

Management Discussion and Analysis

Business Environment

In fiscal 2008, the year ended March 31, 2009, the Japanese economy felt the grip of the recession tighten. The turmoil in the financial and capital markets stemming from the subprime loan problem caused stock prices to plunge, and adding to these troubles, yen appreciation together with the sudden slowdown in the U.S. economy pulled down exports. These forces combined to bring about rapid deterioration in corporate earnings. Meanwhile, on the consumer side, unemployment concerns put consumers in a defensive mood, dampening personal consumption.

In the ethical drugs industry, the generics market is expanding, particularly in NHI pharmacies. In April 2008, reformation of the health care system to promote the use of generic drugs went into effect, including the modified prescription form and the additional medical service fees for dispensing of generic drugs resulting from medical fee revisions.

Also, consideration of adopting low-cost generic drugs for in-patient treatment is expected to increase hand-in-hand with the growth in hospitals introducing the DPC system (comprehensive payments for acute hospitalization). On the downside, patients are increasingly cutting back on visits to medical practitioners, and competition has continued to heat up between originator and rival generic drug manufacturers.

In these circumstances and in accordance with the Medium-term Business plan for 07–09, the Sawai Group has undertaken to establish the Sawai brand as the top brand and Sawai as the “Brand of choice.” We have reinforced sales with DPC hospitals and NHI pharmacies and augmented the production system to meet the anticipated sharp increase in demand. At the same time, we have focused on quality control, information provision, and stable supply to further increase reliability.

Income and Expenses

The Company achieved FY 2008 net sales of ¥44,284 million under these conditions, 17.7% growth from the previous year, driven by initiatives to boost NHI pharmacy and DPC hospital sales.

Sales growth by channel showed healthy expansion of generic drugs to NHI pharmacies and hospitals, generating 32% growth through wholesalers and 9% growth through regional sales agencies, which showed a particularly strong increase for wholesaler channels.

Cost of sales rose 25% year on year to ¥25,156 million. Although gross profit showed a 9.3% increase to ¥19,128 million, the gross margin to sales ratio slipped 3.3 points to 43.2%. This slippage in the ratio can be attributed to recording inventory valuation losses and losses on disposal of inventory in cost of goods sold in conjunction with the application of the ASBJ Accounting Standard for Measurement of Inventories, starting in fiscal 2008. The change in accounting standards generated additional recorded losses of ¥1,547 million versus fiscal 2007.

Selling, general and administrative expenses increased 7.5% year on year to ¥14,461 million as a result of an additional ¥355 million in personnel expenses, ¥168 million in advertising expenses, and ¥186 million in R&D expenses. R&D expenses were up 5.8% year on year to ¥3,408 million while the ratio of R&D expenses to sales fell to 7.7%, a 0.9 point drop.

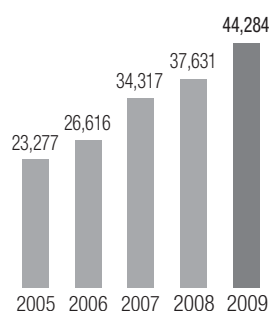
Overall operating income increased 15.3% over the previous year to ¥4,668 million, but the operating margin to sales ratio fell 0.3 points year on year to 10.5%

After the recording of a ¥77 million loss on disposal of buildings and structures for the year under review, net income came to a 40.3% year-on-year increase to ¥2,439 million. Net income per share (basic) was ¥155.32, a ¥44.59 gain over the previous year.

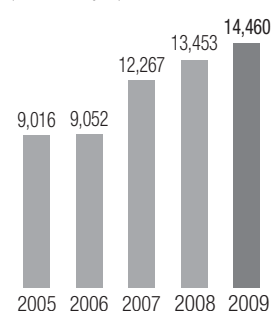
Financial Position

Total assets at the end of the consolidated accounting period stood at ¥72,320 million, a 9.1% increase of ¥6,025 million. Current assets grew by ¥3,613 million to ¥38,954 million on increases of ¥1,159 million in cash and cash equivalents and ¥1,978 million in trade notes and accounts receivable. Inventories also increased by ¥89 million over the end of the previous year to ¥13,589 million.

