

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 translation 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, 2009, which was approximately ¥98.26 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., which 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 the respective subsidiaries.

MEDISA SHINYAKU INC. allocated a portion of its shares, representing 35 percent of the total shares outstanding of the subsidiary, to a third party in January 2006. The Company purchased 5 percent of the shares from the third party during the year ended March 31, 2009, resulting in the ratio of capital contribution of the third party decreasing to 30 percent, with the Company's holding increasing to 70 percent of the outstanding shares of the subsidiary at March 31, 2009.

KAKEN SHOYAKU CO., LTD. became a subsidiary, with a 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 for investments.

(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 three months 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 historic bad debts.

(d) Investment Securities

The Company classifies securities into the following categories: (1) securities held for trading purposes ("trading securities"), (2) debt securities intended to be held to maturity ("held-to-maturity debt securities"), (3) equity securities issued by subsidiaries and affiliated companies, and (4) all other securities that are not classified in any of the above categories ("available-for-sale securities").

The Company does not have any 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 the fair market value of an individual security declines to a level below historical cost and is judged to be material and other than temporary; the carrying value of the individual security is written down.

(e) Inventories

Prior to April 1, 2008, inventories were stated at weighted moving average cost, except for supplies, which are stated at average cost.

For the year ended March 31, 2009, the Company and its consolidated subsidiaries adopted the new accounting standard for Measurement of Inventories ("ASBJ Statement No.9" issued on July 5, 2006). The new accounting standard requires that inventories held for sale in the ordinary course of business be valued at the lower of cost or net realizable value.

As a result of this change, operating income decreased by ¥1,547 million (\$15,744 thousand) and income before income taxes decreased by ¥1,076 million (\$10,951 thousand) for the year ended March 31, 2009 compared with the corresponding amounts which would have been recorded under the previous method.

(f) Property, Plant and Equipment (excluding leases)

Property, plant and equipment are stated at cost. Depreciation is mainly calculated using the straight-line method over estimated useful life of the asset.

The Company and its consolidated subsidiaries have extended the useful life of machinery and equipment as per revisions on or after April 1, 2008 to the Japanese Corporate Tax Law. As a result of this change, gross profit increased by ¥121 million (\$1,231 thousand), operating income and ordinary income and income before income taxes both increased by ¥124 million (\$1,262 thousand) for the year ended March 31, 2009 compared with the corresponding amounts which would have been recorded under the previous method.

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 decreased by ¥21 million, operating income and income before income taxes and minority interests both decreased by ¥24 million for the year ended March 31, 2008 compared with the corresponding amounts which would have been recorded under the previous method.

Prior to March 31, 2007 according to Japanese Corporate Tax Law, tangible fixed assets were depreciated up until to 95 percent of the acquisition cost had been recognized. However due to an amendment to the Japanese Corporate Tax Law in fiscal 2008, tangible fixed assets are to be amortized over a 5 year period. For tangible fixed assets acquired prior to March 31, 2007, the Company will depreciate the remaining 5 percent of the acquisition cost using the straight-line method over 5 years, beginning in the year following the date when the tangible fixed asset net book value reaches 5 percent of acquisition cost. The Company will include these expense amounts in "Depreciation and amortization". As a result of the change, for the year ended March 31, 2008, gross profit decreased by ¥78 million, operating income and income before income taxes and minority interests both decreased by ¥89 million compared to what they would have been using the previous method.

Expenditures for significant renewals and betterments are capitalized, while expenditures for normal repairs and maintenance are expensed as incurred.

(g) Intangible Assets (excluding leases)

The Company includes software costs in intangible assets and depreciates them using the straight-line method over the estimated useful life of five years.

(h) Leases

For lease transactions not involving the transfer of ownership, lease assets are depreciated over their useful life using the straight-line method until the net residual value reaches zero.

For the year ended March 31, 2009, the Company and its consolidated subsidiaries adopted the new accounting standard for Lease Transactions ("ASBJ Statement No.13" issued on March 30, 2007), and the Guidance on Accounting Standard for Lease Transactions ("ASBJ Guidance No.16" issued on March 30, 2007) except for certain immaterial or short-term finance leases, which are accounted for as operating leases. As a result of this change, the impact on operating income, income before income taxes and minority interests was immaterial for the year ended March 31, 2009 compared with the corresponding which would have been recorded under the previous method.

Prior to the year ended March 31, 2009, finance leases which do not transfer ownership or which do not have bargain purchase option provisions were accounted for in the same manner as operating leases in accordance with Japanese GAAP.

(i) Accrued Bonuses

The Company and its consolidated subsidiaries accrue amounts for employees' bonuses based on estimated amounts to be paid in the subsequent period.

(j) 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.

(k) Reserve for Sales Returns

The reserve for sales returns provides for estimated future losses expected to be incurred from the return of products.

For the year ended March 31, 2008, the Company changed the accounting standards for the reserve for sales returns. This resulted in gross profit, operating income and income before income taxes and minority interests to be all decreased by ¥87 million.

