KYOWA HAKKO KOGYO CO., LTD. Annual Report 2006

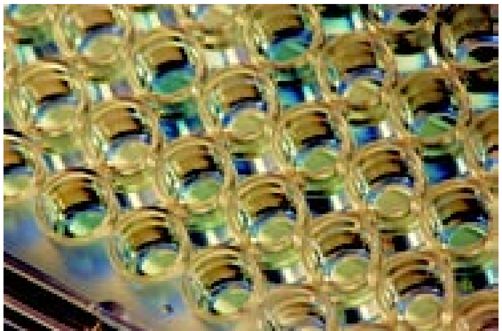
KYOWA

KYOWA HAKKO

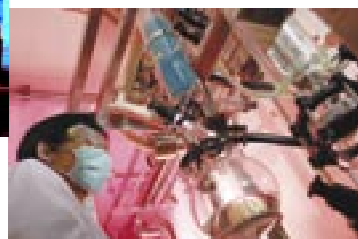
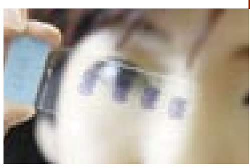
Annual Report 2006

Year ended March 31, 2006

Fortifying Potent Growth Drivers






Kyowa Hakko Kogyo Co., Ltd., is an R&D-based company with special strengths in biotechnology. The Company is dedicated to the creation of new value in the life sciences, especially in its two core business segments of Pharmaceuticals and Bio-Chemicals, and strives to contribute to the health and well-being of people around the world.

In Pharmaceuticals, since contributing to the eradication of tuberculosis in Japan with the introduction of streptomycin and developing Mitomycin C, now a leading cancer chemotherapy agent, the Company has actively engaged in the R&D, production, and sale of pharmaceuticals that address needs in such areas as cancer, allergies, and hypertension.

In Bio-Chemicals, Kyowa Hakko is a global leader in the supply of fermented bulk products, such as amino acids and nucleic acids.

The Company's Chemicals operations are expanding lineups of specialty chemicals that contribute to environmental conservation.

Kyowa Hakko's Food operations use the Company's fermentation and other original technologies to differentiate the Company from competitors in the development of food ingredients, especially natural seasonings.

Shortcuts

Note to Performance Forecasts

Forecasts contained in the Annual Report 2006 represent judgments based on information available as of June 28, 2006. It should be noted that there is a possibility that actual results could differ significantly due to such factors as exchange rate fluctuations.

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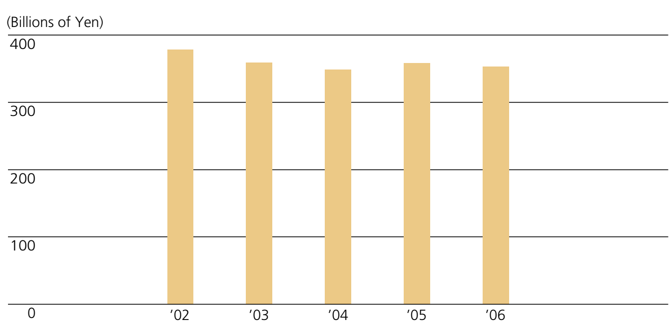
FINANCIAL HIGHLIGHTS

KYOWA HAKKO KOGYO CO., LTD. and Its Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

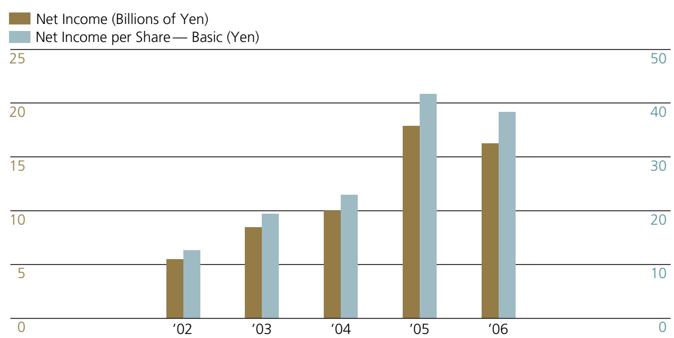
	Millions of Yen			Thousands of U.S. Dollars (Note 1)
	2006	2005	2004	**2006**
For the Year:				
Net sales	¥353,440	¥358,963	¥348,838	$3,008,768
Operating income	25,535	33,507	26,836	217,375
Net income	16,273	17,932	10,017	138,529
Capital expenditures	10,859	7,647	9,041	92,441
Depreciation and amortization	9,789	10,565	11,358	83,332
R&D expenses	32,876	28,762	29,206	279,867
At Year-End:				
Total assets	384,381	374,493	361,096	3,272,163
Interest-bearing debt	12,216	12,193	13,358	103,992
Total shareholders' equity	255,807	235,439	225,042	2,177,636
Per Share Data:	Yen			U.S. Dollars (Note 1)
Net income—basic (Note 2)	¥ 38.4	¥ 41.7	¥ 23.0	$0.327
Total shareholders' equity	604.9	556.3	522.6	5.149
Cash dividends	10.0	10.0	7.5	0.085
Ratios:	%			
Return on assets	4.29	4.88	2.74	
Return on equity	6.63	7.79	4.51	

Notes: 1. U.S. dollar amounts are translated from Japanese yen, for convenience only, at the rate of ¥117.47=US$1, the approximate exchange rate at March 31, 2006.
2. Net income per share of common stock is based upon the weighted average number of shares of common stock outstanding during each year, appropriately adjusted for subsequent free distributions of common stock.

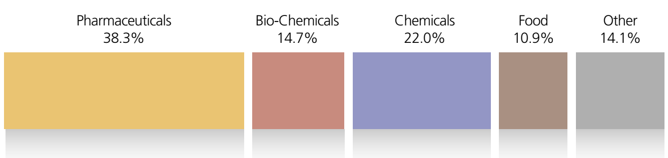
Net Sales



Net Income / Net Income per Share

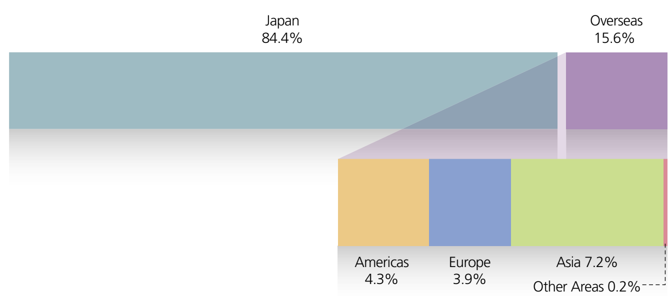


Sales Composition by Industry Segment*



* Figures include inter-segment sales.

Sales Composition by Geographic Area*



* Overseas sales are sales by the Companies to customers outside of Japan.

Business Conditions and Performance

Challenging business conditions continued in fiscal 2006, ended March 31, 2006. In Pharmaceuticals, global competition over marketing and the development of new ethical drugs intensified, while the Japanese government moved forward with measures to curb health care expenses. Meanwhile, Bio-Chemicals saw sluggish domestic demand for amino acids for beverages and fiercer international price competition. Chemicals enjoyed favorable market conditions at home and abroad, as firm demand growth in China counteracted rapidly rising crude oil prices. Food struggled to keep pace with changes in market structure resulting from rapidly diversifying consumer preferences.

Faced with this operating environment, we pursued the overriding goals of growth and development set out in our Ninth Medium-Term Management Plan, a three-year plan launched from fiscal 2006. To these ends, we invested in R&D and facilities to capture long-term growth opportunities. Moreover, we strengthened the competitiveness of our businesses by developing new products and enhancing profitability through strategic sales expansion and comprehensive cost reductions.

Against this backdrop, in fiscal 2006 consolidated net sales decreased 1.5% year on year, to ¥353.4 billion. Reflecting such factors as higher R&D expenses, the Company recorded decreases of 23.8% in operating income, to ¥25.5 billion, and 9.2% in net income, to ¥16.3 billion. Furthermore, cash dividends per share were the same as in the previous fiscal year, ¥10.00, which comprised interim and year-end dividends of ¥5.00 per share.

Outlook for Fiscal 2007

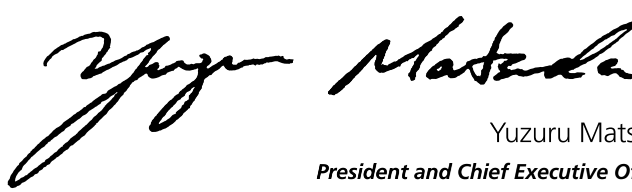
In the current fiscal year, ending March 31, 2007, we believe the operating environment will need ongoing monitoring given concerns regarding additional hikes in crude oil prices and increases in long-term interest rates coupled with uncertainty over the outlook for the economies of the United States and China. Given these business conditions, we intend to invest for growth while taking comprehensive measures to reduce costs. Due to the impact of canceling a distribution agreement for the oral antimycological agent Itrizole®, we project a decline in net sales, to ¥340.0 billion, in fiscal 2007 and expect to secure operating income of ¥26.0 billion—the same level as in the year under review. Furthermore, we expect net income will decrease year on year, to ¥13.0 billion.

Building a Foundation for Growth

Guided by its corporate philosophy of "contributing to the health and well-being of people worldwide by creating new value with the pursuit of advancements in life science and technology," Kyowa Hakko will develop business globally as an R&D-based company fueled by creative, groundbreaking research and technology. Reflecting fiscal 2007's position as the second year in the Ninth Medium-Term Management Plan for investment focused on building a growth foundation, we are steadily implementing the plan's measures to sharpen our competitiveness, enrich our growth potential, and maximize corporate value.

As we continue to take on these challenges, we ask our shareholders for their ongoing support in the coming years.

June 28, 2006



Yuzuru Matsuda

President and Chief Executive Officer

Ninth Medium-Term Management Plan Off to a Solid Start

Kyowa Hakko completed the first year under its Ninth Medium-Term Management Plan, which it embarked on in April 2005. In the following interview, Yuzuru Matsuda gives an overview of progress made under the plan so far and future strategies.

Q How do you evaluate fiscal 2006 business results?

A Overall, I think we achieved a favorable start under the new plan. We have positioned the three-year period covered by the Ninth Medium-Term Management Plan as a period of investment for the purpose of building a growth foundation. The declines in revenues and earnings in the plan's first year, which ended in March 2006, were consistent with the temporary decreases that we anticipated and included in the plan.

Looking at business results for fiscal 2006, ended March 31, 2006, active efforts in Pharmaceuticals to increase sales in Japan led to robust growth in sales of such mainstay lineups as the antiallergic agent Allelock® and the analgesic for persistent cancer pain Durotep® Patch. Meanwhile, revenues from oral capsules of the antimycological agent Itrizole®, marketed under a distribution agreement, decreased substantially. However, this decrease did not significantly affect earnings. We canceled our distribution agreement for Itrizole® with Janssen Pharmaceutical K.K. at the end of March 2006. Net sales were down, and operating income decreased due to such factors as higher R&D expenses related to our promising new anti-Parkinson's disease agent KW-6002 as it proceeded through the final stage of development, phase III clinical trials.

In Bio-Chemicals, net sales edged down and operating income declined sharply, reflecting weak domestic demand for beverage-use amino acids as the strong popularity of beverages containing amino acids receded. Meanwhile, price competition intensified due to low-price amino acids associated with the market entry of Chinese and South Korean manufacturers.

In Chemicals, two increases in product prices did not completely offset hikes in crude oil prices. As a result, although net sales increased, operating income decreased.

In Food, the divestiture of consolidated subsidiary Asahi Foods Products Co., Ltd., counteracted higher sales of *Umami* seasonings and bakery products and ingredients. Consequently, net sales were lower, and operating income remained flat.

Q Kyowa Hakko transferred to an operating holding company system one year ago. Can you give an overview of your achievements since then?

A We had four aims in moving to an operating holding company structure. First, we wanted to base the Company on biotechnology in mainstay Pharmaceuticals and Bio-Chemicals to entrench Kyowa Hakko as a "Bio-Leader." Second, in each segment we sought to lay foundations for businesses that were self-supporting and competitive in their respective industries. Our third objective was to realize management that accurately and rapidly reflects customers' needs. Last, we aimed to heighten the competitiveness of the Kyowa Hakko Group.

When we transferred to the new system, I visited operational bases across Japan and held in-depth consultations with our employees. One year has passed since then, and I feel a change in our employees. They are approaching their work with a more forward-looking attitude and taking the initiative. There is a stronger awareness among employees of Kyowa Hakko being their company and their business.

Ultimately, however, results are what matter. It is important that the transfer to the operating holding company system produces tangible benefits for the Group as a whole. Therefore, we have set out numerical targets for each operational area's respective fiscal years, with a strong emphasis on achieving sustainable growth and development. We are managing operations guided by action plans that incorporate these targets, and I am confident that our efforts will result in concrete gains.

Q In fiscal 2006, the first year of the Ninth Medium-Term Management Plan, what measures did Kyowa Hakko take?

A We invested steadily to lay the foundations for future growth—the overriding objective of the plan. There is absolutely no change in our basic position, which is to steadfastly carry out plans, even if earnings decline temporarily, in preparation for a phase of growth and development during the period of the Tenth Medium-Term Management Plan.

We took measures in six main areas. First, our anti-Parkinson's disease agent KW-6002 completed the final phase of its development, phase III clinical trials, in the fiscal year under review. Currently, we are making concerted efforts to prepare for filing a New Drug Application (NDA) in the United States in the second half of 2006. At the same time, we are selecting alliance partners, since tie-ups with major pharmaceutical companies are essential to marketing KW-6002 worldwide.

KW-6002 has a completely different mechanism than existing treatments for Parkinson's disease. When Parkinson's disease patients who have been continuously administered such treatments as L-dopa take KW-6002 as an adjunct therapy, the efficacy of anti-Parkinson's disease treatments stabilizes and side effects are lessened. We expect KW-6002 to be a major new ethical drug that will generate peak annual revenues of approximately ¥50.0 billion worldwide. Moreover, we are working to expand the indications of KW-6002 to include such conditions as restless legs syndrome (RLS), which has been a focus of attention recently. The market for RLS treatments promises to be even larger than the market for our anti-Parkinson's disease agent.

Second, in therapeutic antibody operations we stepped up the licensing of our unique Potelligent™ technology, which boosts antibody activity more than a hundredfold. Our patenting of Potelligent™ technology has accelerated the development of licensing. When we began Potelligent™ technology licensing three and half years ago, we targeted the conclusion of licensing agreements for 20 antibodies over five years. By the end of fiscal 2006, we had concluded licensing agreements with six companies for 24 antibodies. In March 2006, we announced the granting of a license to Genentech, Inc., an international biopharmaceutical giant accounting for roughly 40% of all sales of therapeutic antibodies worldwide. I think this latest achievement testifies to the recognition of Potelligent™ technology as a global standard. In addition, the in-house-developed therapeutic antibody KW-0761 entered phase I clinical trials. Moreover, we expect a series of therapeutic antibodies currently being developed through the licensing of Potelligent™ technology to enter clinical trials. Also, we are advancing several codevelopment projects for therapeutic antibodies. In these initiatives, Kyowa Hakko provides funds to bio-venture companies to develop their antibodies or antigens using Potelligent™ technology.

Third, we increased sales of such mainstay pharmaceuticals lineups as Coniel® and Allelock®, which performed particularly well and steadily grew its share of the domestic market. In terms of prescriptions, Allelock® is close to becoming the number one treatment among antiallergic agents. Our goal is to establish Allelock® as the top antiallergic agent in Japan in prescriptions and sales.

Fourth, in Bio-Chemicals operations we enhanced cost-competitiveness and production capacity for mainstay amino acids. Our innovative manufacturing process, which dramatically increases amino acid productivity, will be implemented in fiscal 2007 at our U.S. production base, Biokyowa Inc. As a result, we look forward to Biokyowa producing amino acids with greatly strengthened cost-competitiveness. Also, in February 2006 a new plant in Shanghai, China, started operations with an annual amino acid production capacity of 2,500 tons—four times larger than that of its predecessor. Primarily manufacturing amino acids for infusions, the new plant enforces stringent operational standards that fully satisfy U.S. Food and Drug Administration inspections. This new plant completes our three-pronged production system with bases in Japan, the United States, and China and enables a stable supply of amino acid products worldwide.

Fifth, we buttressed competitiveness through comprehensive cost reductions. The Ninth Medium-Term Management Plan sets out a target of ¥10.0 billion for comprehensive cost reductions, which includes curbing personnel expenses by an amount equivalent to the expenses for 700 employees and reducing production costs. In fiscal 2006, we offered employees early retirement twice, and 115 managers from the Head Office as well as 100 employees from the Bio-Chemicals plants applied. Furthermore, we are reviewing appropriate salary levels for separate operations, regions, and job types to fully realize our competitive strengths.

Sixth, we actively invested in Chemicals operations with a view to expanding lineups of environment-friendly specialty chemicals. As Asia's only manufacturer of raw materials for lubricants in air-conditioning and refrigeration equipment that uses CFC substitutes, we will invest to ramp up production. We anticipate an expansion of the market for these materials as the use of refrigerators and air conditioners rises, reflecting China's economic growth.

Q What is the key to growth in each operational field?

