

MANAGEMENT DISCUSSION AND ANALYSIS

Business Environment

Fiscal 2010, the year ended March 31, 2011, brought an upturn in business conditions in Japan due to favorable economic conditions overseas, particularly in Asia, and the impact of the government's measures to create demand and support employment. On the downside, there were lingering risks in the form of further yen appreciation and rising crude oil prices, and the employment and personal income environment remained adverse. Furthermore, the Great East Japan Earthquake of March 11, 2011 had a tremendous impact on Japan's economy, especially the manufacturing industry.

In the ethical drugs industry, in April 2010 the government began implementation of medical system revisions, including a review of additional medical service fees for the dispensing of generic drugs, as a policy to curb ever-increasing social security costs while maintaining the quality of medical care. Early in the fiscal year, promotion of generics use gained impetus. Nevertheless, the rate of increase in the use of generics is leveling off, as indicated by the findings of a survey conducted by the Central Social Insurance Medical Council, an advisory body to the Minister of Health, Labour and Welfare, in December 2012: "The generic drug prescription rate has peaked." In addition, competition in the generics market is intensifying. For instance, 28 companies have entered the market for Glimepiride tablets, an oral blood-glucose-lowering drug which was launched in November 2010. In these circumstances, in keeping with the "Patients first" corporate philosophy, the Sawai Group implemented policies and measures set forth in the M1 TRUST medium-term business plan: 1) Improve "Quality of sales promotion" by strengthening the marketing function, 2) Build up "SAWAI's Trust of its stable supply" and reduce costs of production, 3) Enhance development of value-added generic drugs meeting market needs, and 4) Establish infrastructure enabling net sales of ¥100 billion.

Income and Expenses

As a result of these developments, consolidated net sales in fiscal 2010 increased by 27.5% year on year to a record high of ¥63,853 million.

In the results for sales growth by channel, sales growth in the wholesaler channel was particularly strong, increasing by 40.0%, and sales through regional sales agencies increased by 16.1%. The sales increase is attributable to expanded use of generic drugs in the NHI

pharmacy market.

Cost of sales rose 28.4% year on year to ¥33,736 million, while gross profit rose 26.6% to ¥30,117 million. Accordingly, the gross profit to sales ratio decreased by 0.3 percentage points to 47.2%.

Selling, general and administrative expenses increased by 8.2% year on year to ¥16,531 million as a result of increases of ¥322 million in personnel expenses and ¥309 million in R&D expenses.

As a result, operating income increased by 59.5% over the previous year to ¥13,586 million. The operating profit to sales ratio rose by 4.3 percentage points year on year to 21.3%.

After the recording of bond issue costs of ¥806 million and a loss on devaluation of investments in securities of ¥840 million for the year under review, net income increased by 44.2% year on year to a record high of ¥7,183 million. Net income per share rose ¥138.75 from the previous year to ¥456.07.

The return on equity rose by 3.3 percentage points from the previous year to 15.1%.

R&D expenses

The Research and Development Division controls the Group's R&D system. In keeping with the Group's "Patients first" corporate philosophy, the Division engages in R&D activities focused on the development of pharmaceuticals that meet medical treatment needs, including the development of high value-added products requiring innovation in drug formulation.

In fiscal 2010, the Group obtained approval for the manufacture and sale of 44 items. R&D expenses increased by 8.6% from the previous year to ¥3,902 million, and the ratio of R&D expenses to sales was 6.1%.

Financial Position

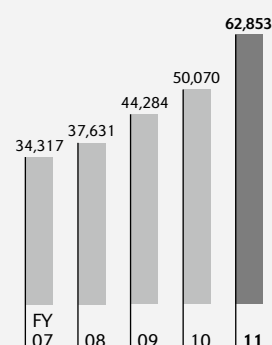
Total assets at the end of fiscal 2010 were ¥117,056 million, an increase of ¥35,820 million, or 44.1%, from the previous year.

Current assets rose by ¥29,479 million to ¥77,495 million, primarily due to increases of ¥21,331 million in cash and deposits, ¥4,744 million in trade notes and accounts receivable, and ¥3,137 million in inventories.

Fixed assets increased by ¥6,341 million to ¥39,561 million. The increase is mainly attributable to an increase of ¥5,044 million in in-

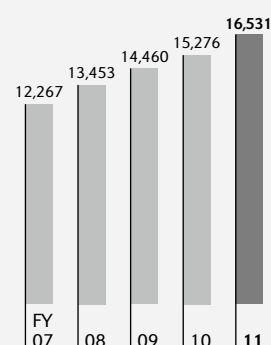
Net Sales

(Millions of yen)



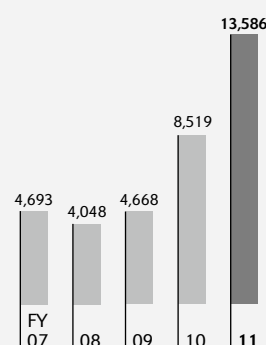
Selling, General and Administrative Expenses

(Millions of yen)



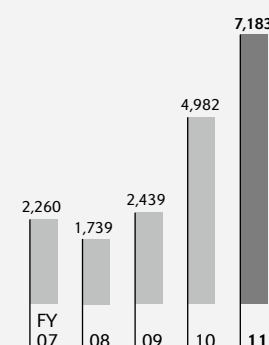
Operating Income

(Millions of yen)



Net Income

(Millions of yen)



vestment securities. Depreciation and amortization rose 1.4% from the previous year to ¥3,066 million. Capital expenditures were ¥2,805 million, ¥2,565 million lower than the previous year. The principal expenditures were for the upgrading and improvement of production facilities.

