	(0)	(0)
Total deferred tax liabilities	(464)	(538)	(4,631)
Net deferred tax assets	¥503	¥301	\$5,020

There was no significant difference between the statutory income tax rate and the effective income tax rate for the years ended March 31, 2008 and 2007.

9. Leases

(a) Finance leases as lessee

At March 31, 2008 and 2007, original lease obligations for machinery and equipment and other assets under non-capitalized finance leases are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Original lease obligations, including finance charges	¥1,028	¥1,069	\$10,259

Lease obligations under non-capitalized finance leases, including finance charges, remaining at March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Payments due within one year	¥186	¥217	\$1,856
Payments due after one year	229	330	2,286
Total	¥415	¥547	\$4,142

Leases payments under such leases for the years ended March 31, 2008, 2007 and 2006 are ¥232 million (\$2,315 thousand), ¥209 million and ¥158 million, respectively.

(b) Operating leases as lessee

Lease obligations under operating leases remaining at March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Payments due within one year	¥22	¥ 4	\$220
Payments due after one year	73	7	728
Total	¥95	¥11	\$948

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 took 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, 2008, 2007 and 2006 as follows:

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
Land	¥ –	¥ 16	¥22	\$ –
Buildings	–	267	5	–
Machinery	–	14	–	–
Total	¥ –	¥297	¥27	\$ –

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