Pharmaceuticals

A Because Kyowa Hakko is an R&D-based company, our management strategy focuses on rapidly bringing differentiated new drugs to market. Kyowa Hakko's new drug discovery capabilities compare favorably with those of major pharmaceutical manufacturers. Aiming to exploit this strength, we concentrate our efforts on speeding up the process from the discovery of a new drug through to proof of concept (POC): the confirmation that a drug candidate is effective on humans in phase IIa clinical trials. We call this front-loading approach the POC Fast strategy. After obtaining POC, we choose the best way to market the drug as soon as possible and maximize its value, such as licensing to another pharmaceutical company or entering a tie-up to jointly develop and market the drug. For example, we are currently negotiating marketing alliances for the anti-Parkinson's disease agent KW-6002 that has recently completed phase III clinical trials. Similarly, we aim to forge alliances once POC has been established for the overactive bladder treatment KW-7158, which is currently undergoing phase IIa clinical trials in Japan. Moreover, we are steadily building systems to further enhance the POC Fast strategy.

In addition, increasing sales of existing mainstay lineups is crucial. Accordingly, by focusing on mainstay offerings we will steadfastly expand sales of existing pharmaceutical products by redoubling efforts under our Sales and Marketing Transformation (SMART) strategy. These efforts are aimed at offsetting such negative factors as the April 2006 revision of official ethical drug prices and the scheduled launch of generic versions of Coniel® in July 2006.

In therapeutic antibody operations, we need to establish the POC Fast strategy to fully draw on the expertise that Kyowa Hakko has accumulated in this field over many years. Bearing this in mind, the Company decided to establish antibody production facilities to raise its production capacity for clinical-trial-use antibodies and expedite the initial clinical development of antibodies. Our pipeline of therapeutic antibodies for in-house development includes BIW-8405, a treatment targeting asthma that BioWa, Inc., is currently developing and will soon enter clinical trials in the United States. Furthermore, while KW-0761 is currently undergoing phase I clinical trials for an allergy treatment indication in Europe, two or three of our alliance partners' therapeutic antibodies using Potelligent™ technology are about to enter clinical trials after 2006. I believe we have to carefully monitor the progress of such development drugs since they will be major contributors to Kyowa Hakko's future earnings and growth.

Growing as a Global Biotechnology Group

Theme: Investing in growth

Basic policy: Aggressive investment to secure growth opportunities, primarily in Pharmaceuticals and Bio-Chemicals

Aggressive investment

Pharmaceuticals

- Promote development of KW-6002
- Build foundation for overseas market development (KW-6002, China)

Bio-Chemicals

- Reinforce overseas production bases for amino acids

Chemicals

- Increase specialty chemicals' production capacity (raw materials for lubricants in air-conditioning and refrigeration equipment that uses CFC substitutes)

Grow sales in existing businesses

Pharmaceuticals

- Bolster domestic marketing of pharmaceuticals (SMART*)
- Implement POC Fast strategy (cancer, allergies, central nervous system, antibodies)
- Expand exports and technology licensing

Bio-Chemicals

- Increase cost-competitiveness in amino acids
- Focus resources on health care operations (Japanese and U.S. health food markets)

Chemicals

- Build operations in growth fields (specialty chemicals)
- Continue to investigate alliances with other companies (basic chemicals)

Food

- Focus on natural seasonings and bread improvers and flavor enhancers

Comprehensive cost-reduction initiatives

(target: ¥10 billion in reductions)

- Bolster competitiveness with comprehensive cost reductions, such as curbing personnel expenses by amount equivalent to 700 employees, revising compensation system, and lowering production costs

* SMART (Sales and Marketing Transformation) is a project involving the quantitative analysis of the effectiveness of the allocation of sales and marketing resources, the optimal reallocation of resources, and the improvement of productivity from the viewpoints of expected return by product, effective marketing methods that match medical needs, and effective sales activities.

Progress in FY 2006

Pharmaceuticals

KW-6002 Pages 10 and 11

- Phase III clinical trials completed
- NDA filing in the United States by late 2006
- Marketing alliance negotiations under way
- Additional indications for monotherapy and RLS in phase IIa

China Pages 12 and 13

- Additional angina pectoris indication for Coniel® in phase III

Japan Page 21

- Sales of mainstay products, such as Allelock® and Durotep® Patch, increased

Exports and technology out-licensing Pages 21 and 22

- Olopatadine-related business increased

Therapeutic antibody operations Pages 13 to 15

- Potelligent™ technology licensed to world's leading therapeutic antibody companies

Bio-Chemicals

United States (Biokyowa) Pages 15 and 16

- Innovative manufacturing process to be implemented in fiscal 2007

China (Shanghai Kyowa Amino Acid) Pages 15 and 16

- New plant launched in February 2006
- Amino acid production capacity to increase fourfold

Japan Pages 15 and 16

- Coenzyme Q10 production to resume in fiscal 2007
- Dipeptide production to be launched in fiscal 2007

Chemicals

Japan Page 26

- Specialty chemicals' production capacity increased (raw materials for lubricants in air-conditioning and refrigeration equipment that uses CFC substitutes)

Food Page 19

- A number of new natural seasonings and bakery products and ingredients launched in fiscal 2006

Comprehensive cost-reduction initiatives

Japan Pages 5 and 8

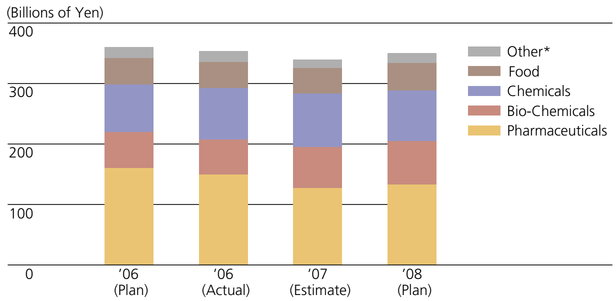
- Implementation of support for employee early retirement program
  (115 managers at the Head Office and 100 production employees at Bio-Chemicals plants)

Numerical Targets

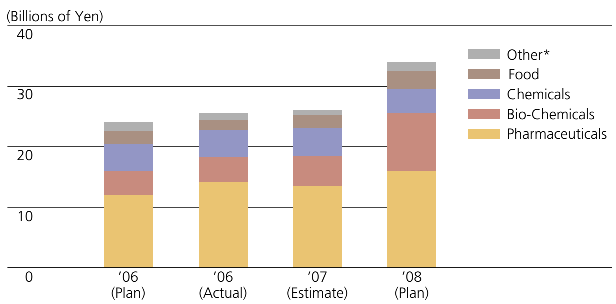
	FY2008 Target
Net Sales (Billions of yen)	350.0
Operating Income (Billions of yen)	34.0
Return on Invested Capital* (%)	12.0

* Return on Invested Capital = operating income / total fixed assets + (accounts receivable + inventories – trade payables)

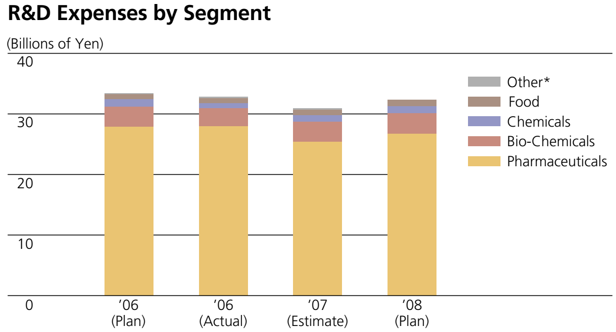
Sales Target by Segment



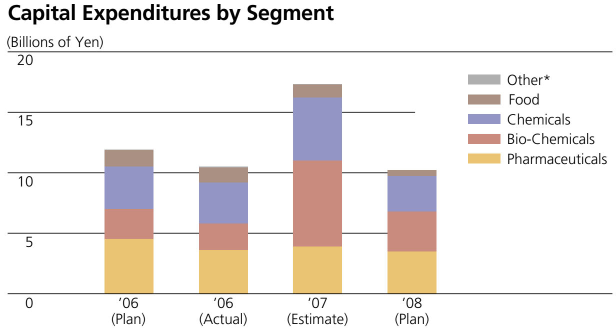
Operating Income Target by Segment



R&D Expenses by Segment



Capital Expenditures by Segment



* Figures for Other include inter-segment transactions.

Bio-Chemicals

There are four principal drivers of growth in Bio-Chemicals. First of all, we need to increase sales of amino acids, the segment's mainstay product. Our revolutionary amino acid manufacturing technology doubles productivity, and its introduction at our U.S. production subsidiary Biokyowa will significantly fortify our ability to compete with the low-pricing strategies of Chinese and South Korean manufacturers. Moreover, by boosting production capacity at Shanghai Kyowa Amino Acid Co., Ltd., in Shanghai, China, we have enabled the stable supply of amino acids worldwide, thanks to our three-pronged production system with bases in Japan, the United States, and China.

Next, in health care products we decided to resume the in-house production of coenzyme Q10. Although we manufactured coenzyme Q10 until 1986, due to cost considerations we switched to purchasing. We decided to restart the in-house production of coenzyme Q10 since demand remains solid and previous cost issues were resolved. Furthermore, markets and sales channels, mainly in the United States, promise future growth. Also, capital investment has been minimized through the use of existing facilities. Moreover, manufacturing coenzyme Q10 will likely enhance the Hofu Plant's overall capacity utilization rate, thereby lowering the plant's production costs. We intend to increase sales of coenzyme Q10 and position it as one of health care operations' principal products.

The third main driver of growth in this segment is the development of new markets for dipeptides, which we produce by joining two amino acids. We are already carving out a new market for alanyl-glutamine, a dipeptide comprising L-alanine and L-glutamine, by providing sample products worldwide. We plan to start commercial production of the new dipeptide shortly.

Last, we are eager to expand health care operations. Customers feel that Kyowa Hakko's health care products are safe and reliable. We are grateful for the trust customers place in us, which I think reflects brand value. Because we are a company centered on pharmaceuticals operations, we take the utmost care to ensure quality and safety in operational development. While carefully preserving the brand value that we have accumulated, we will expand business-to-business health care operations and grow mail-order sales and other areas.

Chemicals and Food

We will step up the development of Chemicals and Food operations under the three overall themes of health, environment, and beauty.

In Chemicals, I feel that the creation of specialty chemicals—functional high-value-added products—is the key to growth. Therefore, we will increase the proportion of environment-friendly lineups in the segment.

In Food, growth will be determined by our ability to draw on original fermentation technologies to develop differentiated new products, such as natural seasonings and bread improvers and flavor enhancers.

Comprehensive cost reductions

Under the Ninth Medium-Term Management Plan, we intend to further bolster competitiveness by resolutely carrying out comprehensive cost reductions totaling ¥10.0 billion, comprising a ¥5.0 billion reduction equivalent to personnel expenses for 700 employees and ¥5.0 billion in other cost reductions. Seeking to strategically lower purchasing costs, in April 2006 we established a purchasing department to consolidate Companywide purchasing. In addition to these measures, we intend to aggressively pursue further cost reductions.

Q What types of measures are you taking to maximize shareholder value?

A Based on a paradigm in which Pharmaceuticals and Bio-Chemicals drive overall business development while Chemicals and Food support them, our fundamental approach is to enhance shareholder value by strengthening respective operations to heighten profitability.

Dividend policy is one of Kyowa Hakko's management priorities. In fiscal 2005, we increased cash dividends per share from ¥7.5 per share to ¥10.0. Because we have designated the term of the Ninth Medium-Term Management Plan as a period of forward-looking investment, in some fiscal years income will likely decrease. However, we are committed to continuing stable payments of cash dividends. Meanwhile, we have earmarked retained earnings for investment in plant and R&D.

The Company held 11,448 thousand shares of treasury stock as of March 31, 2006. In light of cash flows and other considerations, we will continue acquiring treasury stock as required.

Regarding hostile takeovers, I believe the optimal preventive measure is the enhancement of corporate value. Our management team is endeavoring to realize medium- to long-term earnings that satisfy the expectations of our shareholders. Furthermore, we are pursuing a management policy that emphasizes the role of the general meeting of shareholders as a forum for making decisions on a range of issues.

Q What measures are you taking in response to the new Corporate Law, which calls for enhanced internal control systems and stronger corporate governance?

A In conjunction with the enactment of the new Corporate Law, we established an auditing department under the direct control of the president, which checks the appropriateness of operational implementation from a neutral position that is independent of operating systems. Also, we created a risk management committee that carefully controls risk for the Kyowa Hakko Group as a whole. Furthermore, our system of checks based on corporate auditors is functioning adequately. Early on, we established a system comprising three outside corporate auditors, of whom two are standing corporate auditors and one is an in-house corporate auditor. We intend to undertake forward-looking considerations of whether or not to establish an outside director.

Q Can you explain your philosophy regarding corporate social responsibility?

A I am of the opinion that companies are public institutions. Kyowa Hakko has embodied the spirit of corporate social responsibility in the decades since its

foundation. After the Second World War, the founder of Kyowa Hakko became passionately committed to ridding Japan of a tuberculosis epidemic. Disregarding profitability, he obtained a license for an effective tuberculosis treatment, streptomycin, from the U.S. pharmaceutical company Merck & Co., Inc. Also, in response to the scarcity of food in post-war Japan, we applied fermentation techniques for the industrial production of amino acids—the first company in the world to do so. I think these two examples from our earliest years illustrate a commitment to "helping people around the world" lies at the core of Kyowa Hakko. I often impress upon our employees that we must never forget that founding spirit in the development of operations.

In some cases, we decide to develop a drug that patients or medical institutions really need, even though it may not be profitable. I believe that such contributions are Kyowa Hakko's corporate social responsibility and raison d'etre.

Q How do you see operations unfolding in the current fiscal year?

A In fiscal 2007, ending March 2007, we project consolidated net sales of ¥340.0 billion. Breaking that down by segment, we forecast ¥127.0 billion from Pharmaceuticals, ¥68.0 billion from Bio-Chemicals, ¥88.0 billion from Chemicals, ¥43.0 billion from Food, and ¥14.0 billion from Other. Operating income will likely reach ¥26.0 billion, above the Ninth Medium-Term Management Plan's target of ¥24.0 billion. On a segment basis, we expect operating income of ¥13.5 billion in Pharmaceuticals, ¥5.0 billion in Bio-Chemicals, ¥4.5 billion in Chemicals, ¥2.3 billion in Food, and ¥0.7 billion in Other.

In Pharmaceuticals, the April 2006 revision of official ethical drug prices resulted in a 6.8% reduction for Kyowa Hakko's products, which was roughly in line with the industry average. In addition, we plan to file our promising new anti-Parkinson's disease agent KW-6002 in the United States in the second half of 2006. Furthermore, we aim to finalize marketing alliances for the drug by the end of 2006.

In Bio-Chemicals, plans call for the establishment of facilities for the in-house production of coenzyme Q10 during the current fiscal year.

Moreover, we plan a significant year-on-year increase in companywide capital investment, to ¥17.3 billion.

Q How do you see Kyowa Hakko evolving over the long term?

A Fermentation technology is part of Japanese culture. Long ago, people began using fermentation to make soybean paste, soy sauce, and fermented soybeans. Fermentation was used in the biotechnologies that came into the limelight in the 1980s, such as cell culturing and genetic engineering. Today, it is widely used in such leading-edge fields as regenerative medicine, gene therapy, and therapeutic antibodies. In this way, fermentation technology has served as a base for the development of biotechnology in Japan. Kyowa Hakko has developed in tandem with the history of fermentation. Looking ahead, we will continue striving to be the world's number one fermentation / biotechnology company.

Kyowa Hakko's goal is to fully leverage biotechnology-based synergies among four self-supporting operational segments: Pharmaceuticals, Bio-Chemicals, Chemicals, and Food. The uniting themes of these initiatives are health, environment, and beauty. We aim to create new high-value-added technologies and products that directly benefit society. By developing operations guided by these strategies and ideals, Kyowa Hakko will progress and grow.

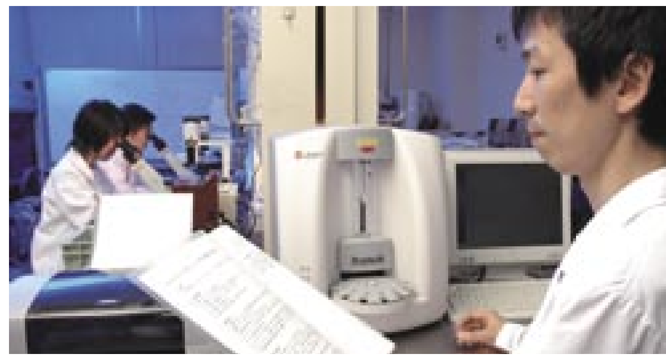
Fortifying Potent Growth Drivers

We are currently in the second year of our Ninth Medium-Term Management Plan, which sets out strategies for laying the foundations of future growth. By pursuing these strategies, we are steadily fortifying a potent mix of growth drivers that will fuel robust expansion. The following sections focus on some of the key elements.

Pharmaceuticals—Global Development

Basic Strategy for New Drug R&D

In the R&D of new ethical drugs, Kyowa Hakko emphasizes the POC (Proof of Concept) Fast strategy. As far as possible, we aim to front-load the process from the discovery of new drug candidates to phase IIa clinical trials, which establish whether the drug has the expected medicinal benefits in humans. Expediting these early development stages



KW-6002: Toward NDA Filing

Indication: Parkinson's Disease (Adjunct therapy)

Lessening of the "Wearing-Off" Effect

- Clinical trials confirmed that 20mg or 40mg daily doses of KW-6002 optimally combined with L-dopa or other treatments for Parkinson's disease lessened the wearing-off effect in advanced-stage Parkinson's disease patients—a symptom that used to be uncontrollable.
- As a result, after phase II trials, phase III trials also confirmed the indication.
- Phase III trials confirmed the same safety profile as phase IIb trials.

Evaluation Recognizes Improved Motor Function

- Daily 40mg doses of KW-6002 improve motor function, according to scores in part III of the Unified Parkinson's Disease Rating Scale, which assesses symptoms.