Total liabilities increased by ¥31,215 million, or 89.2%, from the end of the previous year to ¥66,193 million. Principal factors were a decrease of ¥191 million in trade notes and accounts payable, a decrease of ¥4,110 million in bank debt, an increase of ¥30,662 million in convertible bonds, an increase of ¥3,661 million in other accounts payable, and an increase of ¥485 million in income taxes payable.

Net assets were ¥50,863 million, an increase of ¥4,605 million from the end of the previous year. The equity ratio decreased by 11.1 percentage points to 43.4%.

Cash Flows

■ Cash flows from operating activities

Cash provided by operating activities was ¥5,937 million. The principal items were ¥12,290 million in income before income taxes and minority interests, ¥3,066 million in depreciation and amortization, a loss on devaluation of investments in securities of ¥840 million, an increase of ¥4,744 million in trade notes and accounts receivable, an increase of ¥3,137 million in inventories, a decrease of ¥561 million in trade notes and accounts payable, an increase of ¥2,089 million in other accounts payable and ¥4,573 million in income taxes paid.

■ Cash flows from investing activities

Cash used in investing activities was ¥20,362 million. The principal items were payments of ¥11,000 million for payments for time deposits, payments of ¥2,210 million for the purchase of property, plant and equipment, payments of ¥5,958 million for the purchase of investment securities and payments of ¥1,568 million for additional acquisition of subsidiary's securities.

■ Cash flows from financing activities

Cash provided by financing activities was ¥24,756 million. The principal items were ¥29,944 million in proceeds from the issuance of convertible bonds, a net decrease of ¥4,100 million in short-term bank debts, and ¥1,259 million in cash dividends paid.

As a result, cash and cash equivalents at end of year increased by ¥10,331 million from the previous fiscal year to ¥19,805 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 in line with business performance while maintaining the internal reserves necessary for future business development and reinforcement of the financial structure.

For the year under review, the Company stressed shareholder returns and paid an annual dividend of ¥110 per share of common stock, consisting of an interim dividend of ¥40 per share and a year-end dividend of ¥70.

Outlook for Fiscal 2011

In the outlook for the Japanese economy, although improvement in business conditions is expected due to the implementation of the government's new growth strategy aimed at economic growth fueled by an escape from deflation and employment, the deflationary trend and adverse employment situation remain causes for concern, and possible expansion of the impact of the Great East Japan Earthquake is feared.

In the ethical drugs industry, notwithstanding the revision of additional medical service fees for the dispensing of generic drugs implemented in April 2010, the generic drug prescription rate of 22.6% on a volume basis remains substantially below the government target of 30%. In view of the medical system revision scheduled for fiscal 2012, we expect further government promotion of generic drug use.

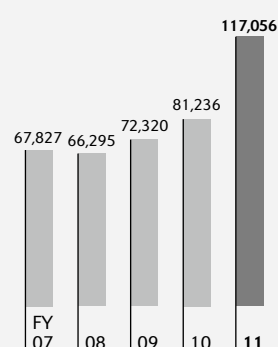
In these circumstances, the Sawai Group will strive to further augment business performance by implementing the measures set forth in the M1 TRUST medium-term business plan in its final year.

We forecast net sales to rise by 13.5% to ¥72,500 million, operating income to increase by 6.7% to ¥14,500 million, and net income to rise by 15.5% to ¥8,300 million in fiscal 2011.

In addition, although the Group incurred minor damage due to the Great East Japan Earthquake of March 11, the forecast may be revised due to factors such as future power-saving measures or the state of recovery at raw materials suppliers.

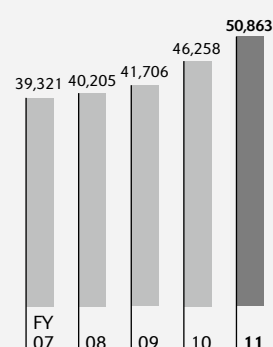
Total Assets

(Millions of yen)



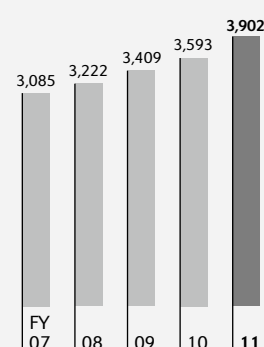
Net Assets

(Millions of yen)



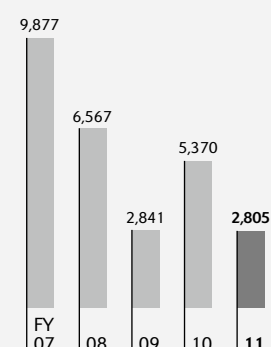
Research and Development (R&D) Expenses

(Millions of yen)



Capital Expenditures

(Millions of yen)



(Years ended March 31)