(l) Reserve for Sales Rebates

The Company calculated the reserve for sales rebates by multiplying accounts receivable by the estimated rebate rates at the end of the fiscal year in order to provide for future estimated sales rebates.

Net sales and operating income decreased by ¥57 million and income before income taxes and minority interests decreased by ¥263 million due to the change in the provision for sales rebates for the year ended March 31, 2008.

(m) Pension and Other Post Retirements Obligations*(i) Employees*

The Company and its subsidiary MEDISA SHINYAKU INC. revised its previous tax qualified pension plan and implemented a new defined contribution plan on October 1, 2005.

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 liability for directors and corporate auditors' retirement benefits is provided based on the Company internally developed criteria.

(n) 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 expensed in the period incurred and amounted to ¥3,409 million (\$34,694 thousand) and ¥3,222 million for the years ended March 31, 2009 and 2008, respectively.

(o) Income Taxes

Income taxes comprise corporation tax, prefectural and municipal in-habitants taxes and enterprise tax. The provision for income taxes is based on income for financial statement purposes. The tax effects of loss carry-forwards and temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting are recognized as deferred income taxes.

(p) Net Income per Share

Computations of net income per share of common stock are based on the weighted average number of common stock outstanding during each year.

(q) 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.

(r) Reclassifications

Certain prior year amounts have been reclassified to conform to the 2009 presentation.

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Inventories

Inventories at March 31, 2009 and 2008 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Finished goods and merchandise	¥ 6,704	¥ 6,647	\$ 68,227
Work-in-process	3,033	2,743	30,867
Raw materials and supplies	3,851	4,110	39,192
Total	¥13,588	¥13,500	\$138,286

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Investment Securities

(a) The following tables summarize acquisition costs and fair market values of available-for-sale securities with available fair values as of March 31, 2009.

(1) Securities with fair market values exceeding acquisition costs:

	Millions of yen			Thousands of U.S. dollars		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥174	¥333	¥159	\$1,771	\$3,389	\$1,618

(2) Securities with fair market 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	¥ 77	¥ 75	¥ (2)	\$ 784	\$ 763	\$ (21)

(b) Total sales of available-for-sale securities in the year ended March 31, 2009 amounted to ¥4 million (\$41 thousand), and the related losses amounted to ¥0 million (\$2 thousand).

(c) Acquisition cost of securities with no available fair values as of March 31, 2009, are as follows:

Unlisted equity securities: ¥136 million (\$1,384 thousand)

(d) The following tables summarize acquisition costs and book fair market values of available-for-sale securities with available fair values as of March 31, 2008.

Securities with fair market values exceeding acquisition costs:

	Millions of yen		
	Acquisition cost	Book value	Difference
Equity securities	¥234	¥660	¥426

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

(f) Acquisition costs of securities with no available fair values as of March 31, 2008 are as follows:

Unlisted equity securities: ¥136 million

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Short-term Debt and Long-term Debt

Short-term debt consisted mainly of unsecured bank loans with weighted average interest rates of 0.777% per annum at March 31, 2009 and 1.059% per annum at March 31, 2008.

Long-term debt at March 31, 2009 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Loans from banks and other public corporations, due 2009 – 2016, interest 0.54% – 2.0%		
Secured	¥ 915	\$ 9,312
Unsecured	10,106	102,850
	11,021	112,162
Current portion of long-term debt	2,550	25,952
	¥ 8,471	\$ 86,210

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

	Millions of yen
Loans from banks and other public corporations, due 2008 – 2015, interest 0.54% – 2.0%	
Secured	¥ 471
Unsecured	9,163
	9,634
Current portion of long-term debt	2,144
	¥7,490

The aggregate annual maturities of long-term debt outstanding at March 31, 2009 are as follows:

March 31,	Millions of yen	Thousands of U.S. dollars
2010	¥ 2,550	\$ 25,952
2011	2,146	21,840
2012	1,832	18,644
2013	1,861	18,940
2014	1,529	15,561
2015-2016	1,103	11,225
Total	¥11,021	\$112,162

At March 31, 2009, 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	¥3,989	\$40,596

At March 31, 2008, 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	¥4,372

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Employees' Pension Benefits

The Company and its subsidiary, MEDISA SHINYAKU INC., revised their tax qualified pension plan and implemented a new defined contribution plan on October 1, 2005.

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 pension benefit obligations.

The liability for employees' pension benefits at March 31, 2009 and 2008 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Projected retirement benefit obligation	¥116	¥169	\$1,180
Liability for retirement benefits	¥116	¥169	\$1,180

Retirement benefit expenses for the years ended March 31, 2009 and 2008 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Service cost	¥ 13	¥ 12	\$ 132
Payment of contribution to defined contribution pension plan	373	348	3,796
Retirement benefit expenses	¥386	¥360	\$3,928

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.

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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.

The proceeds received from the exercise of warrants included consideration for warrant rights, which should be included in capital surplus. This has resulted in the increase in capital surplus to be 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 com-

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Deferred
Income Taxes

mon stock, they are available for dividends by the resolution of shareholders. 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. There are legal reserves 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, 2009, the Company's shareholders approved the payment of year-end cash dividends of ¥25 (\$0.25) per share, totaling ¥393 million (\$4,000 thousand) to the Company's shareholders of record as of March 31, 2009.