Other Indications

Monotherapy Trials (Parkinson's disease)

Restless Legs Syndrome (RLS) Trials

Planned NDA Filings

- United States: Aim to file NDA in second half of 2006
- Europe: Plan to file NDA after U.S. application
- Japan: Make maximum use of overseas data. Combine with future domestic data and file NDA

Clinical Trials

Continue implementation (both additional indications in phase IIa) optimizes competitiveness. Rather than regardlessly pursuing in-house development, we give priority to rapidly establishing POC. An example of this type of strategic management decision making was our licensing of the candidate anticancer agent mitotic kinesin Eg5 inhibitor to Eli Lilly and Company, of the United States. After the POC of a new drug has been verified, from phase IIb clinical trials onward we decide whether to pursue in-house development and file an NDA, license out the compound, or conduct joint development with another company. In making this decision, we look to maximize value based on an overall analysis of our development pipeline.

Furthermore, reflecting our policy of initially developing new drugs overseas, we have established two clinical development subsidiaries: Kyowa Pharmaceutical, Inc., in Princeton, New Jersey, in the United States, and Kyowa Hakko U.K. Ltd., in Slough, Berkshire, near London, in the United Kingdom. These companies have several new candidates entering the clinical stage from the preclinical stage.

Progress with Key Candidate Drugs

KW-6002

KW-6002 is the world's first selective adenosine A2A receptor antagonist. We completed phase III large-scale clinical trials of KW-6002 as a treatment for Parkinson's disease in the United States and Europe. When it is used concomitantly with L-dopa, its effectiveness in improving the "wearing-off" effect has been confirmed. Based on the successful completion of large-scale clinical trials, we aim to file an NDA in the United States. Plans call for subsequent filings in Europe and Japan. Moreover, in the United States phase IIa clinical trials are under way for KW-6002 as a monotherapy for Parkinson's disease and a treatment for restless legs syndrome.

KW-7158

KW-7158 is a non-cholinergic compound with a tricyclic structure. It differs from existing anticholinergic drugs in that it is effective on the peripheral sensory nerves in the bladder. Indications are expected to include urinary frequency, urinary incontinence, and sense of urgency caused by overactive bladder contractions. Currently, phase IIa clinical trials are under way in Japan. The market for this drug is large and includes competing products from major global pharmaceutical companies. Therefore, we will likely base overseas development and operational rollout on alliances.

KW-2871

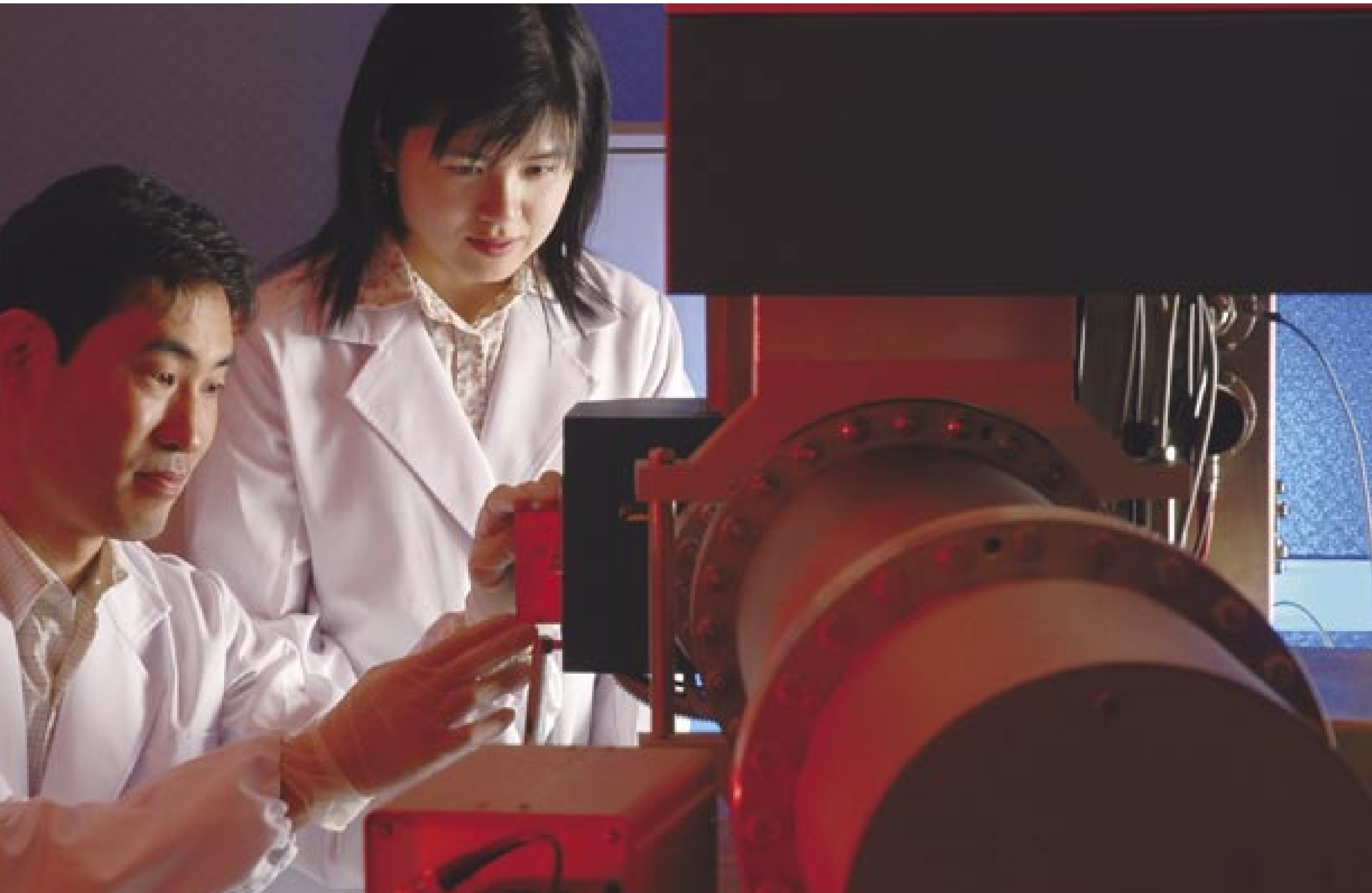
KW-2871 is a monoclonal antibody that binds specifically to the GD3 cell surface antigen, which is expressed in about 90% of melanoma cells. In the United States, phase I / IIa clinical trials have been completed for KW-2871 as an anticancer agent for malignant melanoma. At present, we are looking to development operations based on alliances.

KW-0761

KW-0761 is a humanized monoclonal antibody for CCR4 chemokine receptors selectively expressed in T-helper type 2 (Th2) cells and other cells. Phase I clinical trials are currently under way in Europe for the indications of KW-0761 as an antiallergic agent.

Operational Development in China

We are focusing efforts on marketing Coniel®, an agent for treating hypertension launched in December 2004. At the same time, phase III clinical trials for the antiallergic agent Allelock® and for an additional indication of angina pectoris for Coniel® are under way. Furthermore, aiming to manufacture Coniel® and Allelock® for sale in China, we are constructing a plant in Suzhou, Jiangsu



Province, China, which is scheduled to start up operations in the second half of 2007.

Advancing Toward New Horizons in Therapeutic Antibodies

In addition to KW-0761, the Department of Antibody Research of BioFrontier Laboratories is leading research on a number of antibodies with a view to proceeding to clinical trials. Against this backdrop, we officially decided in April 2006 to construct a new facility—compliant with Good Manufacturing Practice (GMP) standards—for the production of antibodies for use in clinical trials. We will complete the construction of the production facilities at the end of 2008 and initiate operations in the first quarter of 2009. We are optimistic that the new production of antibodies for use in clinical trials will increase the number of antibodies advancing to clinical trials, thereby accelerating the expansion of our development pipeline.

BioWa—Moving Forward

Since its founding as a U.S. subsidiary in February 2003, BioWa has aggressively licensed Potelligent™ technology. In October 2005, following a partial patent acquisition, BioWa stepped up licensing efforts and granted licenses to MedImmune, Inc.; Igeneon GmbH, a wholly owned subsidiary of Aphton Corporation; and Genentech, Inc. In 2004, Genentech-related therapeutic antibodies sales accounted for more than 40% of the total

Expansion of Therapeutic Antibody Business: Potelligent™ Technology

Patent Establishment (United States)

- Potelligent™ cell itself patented
- Targets range of mammal cells with fucosyltransferase gene deficiency

Combined-Type Alliance

- Joint development of therapeutic antibodies using Potelligent™ technology with antibodies / antigens of alliance partner bio-venture companies
- Several projects under way

Accelerated Out-Licensing

Licensed to the World's Leading Therapeutic Antibody Companies

- Potelligent™ licensed for a total of 24 antibodies to 6 companies, including Genentech, MedImmune, Biogen Idec
- Negotiations for new licensing remain under way
- Entry into clinical trials planned for several therapeutic antibodies of Kyowa Hakko and licensees in fiscal 2007

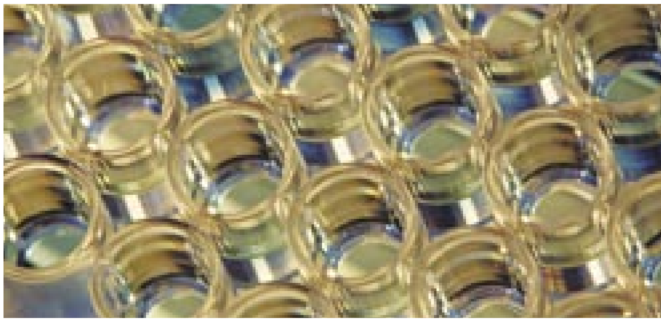
  >>*Establishment of clinical-trial-use antibody production facilities (scheduled operational start-up by March 2009)*

sales of the category in the United States. Consequently, the conclusion of a licensing agreement with Genentech will heighten the credibility of Potelligent™ technology and buoy efforts to license the technology. In addition to granting licenses, since 2004 BioWa has undertaken joint development based on its Potelligent™ technology through alliances with bio-venture companies that have promising antigens or antibodies for the treatment of cancer and allergic inflammation. In October 2005, BioWa agreed on joint research for therapeutic antibodies with the Japanese bio-venture company, OncoTherapy Science, Inc. In addition, BioWa is conducting negotiations aimed at cementing other joint research projects.

In 2005, Kyowa Hakko licensed an anti IL-5 receptor antibody to BioWa that has the potential to become an innovative treatment for asthma. At BioWa, the development team established in March 2005 is progressing favorably with the development of the antibody, which is scheduled to commence clinical trials as a treatment for asthma in the United States in 2006. Sales are forecast to peak between US$400 million and US$500 million worldwide.

Kyowa Hakko—Leading the Way

The market for therapeutic antibodies is experiencing rapid growth. Currently generating sales of approximately ¥1.4 trillion, the market is expected to account for revenues of approximately ¥3.3 trillion in 2010. Aiming to launch new products in this highly promising market, Kyowa Hakko began the clinical development of an anti-CCR4 (CC chemokine receptor 4) humanized monoclonal antibody, KW-0761, in 2006. Because KW-0761 is produced by using Potelligent™ technology, cells that express CCR4 can be depleted by antibody-dependent cellular cytotoxicity. KW-0761 has potential uses as a treatment for disorders in which cells highly express CCR4—the antibody's target.



CCR4 is highly expressed in Th2 cells, which produce various types of cytokines related to inflammation, such as IL-4 and IL-5. Therefore, we are proceeding with the clinical development of KW-0761 as a treatment for seasonal allergic rhinitis, atopic dermatitis,

Antibody Pipeline

Category	Code Name	Target	Antibody	Indications	Stage
Anticancer	KW-2871[1]	Ganglioside GD3	Chimeric monoclonal	Malignant melanoma	Phase I / IIa
Anticancer	Undisclosed[1]	Tumor antigen	Humanized monoclonal	Solid tumor	Preclinical
Anticancer	Undisclosed[1]	Tumor antigen	Humanized monoclonal	Hematologic and solid tumors	Preclinical
Antiallergic	KW-0761[1]	CCR4	Humanized monoclonal	Allergic disorders	Phase I
Anticancer	KW-0761[1]	CCR4	Humanized monoclonal	T-cell lymphoma	Preclinical
Antiallergic	BIW-8405[1, 2]	IL-5 receptor	Humanized monoclonal	Asthma	Preclinical
Anticancer	Potelligent™-FLT-1[1, 2]	VEGF-R/FLT-1	Humanized monoclonal	Breast and colon cancers	Preclinical
Anticancer	Potelligent™-GM2[1, 2]	Ganglioside GM2	Humanized monoclonal	Lung cancer, glioblastoma	Preclinical
Anticancer	Potelligent™-GD2[1, 2]	Ganglioside GD2	Humanized monoclonal	Solid tumor	Preclinical
Anticancer	Undisclosed[2]	FGF8	Humanized monoclonal	Prostate, breast, and ovary cancers	Preclinical

Notes: 1. Potelligent™ technology applied
2. Development conducted by BioWa

and bronchial asthma. Phase I clinical trials are currently under way in Europe. Adult T-cell leukemia / lymphoma (ATLL) cells and peripheral T-cell lymphoma (PTCL) cells also show high expressions of CCR4. Bearing this in mind, we are pursuing the clinical development of KW-0761 for the treatment of ATLL in Japan. Peak sales of these candidate drugs are projected to be between US$900 million and US$1,100 million. However, the outcome of clinical trials could alter this forecast significantly.

Aiming to Expand Bio-Chemicals Operations

In Bio-Chemicals operations, we have set out three strategic targets: heightening the cost-competitiveness of amino acid operations, growing health care operations, and developing mainstay businesses for future growth. Guided by these overriding goals, Kyowa Hakko is taking major strides toward the expansion of Bio-Chemicals operations in the fiscal year ending March 2007.

Amino Acids

In amino acid production, we started up a three-pronged production system. We are curbing costs dramatically, thanks to the introduction of new technology to Biokyowa, in Missouri, in the United States, and capital investment aimed at laborsaving through the multiskilling of employees. We will actively increase sales by rolling out cost-competitive products in the huge market for dietary supplements in the United States and also in markets for amino acids worldwide. In February 2006, Shanghai Kyowa Amino Acid started up operations at a leading-edge plant that is four times larger

than its predecessor. Compliant with Good Manufacturing Practice standards, the new plant will act as a base that supplies markets worldwide with finished products, mainly for such applications as pharmaceuticals and pharmaceutical intermediates. Also, we are buttressing cost-competitiveness by moving forward with the streamlining of personnel at plants in Hofu and Ube in Japan through the implementation of an early retirement incentive program. Meanwhile, we intend to continue tireless research efforts focused on upgrading production processes at plants in Japan and overseas.

Health Care

In health care operations, the Hofu Plant will resume the production of coenzyme Q10, a material that has drawn a great deal of public attention. Previously, the plant produced the coenzyme as a raw material for pharmaceuticals. By fully capitalizing on existing facilities and advances in technology research, we will market high-quality, reasonably priced coenzyme Q10 catering to worldwide demand. Moreover, we will be able to use our know-how to bring high-value-added products to market, thanks to our dietary supplements production plant with softgel technology situated on the West Coast of the United States.

Having established a breakthrough industrial production process for dipeptides, we are making advancements in the marketing of alanyl-glutamine, targeting applications as a component of infusions and enteral nutrients. In addition, we are conducting test production and research for a wide variety of dipeptide combinations, aiming to enhance solubility and mitigate bitterness. Our Healthcare Products Development Center's evaluation of nutritional functions and research on the improvement of flavors enables us to front-load development and offer highly attractive products. Leveraging these capabilities, we will move forward decisively to establish health care operations as an earnings mainstay.

Bio-Chemicals Operations: The Establishment of a Three-Pronged Production System

Japan (Hofu and Ube plants)
- Coenzyme Q10 to resume in-house production (second half of fiscal 2007)
- Marketing of dipeptides (fiscal 2007)

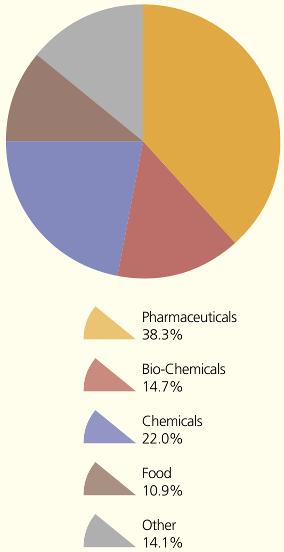
United States (Biokyowa)
- Significantly enhance production efficiency for amino acids (fiscal 2007)

China (Shanghai Kyowa Amino Acid)
- Operations started at new amino acid production plant (February 2006)
- Annual production capacity up from 600 tons to 2,500 tons

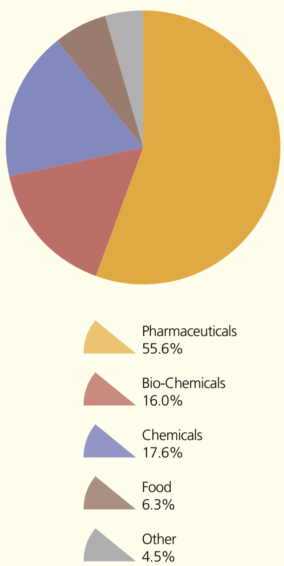
Three-Pronged Production System
(Japan / United States / China)

Full-Fledged Start-Up

Sales Composition by Segment
(Includes inter-segment transactions)



Operating Income Composition by Segment
(Includes inter-segment transactions)



Pharmaceuticals

The Pharmaceuticals segment conducts R&D, production, and sales of ethical pharmaceuticals—principally in the fields of cancer, allergies, and hypertension—and diagnostic reagents. In ethical pharmaceuticals, targeting growth in overseas markets in Europe, North America, and China, we are moving ahead with the clinical development of new drugs and biopharmaceutical operations based on our original strong-acting antibody technologies.

