KYOWA KIRIN

Operating Results and Financial Statements

1. Summary of business performance

During the interim period under review, the Japanese economy weakened and the global economy rapidly deteriorated due to factors such as the cooling of consumer spending against a background of crisis in the financial markets caused by the sub-prime loan problem in the U.S., and the high price of raw materials such as crude oil.

As regards the business environment in which the Kyowa Hakko Kirin Group operates, in the Pharmaceuticals business, the operating environment remained severe as factors limiting medical treatment costs, such as the promotion of generic pharmaceuticals, strengthened, and competition from foreign companies and in new drug development worldwide intensified. The Bio-Chemicals business was affected by rapid increases in the cost of energy and raw material following an intensification of bio-ethanol production. In the Chemicals business, product prices remained at high levels in both overseas and domestic markets as a result of increased oil prices, however due to the effects of a slowdown in housing investment in and consumer spending there was a sharp decrease in sales volumes. In the Food business, further emphasis was placed on initiatives to ensure food safety and security, and upward pressure on raw materials prices became more severe.

Fiscal 2008 is the first year of Kyowa Hakko Kirin Group's three-year medium-term business plan and against the environment outlined above we will strive to become a world-class, Japanese R&D life sciences company, based on bio-technology and with its core business in pharmaceuticals. As a new group, we aim to realize the Kyowa Hakko Kirin vision and implement our action plan to rapidly achieve Group synergies.

In the interim period of fiscal 2008, partly due to the effects of the integration with Kirin Pharma Company, consolidated net sales for were ¥247.7 billion, 28.6% higher than in the interim period of the previous fiscal year. Consolidated operating income was ¥29.1 billion (up 59.8%) and recurring income was ¥30.3 billion (up 67.9%). Consolidated interim net income was ¥8.2 billion (down 25%) due to an extraordinary loss of ¥4.7 billion resulting from impairment losses and integration related expenses, and also, in accordance with tax accounting law, we were required to record a corporate tax adjustment of ¥5.6 billion in respect of a timing difference[*] (see note below) following our decision to sell shares in a consolidated subsidiary.

Summary of segmental performance

Pharmaceuticals

In the Pharmaceuticals business, consolidated sales increased significantly to ¥108.7 billion (up 57.8%) and operating income increased by 102.4% to ¥19.6 billion. Sales of ethical pharmaceutical products in Japan in particular were significantly higher due to the consolidation of Kirin Pharma, and despite reductions

[*] In accordance with tax effect accounting rules we are required to recognize the tax effect of the one-time difference (the difference between the amount of the investment in the consolidated balance sheets and the book value of the investment in the non-consolidated balance sheets) in respect of this investment in our consolidated financial statements.

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in National Health reimbursement prices.
As regards Kyowa Hakko products, despite a decline in sales of *Durotep,* an analgesic for persistent cancer pain, due to the ending of a joint sales contract, strong sales were maintained by *Allelock,* an antiallergic agent, *Depakene*, an anti-epileptic agent, and *Patanol*, an antiallergic ophthalmic solution, while sales of *Coversyl*, an ACE inhibitor for treatment of hypertension, that commenced in April, 2008, also performed well and contributed to growth in sales. At Kirin Pharma, in a severe competitive environment for core anemia products NESP and ESPO, we are actively providing information on them to medical practitioners, while efforts are being made to achieve rapid market penetration of REGPARA tablets, a treatment for secondary hyperthyroidism during dialysis therapy that was launched in January 2008.

In the licensing-out of technologies and export of pharmaceutical products a large one-off contract payment for the outlicensing to U.S. company Amgen of anti-CCR4 humanized monoclonal antibody KW-0761 was recorded, contributing to a large increase in sales. At subsidiary Kyowa Medex, which is responsible for the manufacture and sale of diagnostic reagents, sales of both clinical chemistry reagents and immunological reagents increased, and its sales grew compared to the first half of last fiscal year.

In new drug development in Japan, Phase III clinical trials are progressing for additional indications for anemia treatment NESP, and for KW-2246, an analgesic for cancer pain. We are also carrying out Phase II clinical trials on KRN125 a treatment for neutropenia, KW-6002, an anti-Parkinson’s disease treatment, KW-6500, also an anti-Parkinson’s disease treatment, and KW-7158, a candidate treatment for irritable bowel syndrome. KW-0761, an antibody pharmaceutical, is in Phase I clinical trials as a blood cancer treatment, and KW-3357, an agent for inhibiting blood coagulation, and ARQ 197, an anticancer agent for the treatment of malignant tumors, are also in Phase I clinical trials.

Overseas, Phase I trials are progressing for anticancer agents KRN330 (an antibody pharmaceutical) and KW-2449 in the U.S., and for anticancer agent KW-2478 in Europe.

In Australia, joint Phase I trials with Nuvelo, Inc. of the U.S. for inflammatory bowel disease treatment NU-206 were commenced in July, while in China we received approval in September for the additional indication of angina pectoris for *Coniel,* and filed applications for approval of hyperphosphatemia treatment *Phosblock* in June, and for *Allelock,* an antiallergic agent, in July.