The Company is 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, 2009 and 2008.

Significant components of deferred tax assets and liabilities at March 31, 2009 and 2008 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Deferred tax assets:			
Unrealized gains on land	¥ 29	¥ 29	\$ 295
Retirement benefits for directors and corporate auditors	84	158	855
Unrealized gains on inventories	187	130	1,903
Accrued bonuses to employees	347	326	3,531
Reserve for sales rebates	141	108	1,435
Amount in excess of depreciation and amortization	131	142	1,333
Loss due to impairment of fixed assets	205	205	2,086
Loss on disposal of buildings and structures	147	147	1,496
Enterprise taxes	139	81	1,415
Less valuation allowance	(495)	(520)	(5,038)
Loss on valuation of inventories	439	—	4,468
Other	208	161	2,117
Total deferred tax assets	¥1,562	¥967	\$15,896
Deferred tax liabilities:			
Reserve for deferred gains on sales of fixed assets	(136)	(136)	(1,384)
Reserve for special depreciation	(8)	(25)	(81)
Net unrealized holding gains on securities	(65)	(165)	(662)
Unrealized gain on revaluation of land	(138)	(138)	(1,404)
Other	(0)	(0)	(0)
Total deferred tax liabilities	(347)	(464)	(3,531)
Net deferred tax assets	¥1,215	¥503	\$12,365

The following table summarizes the significant differences between the statutory income tax rate and the effective income tax rate for financial statement purposes for the year ended March 31, 2009.

	2009
Statutory income tax rate	40.87%
Special tax credits	(5.81)
Permanently nondeductible expenses	1.79
Additions and reductions of valuation allowance	(0.59)
Other	0.78
Effective income tax rate	37.04%

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

Leases

As discussed in Note 2, finance leases commenced prior to April 1, 2008 which do not transfer ownership or which do not have bargain purchase option provisions were accounted for in the same manner as operating leases are accounted for as operating leases.

Assumed amounts of acquisition cost and accumulated depreciation at March 31, 2009 and 2008 are as follows:

(a) Finance leases - lessee

At March 31, 2009 and 2008, lease obligations for machinery and equipment and other assets under non-capital finance leases are as follows:

	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Lease obligations, including finance charges	¥650	¥1,028	\$6,615

Lease obligations under non-capital finance leases, including finance charges, remaining at March 31, 2009 and 2008 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Payments due within one year	¥130	¥186	\$1,323
Payments due after one year	94	229	957
Total	¥224	¥415	\$2,280

Leases payments under such leases for the years ended March 31, 2009 and 2008 are ¥183 million (\$1,862 thousand) and ¥232 million, respectively.

(b) Operating leases - lessee

Lease obligations under operating leases remaining at March 31, 2009 and 2008 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Payments due within one year	¥22	¥22	\$224
Payments due after one year	53	73	539
Total	¥75	¥95	\$763

Segment Information

The Companies operate primarily in the pharmaceutical supplies industry in Japan. Accordingly, there is no presentation of information by business segment.

Stock Option Plan

Stock option expenses in the amounts of ¥83 million (\$845 thousand) have been accounted for as "Selling, general and administrative expenses" on the consolidated statements of income for the year ended March 31, 2009.

The details related to the stock option expenses at March 31, 2009 are as follows:

Fiscal year 2009 Stock options	
Position and number of grantee	Directors of the Company: 9 Corporate auditors: 1 Employees: 644 Subsidiary Employees: 39
Type and number of shares	Common stock of Company: 195,700 shares
Date of grant	August 11, 2008
Settlement of rights	After providing service for the period
Period of providing service for stock option	For 2 years (From August 11, 2008 to August 11, 2010)
Exercise period of rights	For 5 years from grant date (From August 12, 2010 to August 11, 2015)

Number of shares of stock options at March 31, 2009 is as follows:

	Number of shares
Before Settlement of rights	
Beginning of year	—
Granted	195,700
Expired	700
Settled	—
End of year	195,000
After Settlement of rights	
Beginning of year	—
Settled	—
Exercised	—
Expired	—
End of year	—

Information per share price at March 31, 2009 is as follows:

	yen	U.S. dollars
	2009	2009
Exercise price	¥4,650	\$47.32
Fair value at grant date	1,257	12.79

Assumptions used in estimation of the fair value of stock options above are as follows:

Fiscal year 2009 Stock options	
Method of estimation	Black-Scholes model
Volatility *1	34.8%
Expected remaining period *2	4 years and 6 months
Expected dividend *3	¥55 (\$0.56)
Risk-free interest rate *4	1.00%

*1 Rate of variability, which is calculated based on the monthly closing prices of common stock of the Company for 4 years and 6 months from February 2004 to August 2008 for the 2009 stock options, respectively.

*2 Mid-term point between date of grant and estimated exercisable period.

*3 Actual dividend per share for the year ended March 31, 2008 for the stock options.

*4 Interest rate for a government bond with similar period as option vesting period as stock options.