Bio-Chemicals

In Japan and overseas, the Bio-Chemicals segment produces and markets fermented bulk products, such as amino acids, nucleic acids, and related compounds. These products are used as raw materials for pharmaceuticals, health foods and dietary supplements, cosmetics, and pharmaceutical intermediates. Moreover, the segment conducts domestic mail-order sales of health food products; produces and markets alcohol for use in alcoholic beverages and in food preservatives and disinfectants; and supplies agrochemicals as well as livestock and fisheries products.

Chemicals

The Chemicals segment produces and markets basic chemicals, which include solvents used in paints and inks, raw materials for plasticizers used as additives in PVC products, and specialty chemicals, which include environment-friendly products and products used in advanced technologies.

Food

The Food segment develops, produces, and markets seasonings—principally natural seasonings made from meat, vegetables, or seafood—and bakery products and ingredients, such as yeast and bread improvers.

Other

The Other segment comprises such related companies as Chiyoda Kaihatsu Co., Ltd., Miyako Kagaku Co., Ltd., and Kyowa Engineering Co., Ltd. The activities of these companies include wholesale, distribution, equipment engineering, and other operations. Kyowa Engineering Co., Ltd., was transferred to the Bio-Chemicals segment in April 2006.

Review of Operations

At a Glance

Segment	Industry Trends
Pharmaceuticals 	Japanese pharmaceutical companies are experiencing dramatic changes in business conditions. To facilitate the development of patient-centered medicine, Japan's health care system is undergoing reform, and laws regulating the pharmaceutical industry, such as the Pharmaceutical Affairs Law, are being revised. Against this backdrop, drug prices have peaked due to the Japanese government's measures to curb health care expenses, while the cost of drug development is rising. Moreover, mergers and acquisitions among pharmaceutical companies are reshaping the industry, and major overseas pharmaceutical companies are making inroads into the domestic market. In response to these business conditions, Kyowa Hakko will develop new drugs that meet medical needs by concentrating management resources on its key areas of competence in cancer, allergies, the central nervous system, and such core technologies as antibodies. At the same time, our goal is to provide high-quality medical information that contributes to the spread of evidence-based medicine and earns us the trust of patients, physicians, and caregivers.
Bio-Chemicals 	Our core bio-chemicals products are fermented bulk products, such as amino acids, nucleic acids, and related compounds. These products are widely used in such applications as pharmaceuticals and pharmaceutical intermediates, health foods and dietary supplements, and cosmetics. The surge in demand for beverages containing amino acids of recent years is now sluggish. Nevertheless, demand for health care related products, such as health foods and dietary supplements, will likely grow substantially on the back of heightening worldwide interest in health maintenance and improvement as well as a need to contain medical expenses. Furthermore, demand is solid for amino acids for use as pharmaceutical ingredients for parenteral and enteral nutrition preparations, pharmaceutical intermediates, and cosmetics. Due to mounting concerns over safety issues, consumers and society at large are increasingly calling for reliable supplies of high-quality products that are underpinned by quality assurance systems. In light of such concerns, Kyowa Hakko will redouble efforts to maintain and reinforce relevant systems.
Chemicals 	In the year under review, backed by worldwide economic expansion and a recovering domestic economy, overall demand in the petrochemical industry in Japan and overseas was firm. Although extraordinary hikes in crude oil prices triggered further increases in raw materials and fuel prices, petrochemical companies as a whole performed favorably by implementing significant price increases for mainstay lineups. However, worldwide competition is projected to intensify due to considerable change in the demand-supply structure resulting from a series of plans to bring large-scale plants producing highly competitive ethylene and its derivatives on stream in the Middle East as well as in China.
Food 	In the food industry, competition among companies intensified in an environment of maturing markets and decreasing product prices. Furthermore, consumers are becoming increasingly aware of food safety issues, with related regulations being strengthened. In this setting, demand for our mainstay seasonings and bakery products and ingredients has been flat, excluding that from such strong sectors as convenience stores and growth companies. Over the medium to long term, we expect steady growth in markets for processed food, take-out food, and food services. Moreover, we expect demand for seasonings and bakery products and ingredients will increasingly focus on not only flavor but also safety and price. Consequently, the development of original new products and the establishment of quality assurance systems are becoming important issues for every company in the food industry.

Topics	Main Products
• Anticancer agent Navelbine® acquires additional indication for inoperable or recurrent breast cancer (May 2005). • Kyowa Medex acquires marketing rights for reagent strips for urinanalysis Uropiece® S (October 2005). • Anti-hypertension agent Coniel® begins phase III clinical trials for additional angina pectoris indication in China (fall 2005). • Anti-Parkinson's disease agent KW-6002 completes phase III clinical trials in the United States and Europe. • Therapeutic antibody KW-0761 begins phase I clinical trials in Europe as a treatment for allergies (January 2006). • BioWa concludes an agreement for licensing Potelligent™ technology to Genentech (March 2006). • The Company cancels a distribution agreement for the oral antimycological agent Itrizole® (March 2006).	**Ethical Drugs** • Coniel® (Hypertension and angina pectoris) • Allelock® (Antiallergic agent) • Depakene® (Antiepileptic agent) • 5-FU (Anticancer agent) • Neu-up® (Recombinant human G-CSF derivative) • Durotep® Patch (Transdermal analgesic agent) **Diagnostic Reagents** • Determiner® series (Clinical chemistry diagnostic reagents)
• New version of dietary supplement Remake Ornithine launched (April 2005). • Launch of Japan's first glucosamine produced using fermentation techniques: Remake Fermented Glucosamine Zn (September 2005). • Discovered new functions for ornithine amino acid that alleviate subjective fatigue symptoms and improve skin conditions (November 2005). • Shanghai Kyowa Amino Acid starts up new plant (February 2006). • Announcement of the resumption of the health food material coenzyme Q10 in the first half of fiscal 2007 (April 2006).	**Fine Chemicals** • Amino acids, nucleic acids, related compounds **Health Care Products** • Amino acids, vitamins, minerals, carotenoids, peptides • Remake series, Enguard series **Agrochemicals and Livestock and Fisheries Products** • Plant growth regulators • Animal health products **Alcohol** • For use in alcoholic beverages / for use in food preservatives and disinfectants
• Kyowa Hakko Chemical increased annual production capacity to 12,000 tons for isononanoic acid and to 40,000 tons for 2-ethyl hexanoic acid, which are raw materials for lubricants in air-conditioning and refrigeration equipment that uses CFC substitutes (in September 2005 and April 2006, respectively).	**Solvents** • Butyl alcohol, ethyl acetate, butyl acetate **Raw Materials for Plasticizers** • Di-2-ethylhexyl alcohol, Oxocol® 900 **Environment-Friendly Products** • Polyvinyl ether, 2-ethyl hexanoic acid, isononanoic acid (raw materials for lubricants in air-conditioning and refrigeration equipment that uses CFC substitutes) **Products for Advanced Technologies** • Squaric acid and its derivatives (raw materials for recording media)
• Kyowa Hakko's Food operations were separated and relaunched as Kyowa Hakko Food Specialties (April 2005). • Launched the natural seasoning Yeast Extract CF-V targeting processed food manufacturers (April 2005). • Launched revamped version of the freeze-dried soup Kyowa Gourmet Egg-Drop Soup (August 2005). • Launched the amino acid seasoning AM Kyowa V (September 2005). • Launched low temperature inactive multipurpose yeast Daiya Yeast VS (October 2005).	**Seasonings** • Natural seasonings **Bakery Products and Ingredients** • Baker's yeast, premixes, baking improvers **Processed Foods** • Instant egg-drop soup

Pharmaceuticals

President of Pharmaceuticals Business Unit

Yoshito Imai
Executive Vice President

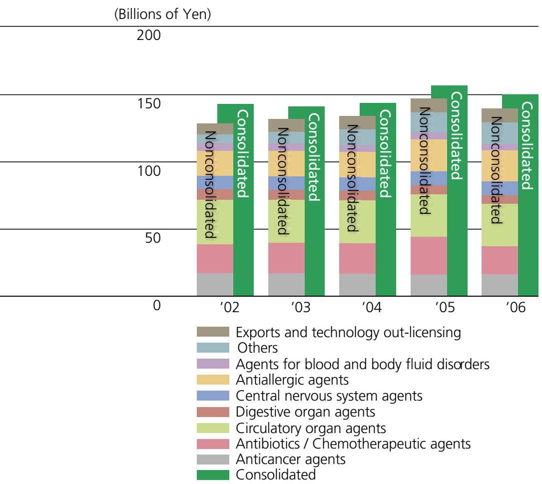
OPERATIONAL STRATEGY

In Pharmaceuticals, we have three strategic objectives. The first is the reinforcement of our domestic operations. To this end, we have been implementing the SMART (Sales and Marketing Transformation) Project. Although the project has already borne fruit for such core products as Coniel®, Allelock®, and Durotep® Patch, we will step up efforts to advance the project and enhance domestic pharmaceuticals sales.

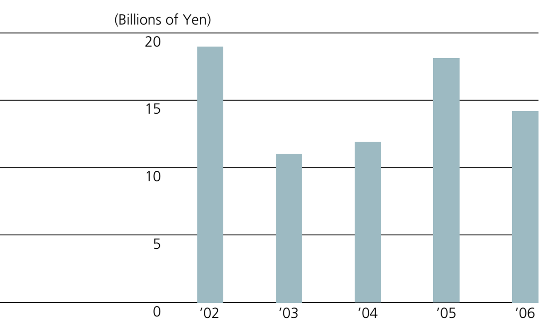
The second objective is to promote the POC (Proof of Concept) Fast strategy, which will enable us to compete with giant, multinational pharmaceutical companies despite our smaller operational scale. Under this strategy, R&D will leverage our solid drug discovery capabilities to accelerate processes from discovery to POC. Once we have obtained POC for new drugs, we will consider timing and success rate and choose from a broad range of options, including joint research, out-licensing, and other alliances. This strategy will maximize the value of new drugs by enhancing speed to market.

Our third objective is the expansion of our overseas operations. We will build our presence in overseas markets by launching an anti-Parkinson's disease agent, KW-6002, as soon as possible in the United States and Europe; expanding our operations in China through the acquisition of an additional indication of angina pectoris for Coniel® and launch of the antiallergic agent Allelock®; and strengthening the operational development of Potelligent™, a high ADCC antibody production technology that can provide dramatic results in the development of therapeutic antibodies.

Segment Sales*



Segment Operating Income*



* Including inter-segment transactions

Overview

Amid government policies to curb health care expenses, Pharmaceuticals faced an intensification of global competition among companies in the marketing and development of new ethical drugs that was driven by U.S. and European pharmaceutical companies' ongoing forays into Japan's market, further industry reorganization, and growing R&D expenses. In Pharmaceuticals, net sales declined 4.4%, to ¥149.5 billion. The decrease in revenues was due to a significant downturn in sales of the antimycological agent Itrizole® that counteracted brisk sales of other mainstay ethical drugs. Meanwhile, higher R&D expenses, mainly related to the anti-Parkinson's disease agent KW-6002, led to a 21.4% decrease in operating income, to ¥14.2 billion.

Ethical Drugs

The segment achieved robust sales of the antiallergic agent Allelock® (olopatadine hydrochloride), which steadily expanded its market share as a hay fever treatment. An analgesic for persistent cancer pain, Durotep® Patch also enjoyed favorable sales and consolidated its position as the top brand. Also, the anticancer agent Navelbine® saw increased sales. Furthermore, revenues from the antiepileptic agent Depakene® edged up year on year. In the face of intensified competition among calcium antagonists, Coniel®, an agent for treating hypertension and angina pectoris, maintained sales at the previous fiscal year's level. However, increases in sales of these mainstay products were unable to completely compensate for a large reduction in sales of the antimycological agent Itrizole®, which was marketed under a distribution agreement until the end of the fiscal year under review.

Principal Drug Sales

	Billions of Yen		
	2006	2005	2004
Coniel	**¥28.1**	¥28.1	¥28.9
Allelock	**19.9**	18.8	13.3
Celtect	**5.4**	6.9	7.0
Itrizole	**21.5**	29.8	23.4
Depakene	**10.2**	10.1	9.8
Adriacin + Farmorubicin	**9.5**	9.1	8.9
Nauzelin	**6.6**	6.9	7.1
5-FU	**3.3**	3.5	4.4
Neu-up	**4.6**	4.7	4.8
Durotep	**13.5**	12.6	8.8
Inovan + Pre Dopa	**4.9**	5.0	5.3
Navelbine	**2.3**	1.5	1.4
Exports and Technology Out-Licensing	**10.6**	10.1	10.0

In exports and technology out-licensing, sales of the antiallergic agent olopatadine hydrochloride were favorable. Kyowa Hakko licenses out this agent to Alcon Laboratories, Inc., of the United States, which markets it around the world in an eyedrop formulation. Furthermore, patents were granted for Potelligent™, a technology developed by Kyowa Hakko that enhances monoclonal antibody activity. Licensing-out contracts for this technology are increasing steadily, significantly surpassing initial targets thanks to aggressive marketing by U.S. subsidiary BioWa, Inc.

Diagnostic Reagents

Subsidiary Kyowa Medex Co., Ltd., handles the manufacture and sale of diagnostic reagents. Diagnostic reagent sales were up year on year on the back of stepped-up revenues from Determiner® HbA1c, a diabetes testing reagent, and Determiner® BNP, a myocardial marker, and the introduction to the lineup of Uropiece® S, reagent strips for urinanalysis.

New Drug Development

In Japan, the Company received approval for additional indications for anticancer agent Navelbine® in May 2005 and for thrombolytic agent Activacin® in October 2005. Furthermore, Bothdel (MM-Q01), an MRI contrast medium for the gastrointestinal tract, received approval in April 2006. In addition, we have filed an NDA for the antiepileptic agent KW-6485. Clinical trials are under way for KW-6002, an anti-Parkinson's disease agent; KW-2246, an analgesic for cancer pain; and KW-7158, a treatment for overactive bladder.

Overseas, we completed phase III clinical trials for the anti-Parkinson's disease indications of KW-6002 in the United States and Europe. We hope to file an NDA in the United States in the second half of 2006. In the United States, the Company is actively advancing clinical trials of KW-6002 for RLS. In Europe, clinical trials of the therapeutic antibody KW-0761 as an antiallergic agent are under way. In China, we are conducting phase III clinical trials of the antiallergic agent Allelock® and an additional angina pectoris indication for the hypertension treatment Coniel®.

Pharmaceuticals Pipeline

(As of June 2006)

Category Code Name *Generic Name*	In-house/Licensed from *Indication*	Stage in Japan	Stage Overseas (Country)	Remarks
Anticancer				
KW-2871	In-house *Malignant melanoma*		Phase I / IIa (U.S.)	Chimeric monoclonal antibody
KW-2246 *Fentanyl citrate*	Orexo *Cancer pain*	Phase I		
Antiallergic				
KW-4679 *Olopatadine hydrochloride*	In-house *Antiallergic*		Phase III (China)	Product name: Allelock® (Launched in Japan)
KW-0761	In-house *Antiallergic*		Phase I (Europe)	Humanized monoclonal antibody (Potelligent™ applied)
Central Nervous System				
KW-6485 *Topiramate*	Cilag *Antiepileptic*	Filed [July 2004]		
KW-6002 *Istradefylline*	In-house *Parkinson's disease*	Phase IIa	Phase III (U.S. & Europe)	Adjunct therapy
KW-6002[2] *Istradefylline*	In-house *Parkinson's disease*		Phase IIa (U.S.)	Monotherapy
KW-6002[2] *Istradefylline*	In-house *Restless legs syndrome (RLS)*		Phase IIa (U.S.)	
Cardiovascular, Urology				
GMK-527[2] *Alteplase*	Genentech *Acute ischemic stroke*	Approved [October 2005]		Jointly developed with Mitsubishi Pharma Original indication: Acute myocardial infarction Product name: Activacin®
KW-7158	In-house *Overactive bladder*	Phase IIa	Phase IIa (U.S. & Europe)	
KW-3049[2]	In-house *Angina pectoris*		Phase III (China)	Product name: Coniel® Original indication: Hypertension
Other				
MM-Q01	Meiji Dairies *Contrast medium for MRI*	Approved [April 2006]		Jointly developed with Meiji Dairies

Notes: 1. KW-2401 (UCN-01), an injectable anticancer agent developed in-house, is in phase II clinical trials in the United States, sponsored by the National Cancer Institute.
2. For additional indication

REVIEW OF OPERATIONS

Bio-Chemicals

President of Bio-Chemicals Business Unit

Yukinobu Kotani
Executive Managing Officer

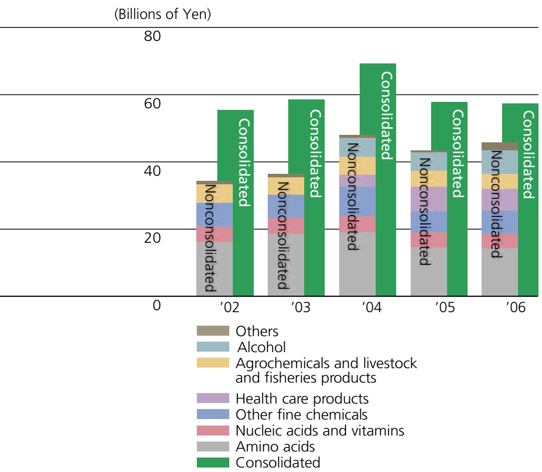
OPERATIONAL STRATEGY

In Bio-Chemicals, we are pursuing three key strategies aimed at leveraging our foundations in such fermented bulk products as amino acids to differentiate our lineups and achieve growth in the health care market. Our first strategy is to enhance our market standing by bolstering cost-competitiveness in amino acids. Kyowa Hakko and Ajinomoto Co., Inc., are the world's two largest manufacturers of amino acids for pharmaceuticals, foods, and industrial applications. However, in recent years Chinese and South Korean manufacturers have used low-pricing strategies to enter the market. In response, Kyowa Hakko is strengthening its three-pronged production system in Japan, the United States, and China through such measures as ramping up production capacity in China. At the same time, we are boosting cost-competitiveness by enhancing productivity through streamlining and production process innovations.