Bio-Chemicals
In the Bio-Chemicals business, sales increased 4.3%, to ¥45.7 billion, while operating income increased 29.0%, to ¥5.2 billion. In pharmaceutical and industrial use raw materials, mainly amino acids, nucleic acids, and related compounds, strong demand continued, primarily in overseas markets, for amino acids for pharmaceutical use raw materials and intravenous liquids, but sales growth was limited partly due to a rise in the yen exchange rate. In addition, sales at Daiichi Fine Chemical declined slightly, affected by a softening vitamin market.
In health care products, sales increased compared to the first half of last fiscal year driven by increasing mail-order sales of the *Remake* series and strong sales of health food ingredients.
Sales of agrochemicals and products for the livestock and fisheries industry increased slightly, and sales of alcohol increased as efforts to expand sales of industrial-use alcohol bore fruit.

In R&D, focus was placed on research to raise the productivity of fermentation production as well as on the integration of our existing fermentation technology with Daiichi Fine Chemical’s synthesis technology in order to develop higher value-added pharmaceutical raw materials and intermediates. We are also seeking to raise the efficiency of fermentation by developing improved microbial strains and production processes.

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Chemicals

In the Chemicals business net sales increased 12.1%, to ¥57.2 billion, but operating income declined by 9.6%, to ¥2.9 billion due to an increase in depreciation expenses following investments in facilities, and other factors. In Japan, sales volumes declined significantly, compared to the first half of the previous fiscal year, partly due to our withdrawal of certain products from this fiscal year, but sales increased as revisions of core product prices were implemented as a significant rise in the naphtha and crude oil markets led to a background of higher raw materials and fuel prices. Meanwhile, export shipment volumes and sales both increased significantly due to high prices for our core products in overseas markets and continued steady operation of production facilities. By product category, volumes and sales of high-purity solvents for the IT industry increased. Specialty chemical product volumes and sales were higher than in the first half of last fiscal year driven mainly by exports and supported by strong growth in core refrigerant oil raw materials.

Food

In the Food business, sales decreased 0.7%, to ¥20.8 billion, while operating income decreased 16.2%, to ¥0.5 billion. In seasonings, sales increased as although higher raw material prices led to difficult market conditions and a sluggish performance for natural seasonings, sales of fermented seasonings through new channels were actively expanded and *Umami* seasonings performed well.

In bakery products and ingredients, sales declined partly due to our decision to halt sales of certain processed milk products due to the rapid rise in raw material prices, and despite strong growth in core flavor enhancers driven by high product approval ratings by customers. In processed foods, sales were slightly higher than in the first half of last fiscal year, partly as a result of an increase in OEM products.

Other

In the Other business segment, sales increased 48.4%, to ¥36.5 billion, while operating income increased by 50.4% to ¥0.6 billion.

Results by location

Japan

In Japan, net sales increased 27.9% to ¥239.2 billion and operating income increased 54.9% to ¥26.3 billion as a result of factors such as the receipt of a large onetime payment from contract out licensing, Kyowa Hakko Chemical's decision to revise product prices in response to an environment of high fuel and raw material prices and the effects of the consolidation of Kirin Pharma from April 2008.

Other regions

Net sales from other regions increase 40.4% to ¥25.9 billion and operating income increased 178.5% to ¥3.6 billion due to a robust market supported by an increase in overseas demand for amino acids, primarily for the amino acids for pharmaceutical use raw materials and intravenous liquids of the overseas subsidiaries of the Bio-Chemicals business, and the effects of consolidating nine overseas subsidiaries of Kirin Pharma.

2. Summary of consolidated financial position

Total assets as of September 30, 2008 were ¥748.4 billion, an increase of ¥354.3 billion compared to the end of the last fiscal year, largely due to the share exchange with Kirin Pharma on April 1, 2008. Since the business integration with Kirin Pharma was deemed a reverse acquisition upon exchange of shares, this reflects changes during the interim period including ¥96.8 billion in consolidated total assets of Kirin Pharma as of the beginning of the interim period of fiscal 2008 and Kyowa Hakko's consolidated total assets at market value.

Current assets increased ¥61.0 billion to ¥293.7 billion due to an increase in accounts and notes receivable, cash and time deposits and others. Fixed assets increased ¥293.2 billion to ¥454.6 billion. As a result of the reverse acquisition, goodwill of ¥191.9 billion was recorded, of which ¥4.7 billion was amortized during the interim period of the current fiscal year. Additionally, the reverse acquisition resulted in ¥67.4 billion recorded as changes in the market value of land and investments in marketable securities.

Liabilities increased ¥59.3 billion to ¥196.6 billion. As a result of the reverse acquisition, market valuation of land and other items resulted in an increase in deferred tax liabilities. Additionally, accounts and notes payable, accrued expenses and other items increased.

Net assets increased ¥295.0 billion to ¥551.8 billion. This reflects changes during the interim period including ¥64.6 billion in consolidated net assets of Kirin Pharma as of the beginning of the period and the market value of consolidated net assets of Kyowa Hakko (acquisition cost of Kyowa Hakko as the acquired company) as of the start of the interim period of fiscal 2008. As a result of the above factors, the shareholders' equity ratio at the end of the interim period was 73.1%, an increase of 8.5 percentage points from the end of the previous fiscal year.