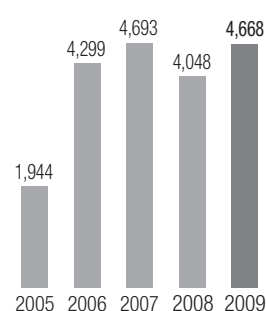
Net Sales
(Millions of yen)



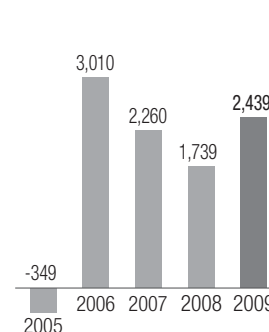
Selling, General and Administrative Expenses
(Millions of yen)



Operating Income
(Millions of yen)



Net Income
(Millions of yen)



Production-related investment, including the sixth-stage expansion of Medisa Shinyaku's Kyushu Factory and the third-stage expansion of the Sanda Factory, pushed up property, plant and equipment by ¥2,967 to ¥31,822 million. Accumulated depreciation also rose, adding on ¥2,016 million for a total of ¥22,314 million.

Capital expenditures were ¥1,132 million higher than at the end of the previous term, reaching a total of ¥5,468 million.

The total of intangible assets and investments and other assets dropped ¥555 million to ¥1,544 million as a result of goodwill amortization and a loss on devaluation of investments in securities, net.

Total liabilities increased versus the end of the previous term to ¥30,614 million, representing a 17.3% increase of ¥4,524 million. The increase was primarily associated with current liabilities including bank loans and other accounts payable. Interest bearing debt increased from the end of the previous period by 16.5%, or ¥1,917 million, to ¥13,551 million.

Net assets were 3.7% higher from the end of the previous year, a ¥1,500 million increase to ¥41,706 million, while the equity ratio decreased 2.9 points to 55.4%

Cash Flows

Cash flows from operating activities

Cash flows from operating activities declined by ¥6,380 million from the previous year to a net inflow of ¥3,169 million. Primary components were ¥4,320 million in income before income taxes and minority interests, ¥2,709 million in depreciation and amortization, ¥449 million from the decrease in trade notes and accounts payable, ¥1,978 million for the increase in trade notes and accounts receivable, and a ¥1,456 million outflow for income taxes paid.

Cash flows from investing activities

Cash flows used in investment activities fell to a net outflow of ¥3,037 million, consisting mainly of payments for purchase of property, plant and equipment, which represents a year-on-year fall of ¥3,526 million.

Cash flows from financing activities

Cash flows from financing activities amounted to a net inflow ¥1,027 million. The primary item was proceeds from long-term debt.

As a result, cash and cash equivalents at end of year increased by ¥1,159 million from the previous fiscal year to ¥6,548 million.

Dividend Policy

The Company considers the distribution of profits to shareholders its most important management priority and has a basic policy of continuing to pay dividends according to business performance while maintaining the internal reserves necessary for future business development and strengthening the financial structure.

For the year under review, Sawai stressed shareholder returns and paid an annual dividend of ¥55 per share, consisting of an interim dividend of ¥30 per share and a year-end dividend of ¥25. The consolidated dividend ratio was 35.4%.

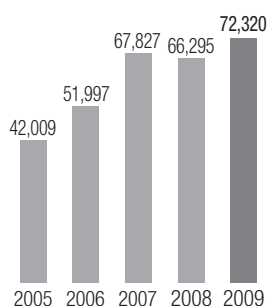
Outlook for Fiscal 2009

We expect that the Japanese economy will continue to face a challenging environment, characterized by a drastic drop in exports and depressed domestic demand for both personal consumption and business investment. We further believe that this period will be a favorable one for promoting the use of generic drugs, and expect to see market expansion.

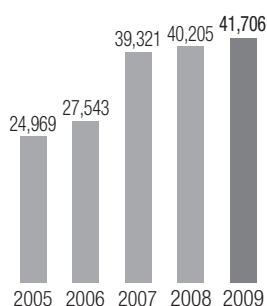
The Sawai Group will augment its business performance by making further inroads in developing new markets through vigorous sales activities while championing the excellence of our products on the basis of quality, information provision, and stable supply. In fiscal 2009, we will execute numerous measures designed to fulfill the M1 TRUST Medium-term Business Plan as we embark on the first year of the plan.

We forecast net sales of ¥49,000 million, operating income of ¥5,800 million, and net income of ¥3,150 million in FY2009 by engaging in business operations according to the policies outlined above.

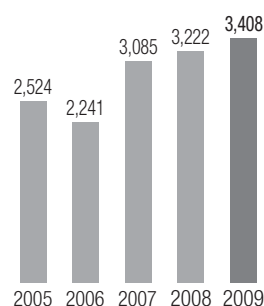
Total Assets
(Millions of yen)



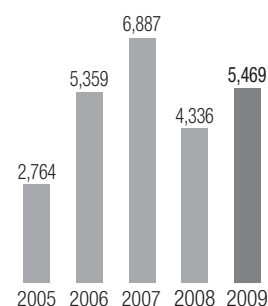
Net Assets
(Millions of yen)



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



Capital Expenditures
(Millions of yen)



(Years ended March 31)