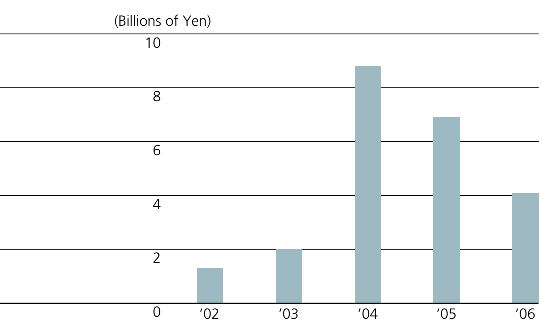
Our second strategy is to strengthen our health care operations, which promise growth. We are exploiting our Healthcare Products Development Center to expand our mail-order and OEM businesses by identifying consumer needs, developing products, and conducting planning and proposals. In the U.S. health care market, we will strengthen our marketing capabilities. Furthermore, we will resume the in-house production of the popular coenzyme Q10.

Our third strategy is to create businesses that will be mainstays of future earnings. Dipeptides and sugar chains, for which we have developed groundbreaking manufacturing processes, are candidates to become future earnings mainstays. In dipeptide operations, we are looking toward the early marketing of alanyl-glutamine—a product that will likely see increasingly heavy demand stemming from such applications as infusions, enteral nutrients, and so-called medical foods.

Segment Sales*



Segment Operating Income*



* Including inter-segment transactions / Reflecting the restatement of fiscal 2004 figures due to the reclassification of business segments effective from fiscal 2005

Overview

Bio-Chemicals registered year-on-year declines of 0.6% in net sales, to ¥57.4 billion, and 40.7% in operating income, to ¥4.1 billion. The slight decrease in net sales and the large reduction in operating income mainly stemmed from sluggish domestic demand for amino acids for use in beverages, intensified international price competition related to Chinese and South Korean manufacturers' entry into the amino acid market, and hikes in crude oil prices.

Fine Chemicals

Centered on amino acids, nucleic acids, and related compounds, raw materials for pharmaceuticals and industrial use recorded sales at the same level as in the previous fiscal year, as efforts to increase domestic sales of raw materials for generic pharmaceutical products offset the impact of fiercer price competition overseas. Meanwhile, revenues from nucleic acids and vitamins decreased.

Health Care Products

Sales of health care products were up from the previous fiscal year. Although demand for beverage-use amino acids in Japan's market was slack, revenues from amino acids for use in health foods grew in overseas markets. Furthermore, mail-order sales of Remake lineups, managed by subsidiary Kyowa Wellness Co., Ltd., contributed to increased sales.

Agrochemicals and Livestock and Fisheries Products

Sales in this category decreased from the previous fiscal year. Despite a year-on-year improvement in agrochemicals sales, revenues from livestock and fisheries products declined due to our withdrawal from overseas feed-grade amino acids business and a deterioration of domestic market conditions.

Alcohol

Sales of alcohol rose steeply year on year. Sales of raw material alcohol for the alcoholic beverage industry were lower as a result of continued weak demand in the refined sake market. However, shipments of industrial-use alcohol, which is mainly used for sterilization and preservation in the food industry, increased markedly in the lead-up to the April 2006 deregulation.

R&D

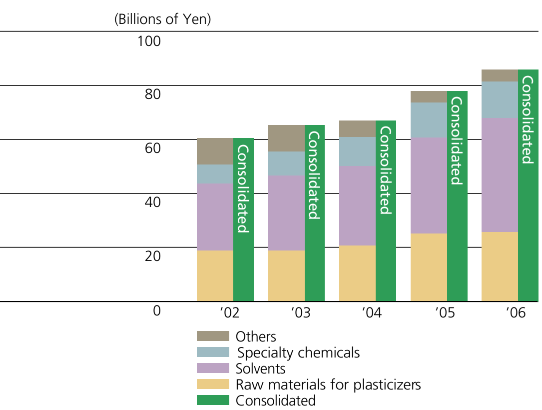
In Bio-Chemicals operations, we continued efforts focused on establishing fermentation production technology aimed at significantly curbing production costs for mainstay amino acids. Furthermore, the segment sustained research tasked with realizing the commercial in-house production of new materials for use in health foods. Also, we continued with projects to discover functions and develop applications for a wide range of amino acids, nucleic acids, and related compounds.

Chemicals

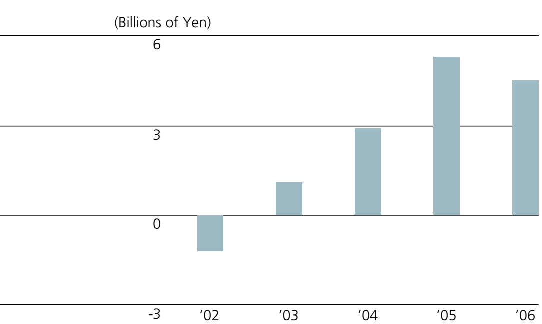
President and Chief Executive Officer of Kyowa Hakko Chemical Co., Ltd.

Shoji Hari
Managing Officer

Segment Sales*



Segment Operating Income*



* Including inter-segment transactions

OPERATIONAL STRATEGY

In such basic chemicals as solvents and raw materials for plasticizers, we will strengthen the market positions of mainstay lineups and increase competitiveness by making additional cost reductions and pursuing tie-ups. Meanwhile, we will further cultivate and expand sales of specialty chemicals that promise market growth, mainly focusing on environment-friendly and IT-related products. We intend to steadily lay the foundations for future growth and development by fortifying our R&D system to enable the rapid development of new products and entry into new markets and investing aggressively to expand facilities.

Overview

Underpinned by resilient demand growth in Asia centered on China, markets at home and abroad were vigorous, shrugging off continued hikes in raw materials and fuel prices. Amid this environment, in Chemicals operations Kyowa Hakko Chemical realized a 10.1% year-on-year increase in net sales, to ¥85.8 billion, thanks to the implementation of product price revisions for mainstay lineups. However, this improvement was unable to entirely compensate for the higher cost of crude oil, and operating income declined 15.7%, to ¥4.5 billion.

Basic Chemicals

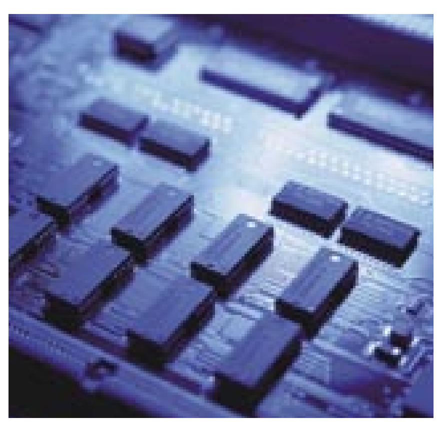
Domestic sales in basic chemicals operations registered a significant year-on-year increase that mainly stemmed from solvents. These higher sales resulted from upward revisions of mainstay product prices to reflect hikes in raw materials and fuel prices. Also, high product prices lifted export revenues despite a decline in shipment volumes from the previous fiscal year.

High-purity solvents for the IT industry witnessed substantially larger revenues.

Specialty Chemicals

Overall revenues from Specialty Chemicals operations rose, with brisk exports counteracting inventory adjustments by domestic purchasers that lowered year-on-year shipment volumes of mainstay raw materials for lubricants in air-conditioning and refrigeration equipment that uses CFC (chlorofluorocarbon) substitutes, which do not damage the ozone layer. Sales of squaric acid derivatives, used as raw materials for recording media, grew favorably.

In addition, targeting an expected increase in demand for raw materials for lubricants, we boosted annual production capacities to 12,000 tons for isononanoic acid and to 40,000 tons for 2-ethyl hexanoic acid.



REVIEW OF OPERATIONS

Food

President and Chief Executive Officer of Kyowa Hakko Food Specialties Co., Ltd.

Takeyuki Yoshida

Managing Officer

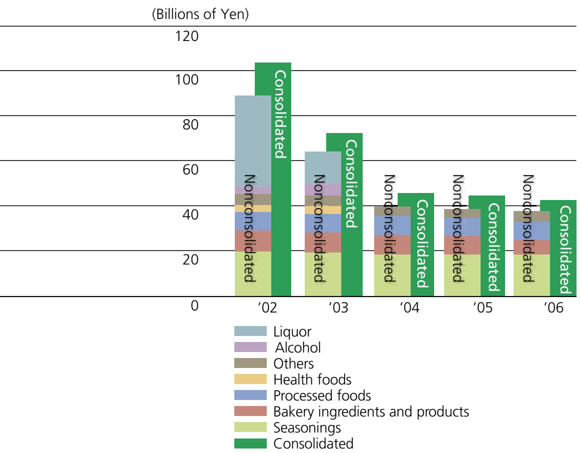
OPERATIONAL STRATEGY

In April 2005, Food operations became the wholly owned subsidiary Kyowa Hakko Food Specialties Co., Ltd. Our mission is to earn the trust of customers by providing safe, high-quality products that contribute to the enhancement of health and diets. We are drawing on our fermentation and other original technologies to develop differentiated food materials. Based on the establishment of a marketing system that unifies R&D and sales activities and a strengthened quality assurance system, Kyowa Hakko Food Specialties will pursue solutions-based marketing to develop markets.

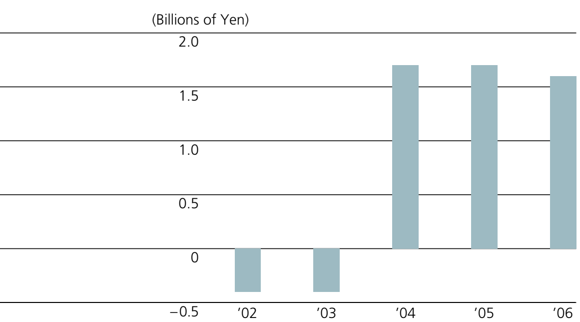
In seasonings, one of our core product areas, we aim to be a leader in natural seasonings, such as extract, amino acid, and brewed seasonings. In bakery products and ingredients, another core area, we will enhance our relationships with major bread companies by offering unique products, such as flavor enhancers and bread improvers.

Currently, we operate plants for the manufacture of natural seasonings and freeze-dried food materials in China. In these operations, we will bolster our marketing capabilities while endeavoring to open up new markets.

Segment Sales*



Segment Operating Income*



* Including inter-segment transactions / Reflecting the restatement of fiscal 2004 figures due to the reclassification of business segments effective from fiscal 2005 / Liquor operations being sold in September 2002

Overview

Food operations face the challenge of responding to rapid changes in market structures driven by diversifying consumer preferences. Mainly due to the divestiture of consolidated subsidiary Asahi Foods Products Co., Ltd., in April 2005, the segment recorded decreases of 4.6% in net sales, to ¥42.4 billion, and 3.6% in operating income, to ¥1.6 billion.

Seasonings

Despite strong sales of extract-type seasonings for home-meal replacement products and *Kokumi* seasonings, revenues from natural seasonings edged down from the previous fiscal year. Meanwhile, *Umami* seasonings staked out a larger market share, with higher sales volume and value.

Bakery Products and Ingredients

Revenues in bakery products and ingredients grew, thanks to stepped-up sales of sweet bread premixes, bread flavor enhancers, and milk preparations.

Processed Foods

Revenues from freeze-dried foods and other processed foods were down year on year due to lower sales of OEM products.

Basic policies on intellectual property

Kyowa Hakko is an R&D-based company and considers intellectual property to be one of its key management resources. The Company actively seeks wide-ranging, robust, and effective intellectual property rights, which play an important role in its business strategies. Also, we respect third parties' rights and do our utmost to refrain from infringing on them, thereby giving us a high degree of freedom in the pursuit of research and business activities and enabling us to maximize the value of these activities.

Accordingly, the Company is strengthening systems to acquire and protect intellectual property rights and monitor third parties' rights from a worldwide perspective. For example, in mainstay operations related to pharmaceutical development products, the Company protects core technologies and prolongs the lives of products through the strategic filing of relevant patents.

Functions of the Intellectual Property Department

The Intellectual Property Department has companywide functions and is positioned to support the Company's respective business divisions and the major subsidiaries of Kyowa Hakko (business divisions hereafter). Although Chemicals and Food operations have been separated into wholly owned subsidiaries, Kyowa Hakko has, in principle, maintained its long-standing centralized control system to not only enhance efficiency but also strengthen risk management with regard to intellectual property operations. As part of efforts to fortify intellectual property functions, in 2005 the Company integrated the Technological Information Division, previously an independent organization, with the Intellectual Property Department. The Company is enhancing the intellectual property department's capabilities to investigate, evaluate, and utilize information.

In recent years, Kyowa Hakko has recognized that integrating business strategies and intellectual property strategies is an important Companywide issue. The Intellectual Property Department is enhancing coordination with business and research divisions by holding regular meetings. Also, the department regularly exchanges information and has consultations with researchers at research laboratories. Moreover, we understand that an appropriate evaluation of intellectual property environments is essential when making important decisions on R&D and business activities. Consequently, members of the Intellectual Property Department participate in major projects relating to development themes, existing products, and licensing.

In addition, the education of employees regarding intellectual property rights is an important function of the Intellectual Property Department. Therefore, the department undertakes overseas training for its members while strengthening in-house employee education. Kyowa Hakko implements various types of employee-training programs for employees working in different fields or classes. Furthermore, the Company has established a system to receive advice and guidance from lawyers and patent attorneys with proven track records in the intellectual property field in Japan or overseas. This system will enable us to respond appropriately to highly specialized issues.

Acquisition and control of intellectual property rights

The Company in principle encourages activities to produce numerous initial basic inventions and to file patent applications based on them. However, when filing applications overseas, requesting examinations, and maintaining registered rights, the Company prioritizes each project based on considerations of cost-effectiveness. For those deemed unnecessary, the Company does not uphold its rights. This process allows the Company to focus its intellectual property resources on significant projects in accordance with its principles of selection and concentration.

Contributions to licensing activities

Given that continuing to discover and develop new drugs independently has become challenging, in Pharmaceuticals operations the Company actively licenses products developed in-house based on the POC Fast strategy. At the same time, we are stepping up licensing-in efforts. Consequently, the evaluation of intellectual property rights for licensing-in candidates is becoming more important. In response, the Company is further enhancing coordination between the Intellectual Property Department and respective business divisions with regard to significant licensing-related projects.

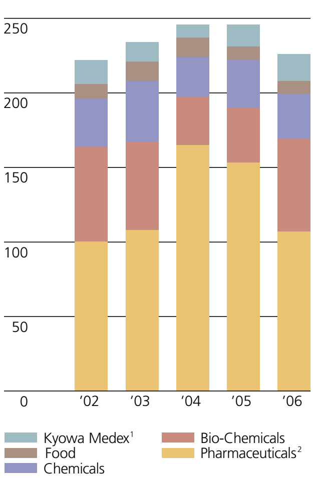
In recent years, opportunities to license R&D achievements to other companies have increased, particularly in Pharmaceuticals. For example, the in-house-developed antiallergic agent olopatadine hydrochloride has become a mainstay of revenues from technology licensing. Also, in the previous fiscal year, we began licensing the mitotic kinesin Eg5 inhibitor. As a result, revenues from the licensing-out of patents and technologies are accounting for a larger share of operating income. The Company expects such revenues to increase.

Furthermore, the Company has accumulated numerous core technologies in the process of pursuing R&D activities that are underpinned by innovative research and technology. For example, the Company is trying to acquire multifaceted patent rights for its unique Potelligent™ technology, which dramatically enhances the antibody-dependent cellular cytotoxicity of antibodies. Through its U.S. subsidiary, BioWa, Inc., Kyowa Hakko is emphasizing the advantages of its unique technology and generating earnings by actively licensing out Potelligent™ technology to the principal pharmaceutical companies that develop antibodies in the United States and Europe. Also, the Company has intellectual property rights related to its other core technologies for drug formulation and will exploit them to contribute to profits.

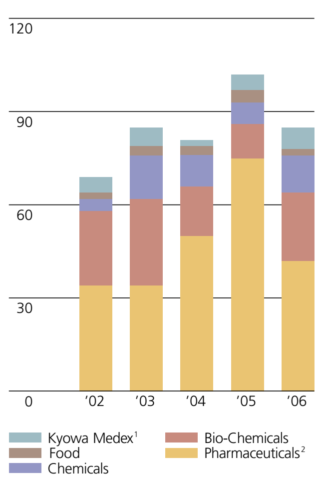
Policies relating to intellectual property portfolio

The Company undertakes the timely prioritization of individual projects and does not pursue those that are considered unnecessary. For example, in Pharmaceuticals the heads of relevant departments meet regularly to discuss the importance of projects and decide which patent applications or patents should be filed or maintained. The respective business divisions aim to construct an intellectual property portfolio that is consistent with their business strategies. Due to the particular importance of intellectual property strategies in Pharmaceuticals, the segment has established a system for deliberating and evaluating intellectual property rights as a whole or as individual projects, which includes a Portfolio Committee that makes significant decisions relating to R&D.