Cash flow summary

The balance of cash and cash equivalents at the end of the period was ¥54.3 billion. As accounting regulations deem the share exchange that occurred on April 1, 2008 between Kyowa Hakko and Kirin Pharma a reverse acquisition, the balance of cash and cash equivalents at the beginning of the period includes ¥10.4 billion representing Kirin Pharma's consolidated balance at the beginning of the period and an increase of ¥43.7 billion in cash and cash equivalents from new consolidation (this includes Kyowa Hakko's cash and cash equivalents of an equivalent of ¥44.1 billion as of the end of the previous fiscal year) and reflects changes during the interim period. As a result, changes to cash and cash equivalents during the period were an increase of ¥0.1 billion. (Note: Compared to the ¥44.1 balance of cash and cash equivalents at the end of the previous fiscal year, cash and cash equivalents increased ¥10.2 billion.)

The primary factors contributing to changes in cash flows are as follows:

Cash flow from operating activities was ¥23.7 billion. The main positive contributing factors included ¥25.5 billion in income before income taxes, depreciation and amortization of ¥9.6 billion, a ¥6.5 billion increase in trade payables and amortization of goodwill of ¥4.9 billion. The main negative contributing factors included a payment of ¥12.5 billion in corporate, etc. taxes and a ¥3.6 billion increase in inventories.

Cash flow used in investing activities was ¥11.6 billion. The main contributing factor was the ¥8.4 billion in payments for acquisition of tangible fixed assets and ¥3.8 billion of payments into fixed-term deposits.

Cash flow used in financing activities was ¥12.4 billion. The main contributing factors were ¥10.1 billion for repayment of long-term debt and ¥1.9 billion for payment of dividends.

3. Forecasts for the fiscal year ending March 31, 2009

There are no changes to the forecasts for fiscal 2008 that were previously announced on October 21, 2008.

4. Other

(1) Changes to subsidiaries during the period (Changes to the scope of consolidation following changes to specific subsidiaries):

On April 1, 2008, Kyowa Hakko, implemented a share exchange making Kirin Pharma Company, Limited, a wholly-owned subsidiary (special subsidiary). As a result, Kirin Pharma Company, Limited has been included within the scope of consolidation as of the first quarter of the current fiscal year.

(2) Use of simplified accounting methods or special accounting procedures:

No applicable items.

(3) Changes in accounting methods, procedures and presentation in the making of these financial statements:

① As of the first quarter of the current consolidated fiscal year, Accounting Standards for Quarterly Reporting (Accounting Standards Board of Japan Article 12) and Application Guidelines related to Accounting Standards for Quarterly Reporting (Accounting Standards Board of Japan Application Guideline 14) have been applied. Further, in accordance with the Regulations for Consolidated Quarterly Reporting a quarterly consolidated financial report has been prepared.

② Changes to the valuation standards and methods for significant assets

Inventory assets

Previously, assets held in inventory for ordinary sale were calculated based on the overall average cost method, however as of the first quarter of the current fiscal year, and following the application of Accounting Standards Related to the Evaluation of Inventory Assets (Accounting Standards Board of Japan, Article 9, July 5, 2006), assets held in inventory have been calculated primarily using the overall average cost method (using the reduced book value method for balance sheet amounts based on profitability declines). As a result, operating income, recurring income and income before income tax each decreased by ¥43.6 million yen for the period under review.

③ Application of the Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for Consolidated Financial Statements.

The “Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for consolidated Financial Statements” (Practical Issues Task Force No. 18, May 17, 2006) has been applied from the first quarter of the current consolidated fiscal year.

There is no effect on profits and losses during the period under review as a result of this change.

④ Application of Accounting Standards for Lease Transactions

Previously, the accounting treatment for finance lease transactions, other than those involving ownership transfer, was based on accounting methods for operating lease transactions. However, we are now able to apply the Accounting Standards Related to Lease Transactions (Accounting Standards Board of Japan, Article 13, June 17, 1993, (First Committee of the Business Accounting Council)), revised March 30, 2007, and the Application Guidelines for Accounting Standards Related to Lease Transactions (Accounting Standards Board of Japan, Application Guideline 16, January 18, 1994) (Japanese Institute of Certified Public Accountants, Committee on Accounting Systems)), revised March 30, 2007, to the consolidated financial reports for the consolidated accounting year beginning April 1, 2008. As a result, from first quarter of the current fiscal year these accounting standards will be the usual method used to account for such transactions. Further, as regards the depreciation method for leased assets related to finance lease transactions other than those involving ownership transfer, the straight-line method will be applied to the residual value over the useful life of the asset until it reaches zero. For finance lease transactions, other than those involving ownership transfer for lease transactions, with a start date prior to the application of accounting standards at the beginning of the fiscal year the standard accounting treatment for leases will continue to be applied. The effect on profits and losses during the period under review as a result of this change is immaterial.