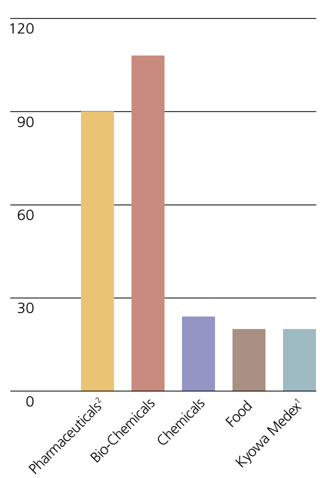
Number of Patent Applications (Japan)



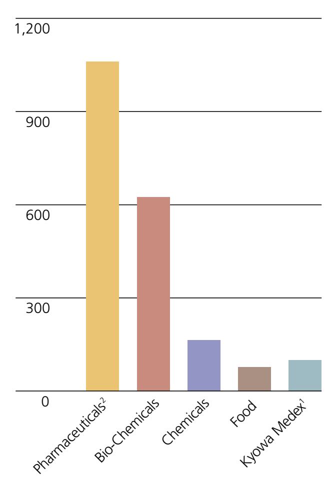
Number of Patent Applications (Overseas)



Number of Patents Owned (Japan)



Number of Patents Owned (Overseas)



Notes: 1. Kyowa Medex Co., Ltd., manufactures and sells diagnostic reagents.
2. Pharmaceuticals exclude Kyowa Medex Co., Ltd.

Fundamental Approach

Kyowa Hakko conducts operations in accordance with its corporate philosophy of "contributing to the health and well-being of people worldwide by creating new value with the pursuit of advancements in life science and technology." Our basic pursuit in corporate governance is to frame responsibilities and duties of the management organization and ensure the policies we have in place are followed and are leading us to the actualization of the Company's philosophy. We recognize the importance of increasing management transparency and reinforcing oversight functions to raise corporate value continually and improve corporate governance.

Progress in Governance

Kyowa Hakko's system of basic management institutions comprises a Board of Directors and a Board of Auditors as stipulated by the Commercial Law Act. Convening once a month in principle, the Board of Directors, which had seven members as of June 28, 2006, decides on management policy and other such critical issues as strengthening management efficiency and strategic planning as well as monitoring operational execution. The Board of Auditors had four members, of whom three are outside auditors, as of June 28, 2006. Pursuant to auditing policies determined by the Board of Auditors, the auditors attend such important meetings as Board of Directors' meetings, investigate operations and assets, and audit the work of directors.

In addition, the Management Meeting has been established as a decision-making body to make accurate and effective management decisions from a strategic viewpoint for all important issues related to management. Moreover, the Company's Executive Officers' Meeting has been introduced to further expedite management decision making and administrative execution in the course of business.

Kyowa Hakko established the Advisory Board to provide outside viewpoints to management, strengthen the management constitution, and increase the transparency and soundness of management in regard to issues faced by the Company. The Advisory Board comprises four outside advisors.

To ensure the Company observes all laws and standards concerning financial reporting and reports its financial affairs in an accurate, open, timely, and fair manner, we have retained the services of an independent auditor to make determinations as to the fairness and accuracy of reporting.

In addition, to ensure the observance of all laws and regulations pertaining to the execution of business and provide advice concerning problems that may occur in the course of conducting business activities, the Company retains legal advice from third parties, such as legal attorneys, as necessary.

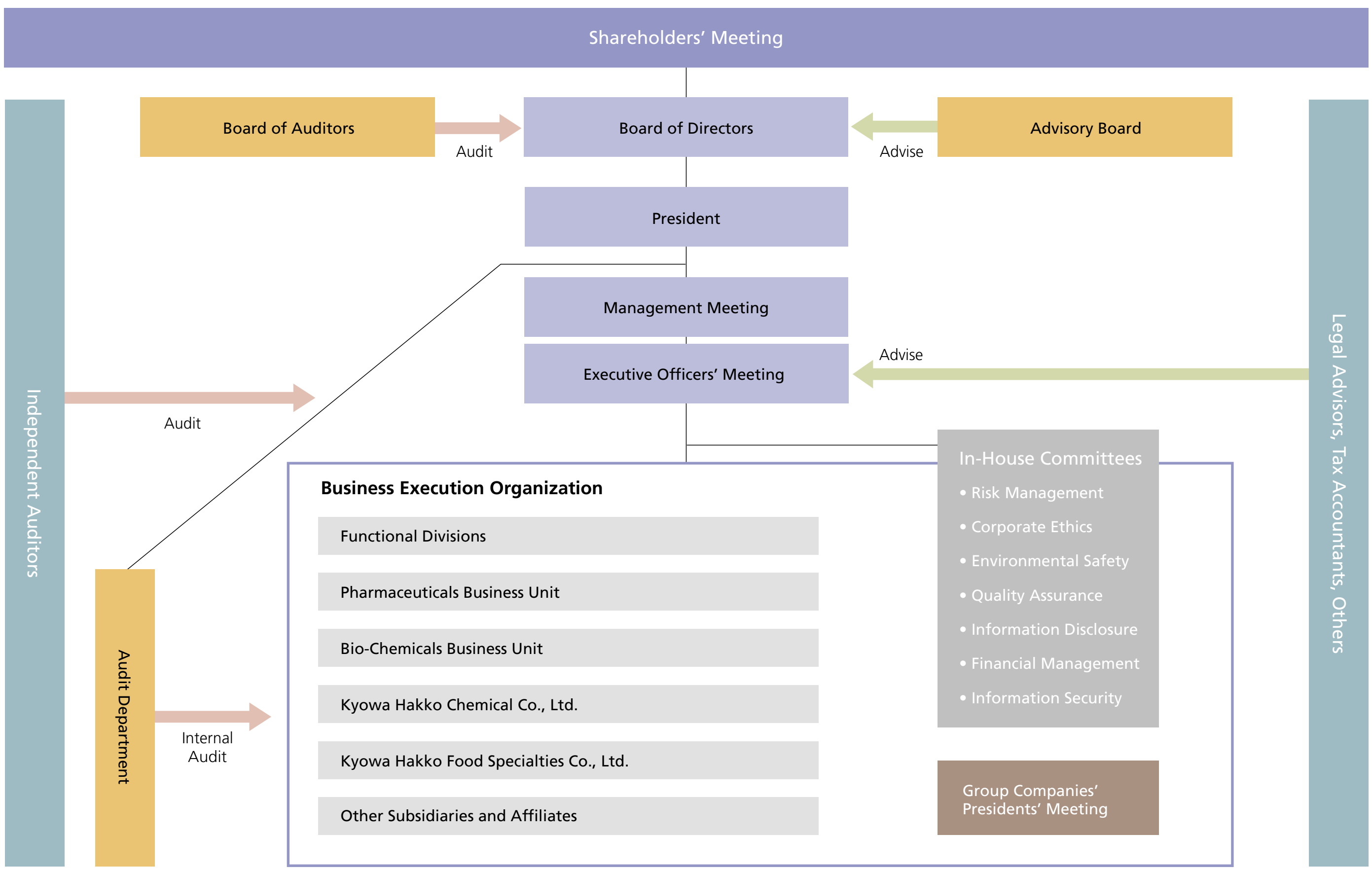
To respond to a range of risks related to management issues and establish soundness in our corporate governance, we have set up seven in-house committees, each of which regularly reports to the Board of Directors. Ensuring the Company earns the trust of society, the Corporate Ethics Committee oversees strict compliance with laws and ethical behavior and deliberates on the soundness and appropriateness of corporate activities. The Environmental Safety Committee is an advisory committee to the president and handles basic policies regarding environmental conservation and safety. Another advisory committee to the president is the Quality Assurance Committee, which formulates basic policies regarding quality assurance. The Information Disclosure Committee evaluates basic policies regarding information activities and important matters related to information disclosure. The Financial Management Committee conducts efficient financial activities and considers associated risks. Finally, the Information Security Committee examines basic policies regarding the protection and handling of confidential information held by the Company. In April 2006, we established the Risk Management Committee, which has been mandated to assess, deliberate, report, and oversee risk management on a companywide basis so that the Company operates in an optimized risk management environment.

Also, in April 2006 we reorganized the Audit Department, which is responsible for making determinations as to the accuracy and efficient functioning of the Company's internal control system. Independent of the operating organization, the Audit Department makes objective assessments concerning the legal and financial compliance of our business operations.

Corporate Ethics

The Company is dedicated to ensuring that the highest standards of ethics are understood and observed by every employee and officer of the Company and that we remain an ethical enterprise in every area of our business operations. Therefore, we have established the Kyowa Hakko Code of Ethics and the Kyowa Hakko Standards of Ethical Conduct and take measures to ensure that all employees and officers are in complete understanding and observance of the codes and standards stated therein.

Corporate Governance Structure



(As of June 28, 2006)

As stated in its management guidelines, Kyowa Hakko considers quality assurance, environmental safety, and social contribution activities to be important management issues. The leadership of top management provides an example that is followed by everyone at Kyowa Hakko.

Environmental Safety Issues

Environmental Safety Management Systems

To ensure continual improvement in environmental safety, environmental preservation, disaster prevention, and product safety, the Company's environment and safety management system integrates the environmental management system ISO 14001 and the Occupational Safety and Health Management System (OSHMS). Risk management activities are promoted by implementing our Plan, Do, Check, and Act (PDCA) cycle. In the fiscal year ended March 2006, we made steady progress in applying these systems at consolidated subsidiaries. We participate in responsible care (RC) practices that encompass a wide range of environmental safety-related activities.

Compliance and Communication

In environmental safety-related activities, we ensure full compliance with relevant laws and statutory regulations and have established our own even-stricter standards. Kyowa Hakko's Head Office monitors compliance with these standards. Furthermore, we endeavor to provide transparent disclosure by having third parties verify the environmental safety information included in our annual *Sustainability Report* and by reflecting the outcomes of dialogues with stakeholders in our operations.

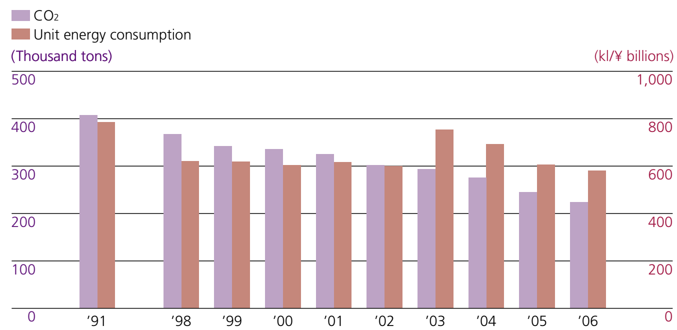
Performance

In the fiscal year ended March 2006, we worked to reduce the environmental burden of our operations through Companywide activities, centered on energy saving, resource saving, and zero emissions. As a result, for two consecutive years the Company has reached or exceeded its stringent targets for zero emissions, which include the thorough control of emissions and the recycling of industrial waste. In addition, we were able to lower greenhouse gas emissions by an amount approximately equivalent to 35,000 tons of carbon dioxide.

Toward improving the quality of the water environment, the Group took steps to improve production processes and wastewater treatment equipment. Compared with the previous fiscal year, we achieved an approximately 14% reduction in the pollution burden. Moreover, we

Yearly Changes in Unit Energy Consumption

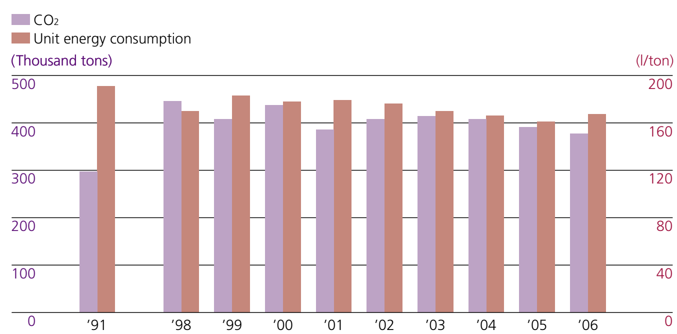
Kyowa Hakko, except Kyowa Hakko Chemical



Note: Due to the transfer of the alcoholic beverage operations, unit energy consumption increased in 2003.

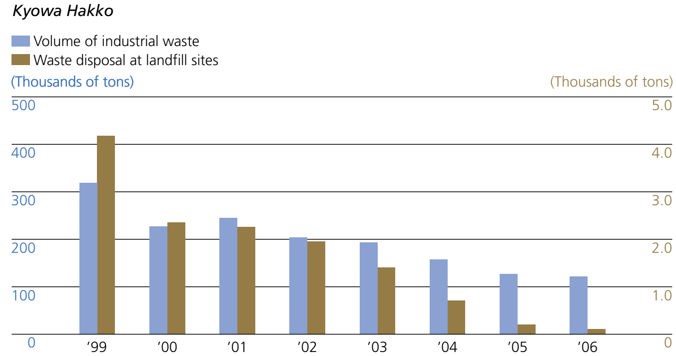
Yearly Changes in Unit Energy Consumption

Kyowa Hakko Chemical



Yearly Changes in Volume of Industrial Waste

Kyowa Hakko



continued to reduce environmental discharges by installing collection devices for controlling the discharge of chemical substances into the environment.

Furthermore, the Company is working in concert to achieve results in its green office plan activities, which focus on the promotion of a green supply chain as well as energy saving and recycling promotion in administrative departments.

In safety, we continue to rank at the top in our industry, with an accident rate of zero at Kyowa Hakko, Kyowa Hakko Food Specialties Co., Ltd., Kyowa Hakko Chemical Co., Ltd., and Kyowa Medex Co., Ltd. Also, in the fiscal year under review, the Group did not experience any serious incidents involving fires or leakages.

Development of Technologies and Products for Environmental Safety

The Company takes active measures to develop environmental safety technology and products as well as resource-saving technologies. Our raw materials for lubricants in air-conditioning and refrigeration equipment that uses CFC substitutes contribute to environmental preservation.

Also, we produce raw materials for water-based coatings, which help prevent atmospheric pollution by curbing environmental emissions of organic solvents. We continue to participate in national research projects in the biotechnology field. For example, we are conducting basic research aimed at improving the efficiency of the development of bioprocesses. We are developing fermentation production technologies that use wood-based biomass as raw material. In addition, we are implementing an ISO 14001-based management system at research laboratories and production bases as one facet of our commitment to addressing environmental safety issues from the R&D stage onward.

Quality Assurance

To raise awareness of quality assurance throughout the Kyowa Hakko Group, the Company purposefully pursues its "Quality Assurance Action Policy," which it has developed for all operational areas, including those overseas.

Kyowa Hakko's Quality Assurance Action Policy

1. We, all employees, aim to meet our customers' needs or expectations, from research and development to purchasing, production, logistics, and marketing, to keep our promise to provide products, services, and information for customers' satisfaction.
2. We promise to provide products with stabilized quality and satisfied service in accordance with our quality assurance system to every business, based on our compliance with relative laws and priority for safety.

To assure compliance with the revised Pharmaceutical Affairs Law, our Pharmaceuticals segment has in place systems for production and quality control as well as post-marketing safety control. To accompany the development and introduction of new products, we have established a rigorous global quality assurance system that extends across all departments in all geographic areas of operations. The Medical Information Center acts as a rapid interface for complaints, requests for advice, or product suggestions from our customers.

In the Bio-Chemicals segment, where quality assessment is of the utmost importance, we hold new product development meetings, and, in cases where raw materials or production methods are modified, strict change controls are set up to evaluate changes and verify quality.

To ensure we are operating our quality assurance systems in accordance with product attributes, Kyowa Hakko adheres to international standards laid out in such benchmarks as GMP standards, ISO 9001, and HACCP. In this way, the Company constantly endeavors to enhance its production control and quality control systems.

In the fiscal year under review, the Company's subsidiaries Zenmi Foods Inc., Ohland Foods Co., Ltd., Houmi Foods Co. Ltd., and Biokyowa Inc., in the United States, were newly certified under ISO 9001. The Company has already received certification at the Hofu and Ube plants, Kyowa Hakko Chemical's Chiba and Yokkaichi plants, Kyowa Hakko Food Specialties' Tsuchiura Plant, and Kyowa Medex's Fuji Plant.

In the future, we will continue making improvements in quality assurance at all Kyowa Hakko operations worldwide. Reinforcing risk management, particularly in the area of enhancing quality auditing, remains a top priority.

Corporate Citizenship

Kyowa Hakko's management guidelines state a fundamental policy: to ensure that management is open to society. The guidelines also declare that international standards be fully adopted into management practices and management maintains open lines of communication with local communities to earn society's understanding and trust. Through exchanges of information, good corporate citizenship, and social contribution activities, the Company is endeavoring to communicate openly through a wide range of activities.

"Science for a Happier 21st Century" Essay Competition

The increasing complexity of science is causing Japan's younger generation to lose touch with this important field. In response, Kyowa Hakko aims to offer the kinds of opportunities that will spur young students toward a greater interest in science and, to this end, holds an annual scientific essay competition open to students throughout Japan. The competition's purpose is to encourage the nation's young people to gain a keen interest in science. Written on the theme of "Science for a Happier 21st Century," science compositions of junior and senior high school students are judged and awards given to students whose essays show the most promise. Started in 1999, the competition will be held for the eighth time in summer 2006. The Mainichi Newspapers and Japan's Ministry of Education, Culture, Sports, Science and Technology are among the other sponsors and supporters of the competition.

Mobile Science Experiment Classroom– The BioAdventure Vehicle

Kyowa Hakko operates a vehicle that serves as a mobile science experiment classroom, with the Company's researchers serving as instructors, that supports science education. Designed to bring a scientific laboratory on wheels to students at elementary and junior and senior high schools, the BioAdventure vehicle is equipped with microscopes and other experimental equipment. Staff members of BioFrontier Laboratories are on board to assist students in conducting experiments and gaining practical skills.

At our Pharmaceutical Research Center, Kyowa Hakko provides science laboratory classrooms to local elementary school students during their spring vacation. During summer vacation, students of elementary schools and junior high schools are invited to participate in science-related activities at our Ube Plant.

Asahi Young Session

Since 1988, the Company has sponsored an annual lecture series, the Asahi Young Session. Although each year a new theme is introduced, the overlying message is the importance of future directions, dreams, and a desire for life. Leaders from various fields are brought in to deliver inspirational messages to young people, and this year the keynote lecture will be delivered by a pioneer in the field of electron holography, Dr. Akira Tonomura of Hitachi, Ltd. Printed transcripts of Dr. Tonomura's address will be available upon request for those unable to attend the lecture. The series has been held yearly since 1988 and marked its 18th session in March 2006. The Asahi Shimbun and the Ministry of Education, Culture, Sports, Science and Technology are among the other sponsors and supporters of the series.

Kato Memorial Bioscience Foundation

Reaching out to the community in various ways, Kyowa Hakko is providing financial support for researchers for their works of innovation in the basic fields of bioscience through the Kato Memorial Bioscience Foundation. The foundation was set up in commemoration of Kyowa Hakko's founder, Dr. Benzaburo Kato. Among its other activities, the foundation supports an annual public symposium based on various themes within the bioscience sphere.

CONTENTS

Financial Section

ELEVEN-YEAR SELECTED FINANCIAL DATA

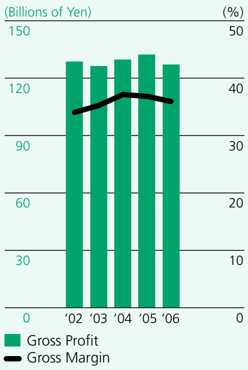
KYOWA HAKKO KOGYO CO., LTD. and Its Consolidated Subsidiaries
For the years ended March 31, 2006, 2005, 2004, 2003, 2002, 2001, 2000, 1999, 1998 and 1997 and the three-month period ended March 31, 1996

	2006	2005	2004	2003
For the Year:				
Net sales	¥353,440	¥358,963	¥348,838	¥359,285
Gross profit	126,983	132,113	129,507	126,328
Selling, general and administrative expenses	101,448	98,606	102,671	110,239
Operating income	25,535	33,507	26,836	16,089
Net income	16,273	17,932	10,017	8,485
Capital expenditures	10,859	7,647	9,041	11,791
Depreciation and amortization	9,789	10,565	11,358	14,768
R&D expenses	32,876	28,762	29,206	31,438
Cash Flows:				
Net cash provided by operating activities	14,303	30,104	34,264	18,193
Net cash (used in) provided by investing activities	(1,796)	(8,104)	10,477	2,586
Net cash used in financing activities	(5,139)	(9,116)	(44,226)	(38,748)
Cash and cash equivalents at the end of the year	45,820	37,818	24,911	24,588
At Year-End:				
Current assets	212,985	210,341	194,062	195,878
Total assets	384,381	374,493	361,096	368,772
Current liabilities	94,148	103,489	98,914	95,046
Interest-bearing debt	12,216	12,193	13,358	51,969
Total shareholders' equity	255,807	235,439	225,042	219,047
Number of employees	5,800	5,960	6,294	6,749
Per Share Data:				
Net income—basic (Note 2)	¥ 38.4	¥ 41.7	¥ 23.0	¥ 19.4
Total shareholders' equity	604.9	556.3	522.6	505.4
Cash dividends	10.0	10.0	7.5	7.5
Common Stock Price Range (Per share)**:**				
High	946	864	719	780
Low	656	661	495	411
Stock Information (Thousands of shares):				
Number of common stock issued	434,244	434,244	434,244	434,244
Weighted average number of common stock issued	422,920	427,636	431,497	433,748
Financial Ratios:				
Return on assets	4.29	4.88	2.74	2.12
Operating return on assets	6.73	9.11	7.35	4.03
Return on equity	6.63	7.79	4.51	3.94
Equity ratio	66.55	62.87	62.32	59.40
Debt/equity ratio	4.78	5.18	5.94	23.73

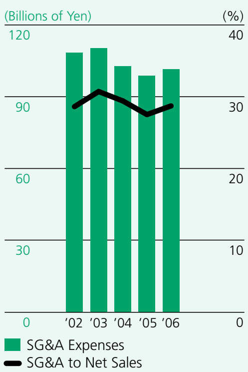
Notes: 1. U.S. dollar amounts are translated from Japanese yen, for convenience only, at the rate of ¥117.47=US$1, the approximate exchange rate at March 31, 2006.
2. Net income per share of common stock is based upon the weighted average number of shares of common stock outstanding during each year, appropriately adjusted for subsequent free distributions of common stock.
3. As a result of a change in the Company's fiscal year-end from December 31 to March 31, fiscal 1996 was the three-month period ended March 31, 1996.
4. Only nonconsolidated figures are available.

Millions of Yen							Thousands of U.S. Dollars (Note 1)
2002	2001	2000	1999	1998	1997	1996 (Note 3)	2006
¥378,668	¥375,610	¥374,910	¥384,671	¥397,361	¥397,629	¥ 82,990	$3,008,768
128,744	123,945	126,872	127,864	144,191	144,248	31,645	1,080,982
108,387	106,233	105,216	104,407	109,448	110,320	24,959	863,607
20,357	17,712	21,656	23,457	34,743	33,928	6,686	217,375
5,535	9,395	11,274	6,143	13,528	12,339	1,296	138,529
11,454	17,092	21,053	24,408	24,555	19,132	4,317	92,441
17,819	18,502	19,153	17,673	17,113	16,701	3,926	83,332
29,294	28,921	25,888	24,083	25,358	22,882	5,026	279,867
16,955	28,789	32,737	—	—	—	—	121,759
8,377	(1,991)	23,422	—	—	—	—	(15,289)
(16,843)	(20,871)	(50,077)	—	—	—	—	(43,747)
41,908	32,600	26,215	—	—	—	—	390,058
244,410	237,852	223,353	270,499	235,697	236,337	228,298	1,813,101
430,113	431,410	433,958	477,729	437,271	431,774	418,956	3,272,163
162,508	169,821	158,542	211,376	181,554	182,648	175,389	801,464
74,354	87,624	102,870	151,489	98,282	97,786	98,195	103,992
211,652	194,692	195,039	185,766	188,645	180,391	174,294	2,177,636
7,299	7,766	7,866	5,044 (Note 4)	5,134 (Note 4)	5,174 (Note 4)	5,172 (Note 4)	
Yen							U.S. Dollars (Note 1)
¥ 12.7	¥ 21.6	¥ 26.0	¥ 13.9	¥ 30.3	¥ 27.6	¥ 2.9	$0.327
487.5	448.3	449.1	427.8	422.6	404.2	390.5	5.149
7.5	7.5	10.0	7.5	7.5	7.5	1.9	0.085
899	1,225	1,581	694	888	1,080	1,030	8.053
587	701	610	485	492	720	914	5.584
434,244	434,244	434,244	434,244	446,343	446,343	446,343	
434,244	434,244	434,244	441,906	446,343	446,343	446,343	
%							
1.28	2.17	2.47	1.34	3.11	2.90	0.30	
4.73	4.09	4.75	5.13	8.00	7.98	1.57	
2.72	4.82	5.92	3.28	7.33	6.96	0.74	
49.21	45.13	44.94	38.89	43.14	41.78	41.60	
35.13	45.01	52.74	81.55	52.10	54.21	56.34	

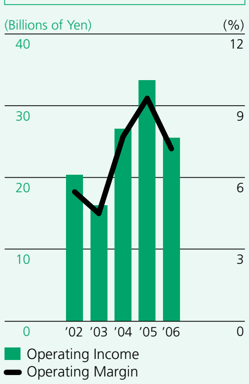
Gross Profit



SG&A Expenses



Operating Income



Operating Environment and Business Performance

In fiscal 2006, ended March 31, 2006, Japan's economy recovered modestly. Despite such causes for concern as hikes in crude oil prices, corporate earnings and capital investment continued to trend upward, while consumer spending showed signs of recovery.

Overall, Kyowa Hakko's operating environment remained tough. The Japanese government continued to rollout measures to curb health care expenses. Against this backdrop, Pharmaceuticals operations saw a further heightening of global competition for the development and marketing of new ethical drugs, which stemmed from European and North American pharmaceutical companies' inroads into Japan's market and realignment within the pharmaceutical industry. Moreover, the segment was burdened with heavier R&D investment. Bio-Chemicals operations also continued to face challenging conditions, characterized by lackluster domestic demand for amino acids for beverages and intensified international price competition triggered by the entry of Chinese and South Korean manufacturers into the amino acids market. In Chemicals operations, despite continued hikes in crude oil prices, market conditions remained favorable at home and abroad, buoyed by steady growth in demand from China. Meanwhile, Food operations struggled to keep pace with changes in market structure that reflected increasingly diverse consumer preferences.

In response to these business conditions, the Company aggressively invested in R&D and facilities to secure long-term growth opportunities. These efforts focused on the overriding goals of growth and development set out in our Ninth Medium-Term Management Plan, a three-year plan initiated in fiscal 2006. At the same time, the Company strengthened the competitiveness of its businesses by strategically expanding sales, improving profitability through comprehensive cost-reduction measures, and developing new products. However, unable to fully overcome exacting business conditions, the Company posted lower revenues and income.

Profit and Loss

On the back of price revisions that accompanied crude oil price hikes, favorable results in Chemicals operations failed to entirely offset decreases in revenues from Pharmaceuticals, Bio-Chemicals, and Food operations. As a result, consolidated net sales in fiscal 2006 decreased 1.5% year on year, to ¥353.4 billion.

Cost of Sales and SG&A Expenses

The cost of sales edged down 0.2%, to ¥226.5 billion, and the cost of sales ratio rose 0.9 percentage point, to 64.1%. Gross profit declined 3.9%, to ¥127.0 billion, while the gross margin edged down 0.9 percentage point, to 35.9%. Selling, general and administrative (SG&A) expenses grew 2.9%, to ¥101.4 billion. The ratio of SG&A expenses to net sales was up 1.2 percentage points, to 28.7%, because factors including a spike in R&D expenses for the clinical trials of the anti-Parkinson's disease agent KW-6002 canceled a reduction in personnel expenses.

Operating Income

Operating income registered a 23.8% decrease, to ¥25.5 billion, due to the significant effect of lower sales and increases in the cost of sales and SG&A expenses. The operating margin declined 2.1 percentage points, to 7.2%.

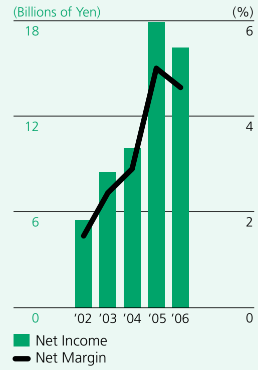
Other Revenue (Expenses)

Net other expenses improved substantially, from ¥3.6 billion in the previous fiscal year, to ¥0.7 billion. The Company incurred new expenses totaling ¥5.6 billion, which comprised expenses on support for employees' early retirement of ¥4.6 billion and loss on impairment of fixed assets of ¥1.1 billion. However, a ¥1.6 billion reduction in loss on disposal of inventory assets; a ¥2.2 billion equity in gain of anonymous association, up from ¥0.3 billion in the previous fiscal year; and a ¥1.7 billion gain on sale of property, plant and equipment offset these new expenses. Moreover, in the previous fiscal year the Company recorded a provision for loss on liquidation of business, a provision for doubtful receivables, and a provision for cost of disposal of fixed assets amounting to ¥1.9 billion. As a result, income before income taxes and minority interests decreased 16.8%, to ¥24.9 billion.

Income Taxes

Current and deferred income taxes were ¥8.5 billion, down ¥3.4 billion from the

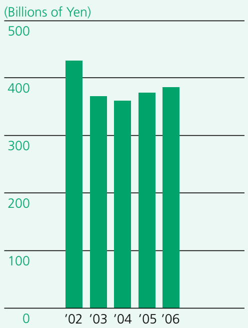
Net Income



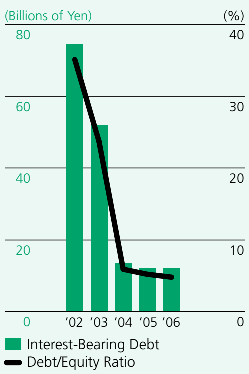
	Millions of Yen						Thousands of U.S. Dollars (Note 1)
	2006	2005	2004	2003	2002	2001	**2006**
Sales by Industry Segment:							
Pharmaceuticals	¥149,535	¥156,426	¥142,881	¥140,594	¥142,297	¥141,450	$1,272,963
Bio-Chemicals	57,424	57,767	69,195	58,525	55,496	52,720	488,840
Chemicals	85,835	77,983	66,899	65,158	60,410	60,659	730,697
Food[2]	42,440	44,500	45,912	72,322	103,531	103,353	361,284
Other	55,368	57,784	62,906	63,485	59,777	57,627	471,337
Corporate, elimination and other	(37,162)	(35,497)	(38,955)	(40,799)	(42,843)	(40,199)	(316,353)
Total	¥353,440	¥358,963	¥348,838	¥359,285	¥378,668	¥375,610	$3,008,768
Operating Income (Loss) by Industry Segment:							
Pharmaceuticals	¥14,230	¥18,100	¥11,943	¥11,014	¥18,959	¥19,574	$121,137
Bio-Chemicals	4,083	6,887	8,847	1,975	1,268	(1,191)	34,758
Chemicals	4,501	5,339	2,893	1,100	(1,174)	(2,684)	38,316
Food[2]	1,602	1,662	1,654	(368)	(440)	919	13,638
Other	1,155	1,634	1,767	2,597	1,756	1,141	9,832
Corporate, elimination and other	(36)	(115)	(268)	(229)	(12)	(47)	(307)
Total	¥25,535	¥33,507	¥26,836	¥16,089	¥20,357	¥17,712	$217,374

Notes: 1. U.S. dollar amounts are translated from Japanese yen, for convenience only, at the rate of ¥117.47=US$1, the approximate exchange rate at March 31, 2006.
2. Due to the transfer of alcoholic beverage operations in September 2002, the name of the Liquor and Food Segment was changed to the Food Segment from the year ended March 31, 2004.
3. Due to the reclassification of business segments effective from fiscal 2005, segment information for fiscal 2004 has been restated. However, segment information for years prior to fiscal 2004 has not been restated.

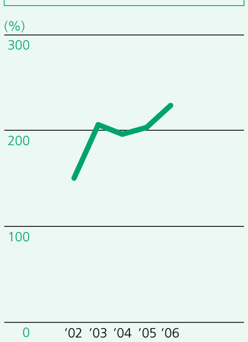
Total Assets



Interest-Bearing Debt



Current Ratio



previous fiscal year. The effective tax rate declined from 39.8% in the previous year to 34.1%.

Net Income

Consequently, net income booked a 9.2% decrease, to ¥16.3 billion, while the net margin edged down 0.4 percentage points, to 4.6%.

Performance by Segment

Sales, operating expenses, and operating income for the Company's business segments are as follows. Segment performance figures include inter-segment transactions.

Pharmaceuticals

The segment saw a 4.4% year-on-year reduction in sales, to ¥149.5 billion, representing 42.3% of total sales, while operating expenses were 2.2% lower, at ¥135.3 billion. Consequently, the segment registered a 21.4% decrease in operating income, to ¥14.2 billion. A decrease in the profit margin was mainly because of a marked increase in R&D expenses stemming from the final stages of phase III clinical trials for KW-6002.

Bio-Chemicals

Sales edged down 0.6%, to ¥57.4 billion, or 16.2% of total sales. Operating expenses posted a 4.8% increase, to ¥53.3 billion, while operating income fell 40.7%, to ¥4.1 billion. A large fall in the profit margin reflected a drop in prices for amino acids.

Chemicals

Sales grew 10.1%, to ¥85.8 billion, which accounted for 24.3% of total sales. However, operating expenses were up 12.0%, to ¥81.3 billion, resulting in a 15.7% decrease in operating income, to ¥4.5 billion. The profit margin deteriorated because the segment was unable to expand profits by exploiting higher prices arising from soaring crude oil prices—a key raw material.

Food

Sales were down 4.6%, to ¥42.4 billion, or a 12.0% share of total sales. Operating expenses declined 4.7%, to ¥40.8 billion, while operating income decreased 3.6%, to ¥1.6 billion. Thanks to a comparatively strong performance by seasonings, the profit margin registered modest improvement.

Other

Sales in the Other segment declined 4.2%, to ¥55.4 billion, representing 15.7% of total sales. Operating expenses decreased 3.4%, to ¥54.2 billion, while operating income was down 29.3%, to ¥1.2 billion. Operations in the Other segment include wholesaling, logistics, and the design and operation of facilities.

Cash Flows

Net cash provided by operating activities in the fiscal year under review totaled ¥14.3 billion, down ¥15.8 billion from the previous fiscal year. This decrease was related to such factors as a ¥5.0 billion decline in income before income taxes and minority interests, a decrease in reserve for retirement benefits, an increase in inventories, and an increase in trade payables.

Net cash used in investing activities decreased ¥6.3 billion from the previous year, to ¥1.8 billion, mostly because ¥4.1 billion in proceeds from sale of investments in securities and ¥3.2 billion in proceeds from sale of property, plant and equipment partly offset ¥9.0 billion used for acquisition of property, plant and equipment.

Net cash used in financing activities decreased ¥4.0 billion, to ¥5.1 billion, which mainly stemmed from a ¥5.3 billion reduction in acquisition of treasury stock that counteracted a ¥1.5 billion rise in dividends paid as a result of an increase in the previous year-end cash dividend.

As a consequence, cash and cash equivalents at fiscal year-end were up ¥8.0 billion, to ¥45.8 billion.

Financial Position

Assets

At the end of fiscal 2006, total current assets rose 1.3% from the previous year-end, to ¥213.0 billion, resulting from increases in commercial paper for short-term operational purposes, included in the item marketable securities; in investments in accounts receivable securitization, included in other accounts and notes receivable; and in inventories, which compensated for decreases in cash, time deposits, and accounts and notes receivable, trade.

Investments and advances were up 17.6% from the previous fiscal year-end, to ¥81.5 billion, principally due to growth in investments in securities spurred by increases in the prices of listed shares held.

Property, plant and equipment was down 3.8%, to ¥88.2 billion, as a result of factors including a ¥1.1 billion loss on impairment of fixed assets, which the Company began recognizing from the year under review.

As a result, total assets at year-end rose 2.6% from the previous fiscal year-end, to ¥384.4 billion.

Liabilities

Total current liabilities recorded a 9.0% decrease, to ¥94.1 billion, that mainly reflected reductions in accounts and notes payable, including a decrease in accounts and notes payable, trade, and income taxes payable.

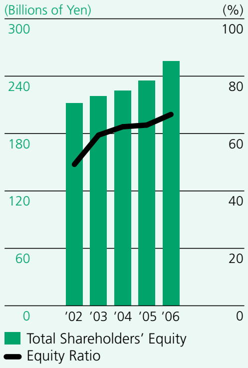
Non-current liabilities were down 4.1%, to ¥32.7 billion, with higher deferred tax liabilities canceled by decreases in such items as reserve for loss on liquidation of business, reserve for loss on disposal of fixed assets, and reserve for retirement benefits, which accompanied an extraordinary premium contribution to a corporate pension fund and the implementation of an extraordinary early retirement preferential system.

Total interest-bearing debt amounted to ¥12.2 billion at year-end, the same level as at the previous fiscal year-end. As in the previous year, cash and time deposits significantly exceeded debt, with short-term borrowings edging up approximately ¥0.1 billion and long-term debt shrinking to only ¥12.0 million.

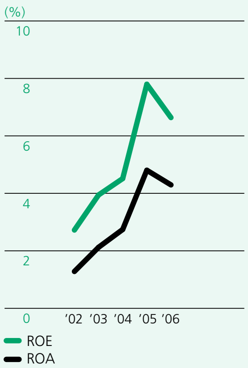
Shareholders' Equity

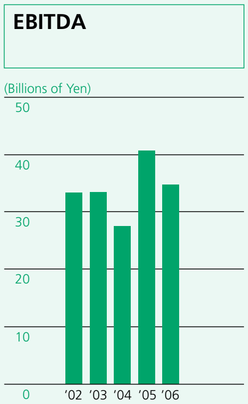
Total shareholders' equity grew 8.7% from the previous year-end, to ¥255.8 billion, because net income of ¥16.3 billion and an

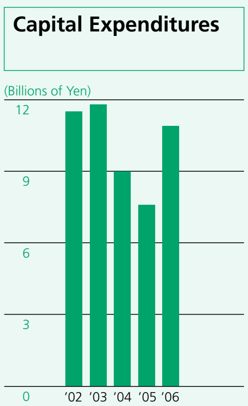
Total Shareholders' Equity



ROE and ROA







increase in unrealized gains on available-for-sale securities of ¥9.0 billion—thanks to rising share prices—covered a ¥1.5 billion rise in dividends paid.

As a result, the equity ratio rose from 62.9% at the previous year-end, to 66.6%. Moreover, the debt / equity ratio[1] improved from 5.2% to 4.8%, testifying to the Company's enhanced stability.

Management Indexes

Lower profit margins greatly impacted management indexes. Return on equity (ROE) declined to 6.63%, from 7.79% in fiscal 2005. Return on assets (ROA) edged down to 4.29%, from 4.88%. Operating return on assets decreased from 9.11%, to 6.73%. Further, since the commencement of the Ninth Medium-Term Management Plan the Company has spotlighted return on invested capital (ROIC)[2] as a key management indicator. Kyowa Hakko targets ROIC of 12.0% in the fiscal year ending March 2008. At the end of the fiscal year under review, ROIC was 9.2%. In addition, EBITDA[3] declined 14.4%, to ¥34.8 billion.

Capital Expenditures

Capital expenditures in fiscal 2006 jumped 42.0%, to ¥10.9 billion. Guided by the Ninth Medium-Term Management Plan, which covers a three-year term designated as a period of investment focused on building a growth foundation, the Company has slated an ambitious program for the expansion and strengthening of production plants. Although efforts in the first year of the management plan came up marginally short of initial projections, Kyowa Hakko successfully developed and fortified overseas production bases for amino acids while ramping up production capacity for specialty chemicals.

Meanwhile, depreciation and amortization decreased 7.3%, to ¥9.8 billion. Capital expenditures were slightly higher than depreciation and amortization. However, the Company was able to adequately cover that difference with internal reserves. A breakdown of capital expenditures and depreciation and amortization is shown in the table below.

Notes: 1. Debt / equity ratio = Interest-bearing debt (short-term borrowings + current portion of long-term debt + long-term debt) / total shareholders' equity
2. ROIC = operating income / total fixed assets + (accounts receivable + inventories – trade payables)
3. EBITDA = Income before income taxes and minority interests + interest expenses + depreciation and amortization

	Billions of Yen					
	Capital Expenditures			Depreciation and Amortization		
	2006	2005	2004	2006	2005	2004
Pharmaceuticals	¥ 3.9	¥2.7	¥3.6	¥3.9	¥ 4.4	¥ 4.6
Bio-Chemicals	2.3	2.2	1.9	2.6	2.7	3.0
Chemicals	3.4	1.6	1.8	2.3	2.3	2.7
Food	1.2	0.5	1.8	0.8	1.1	1.0
Other	0.1	0.6	0.1	0.2	0.1	0.1
Corporate, elimination and other	0.0	(0.0)	(0.1)	0.0	(0.0)	(0.0)
Total	¥10.9	¥7.6	¥9.0	¥9.8	¥10.6	¥11.4

R&D Expenses

R&D expenses, which are included in production expenses and in SG&A expenses, increased 14.3% from the previous fiscal year, to ¥32.9 billion. As initially predicted, the final stages of phase III clinical trials for KW-6002 spiked R&D expenses, which accounted for 9.3% of consolidated net sales, up from 8.0% in the previous fiscal year. R&D expenses in Pharmaceuticals totaled ¥28.0 billion, representing 85.4% of total R&D expenses and 18.8% of Pharmaceuticals segment sales, compared with 15.5% in fiscal 2005.

Per Share Data

In fiscal 2006, net income per share decreased from ¥41.7 in the previous year, to ¥38.4. Total shareholders' equity per share rose from ¥556.3 to ¥604.9. As in the previous year, cash dividends per share were ¥10.00, comprising interim and year-end dividends of ¥5.00 per share, respectively.

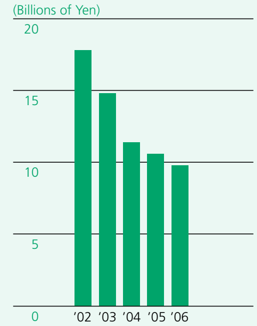
Distribution of Profits

Kyowa Hakko considers providing a return to shareholders to be one of its most important management issues. The Company's basic policy on dividends calls for the enrichment of retained earnings while making steady, continuous dividend payments, giving comprehensive consideration to the consolidated results of operations, the dividend payout ratio, and the dividends-on-equity ratio. Mindful of this policy and of fiscal 2006's reduced earnings, the Company decided to maintain cash dividends at the same level as in the previous year. In addition, Kyowa Hakko has earmarked retained earnings for investment in facilities, R&D, and other areas that will fuel new growth. Further, although May 2006 saw the enactment of a new corporate law, Kyowa Hakko does not have any plans to change its basic dividend payment policy.

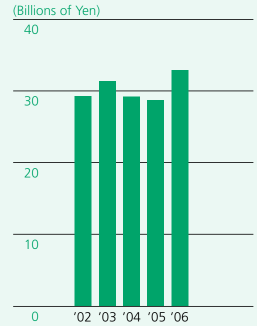
Treasury Stock

The Company will uphold its flexible approach to the acquisition of treasury stock. In the fiscal year under review, Kyowa Hakko acquired 237,315 shares, at a cost of ¥0.2 billion. The Company held 11,447,609 shares of treasury stock at the end of fiscal 2006.

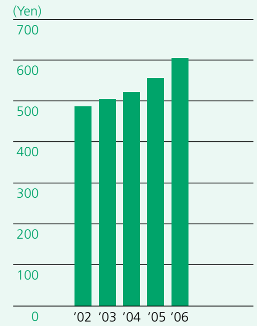
Depreciation and Amortization



R&D Expenses



Total Shareholders' Equity per Share



With regard to Kyowa Hakko's business performance and financial position, the major risks that could have a significant influence on the judgment of investors include those outlined below. The Company recognizes that these risk events may occur and uses a risk management system to prevent the occurrence of risk events that can be controlled by the Company. At the same time, in the event of the occurrence of a risk event, the Company will do its utmost in responding. Matters in this section dealing with the future represent the judgment of Kyowa Hakko as of March 31, 2006—the end of the fiscal year under review.

Risks associated with the operating environment in the domestic pharmaceutical industry

In the Company's core Pharmaceuticals operations, under the domestic public drug pricing system, the official prices of the majority of ethical drugs are periodically reduced. As a result, the Company is unable to avoid reductions in the selling prices of its drugs.

Risks that substantial R&D investment will not be recovered

The Company conducts substantial R&D investment in the development of new products and technologies, the improvement of existing products, and the development of new applications for existing products. However, there is no guarantee that these investments will successfully bear fruit. For example, in ethical drug operations the development of new drugs requires lengthy periods of time and substantial R&D expenditures. It may not be possible for the Company to recover its investment in R&D due to various factors, such as the cancellation of development if the expected efficacy is not confirmed, lackluster sales following market launch, or the cancellation of sales due to the expression of serious side effects.

Risks related to intellectual property rights

The creation of new products and new technologies based on R&D is a basic corporate management strategy of the Company. Kyowa Hakko endeavors to accumulate technologies and acquire intellectual property rights to differentiate itself from other companies. Furthermore, the Company is strengthening its information control systems to prevent external leakages of technologies and expertise that it has developed. Although the Company strives to ensure that it does not infringe on the intellectual property rights of others, its inability to appropriately protect or control such intellectual property rights could adversely affect the Company's operational activities, business performance, or financial position.

Risks related to statutory regulations

In the course of carrying out operations in Japan and overseas, there are statutory regulations that must be observed. To ensure that it does not violate relevant statutory regulations in the course of operations, the Company emphasizes compliance and works to bolster internal control functions through such means as administrative oversight. However, the possibility that the Company could inadvertently violate statutory regulations cannot be entirely eliminated. Such an eventuality could adversely affect the Company's business performance or could lead to a loss of public trust in the Company.

Risks related to defective products

Kyowa Hakko manufactures a variety of products at plants in countries in which it operates pursuant to locally recognized quality control and other standards. Furthermore, the Company requires that the products it purchases for sale conform to the same quality and standards required of Kyowa Hakko products. However, there is no guarantee that all products will be free of defects. Therefore, the possibility of product defects resulting in large-scale product recalls or product liability claims cannot be ruled out.

Risks related to the effect of disasters and accidents

To minimize the negative effects of halting manufacturing line activities, the Company conducts regular disaster prevention tests and inspections of all of its production facilities. However, there is no guarantee that the Company will be able to completely prevent events that interrupt production, such as accidents, electricity outages, and boiler stoppages. Furthermore, the Company handles such flammable materials as alcohol and petrochemical products as well as substances that are subject to an array of statutory regulations and guidelines. As a result of disasters, natural disasters, or some other reason, these substances could damage surrounding areas. Such an accident or disaster could not only result in the Company incurring large damages in liabilities, but also adversely affect the public's trust in the Company.

Risks related to the effect of the strengthening of environmental regulations on production activities

The Company processes and disposes of waste fluid generated from its fermentation production processes in accordance with the environmental regulations of the countries in which plants are located. Furthermore, the Company is endeavoring to change over to raw materials that minimize environmental burden and improve its waste fluid treatment technology. However, given the trend toward strengthening environmental regulations, it is possible that regulatory changes could lead to restrictions on the Company's production activities or increases in production costs.

Risks related to conducting business activities overseas

The Company conducts business activities in the United States, Europe, and Asia. Developing operations in overseas markets entails a number of potential risks, which are outlined below.

- Unforeseeable laws and regulations, disadvantageous changes in tax systems
- The occurrence of disadvantageous political or economic factors
- Difficulty in recruiting and maintaining personnel
- Social unrest resulting from terrorism, war, or other factors

In some of these cases, the Company could be unable to effectively carry out overseas operations due to the manifestation of such potential risk events.

Risks relating to falling product prices due to fluctuations in the balance of supply and demand

The markets for some of the Company's lineups, such as solvents, plasticizers, and raw materials for plasticizers in Chemicals operations, fluctuate significantly in response to the worldwide balance of supply and demand. It is possible that sales prices could fall significantly as a result of excess supply.

Risks related to declines in profitability due to considerable fluctuations in crude oil prices

The primary raw materials for the products of the Company's Chemicals operations include ethylene and propylene, which are made from naphtha, refined from crude oil. The prices of these raw materials are significantly affected by fluctuations in the price of crude oil, which can result from such unpredictable factors as the worldwide balance of supply and demand, weather conditions, war, and terrorism. In some cases, the Company may not be able to achieve the timely reflection of fluctuations in raw materials prices in product prices or offset fluctuations through cost-reduction measures.

CONSOLIDATED BALANCE SHEETS

KYOWA HAKKO KOGYO CO., LTD. and Its Consolidated Subsidiaries
As at March 31, 2006 and 2005

	Millions of Yen		Thousands of U.S. Dollars (Note 3)
ASSETS	2006	2005	2006
Current Assets:			
Cash	¥ 24,911	¥ 34,764	$ 212,063
Time deposits	1,108	1,375	9,432
Marketable securities	15,494	1,000	131,898
Accounts and notes receivable:			
Trade	90,991	99,298	774,589
Unconsolidated subsidiaries and affiliates	8,376	9,008	71,303
Other	2,436	3,728	20,737
	101,803	112,034	866,629
Inventories	55,486	50,490	472,342
Deferred tax assets (Note 7)	6,366	6,868	54,193
Other current assets	8,006	4,017	68,153
Less: allowance for doubtful accounts	(189)	(207)	(1,609)
Total current assets	212,985	210,341	1,813,101
Investments and Advances:			
Investments in securities (Note 4)	58,447	44,735	497,548
Investments in and advances to unconsolidated subsidiaries and affiliates (Note 4)	18,764	20,197	159,734
Long-term loans to employees, mostly for housing	36	36	306
Long-term loans and other investments	5,848	5,990	49,784
Less: reserve for write-down of investments in securities	(449)	(452)	(3,822)
Less: allowance for doubtful accounts	(1,160)	(1,219)	(9,875)
	81,486	69,287	693,675
Property, Plant and Equipment (Note 6):			
Buildings and structures	118,568	121,464	1,009,347
Machinery and equipment	211,619	211,282	1,801,473
	330,187	332,746	2,810,820
Less: accumulated depreciation	(265,049)	(264,421)	(2,256,312)
	65,138	68,325	554,508
Land	20,268	21,663	172,538
Construction in progress	2,782	1,647	23,682
	88,188	91,635	750,728
Deferred Tax Assets (Note 7)	343	2,237	2,920
Other Assets	1,379	993	11,739
	¥ 384,381	¥ 374,493	$3,272,163

The accompanying notes are an integral part of the statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of Yen		Thousands of U.S. Dollars (Note 3)
	2006	2005	2006
Current Liabilities:			
Short-term borrowings (Note 5)	¥ 12,204	¥ 12,107	$ 103,890
Accounts and notes payable:			
Trade	42,269	45,501	359,828
Unconsolidated subsidiaries and affiliates	5,223	5,690	44,462
Construction and acquisition of properties	3,389	1,750	28,850
Other	12,802	16,375	108,981
	63,683	69,316	542,121
Income taxes payable	3,828	8,177	32,587
Reserve for accrued sales returns	39	54	332
Reserve for accrued sales rebates	1,072	1,231	9,126
Reserve for accrued sales promotion expenses	718	902	6,112
Accrued bonuses	3,304	—	28,126
Reserve for cost of disposal of fixed assets	—	1,031	—
Reserve for loss on liquidation of business	—	1,224	—
Guarantee deposits from customers	7,120	7,472	60,611
Other current liabilities	2,180	1,975	18,559
Total current liabilities	94,148	103,489	801,464
Long-Term Debt (Note 5)	12	86	102
Deferred Tax Liabilities (Note 7)	7,382	2,010	62,842
Reserve for Retirement Benefits:			
Employees (Note 8)	24,517	30,571	208,709
Directors and corporate auditors	92	841	783
Reserve for Cost of Disposal of Fixed Assets	—	277	—
Reserve for Loss on Guarantee of Liabilities	—	17	—
Other Non-Current Liabilities	739	304	6,291
Minority Interests in Consolidated Subsidiaries	1,684	1,460	14,336
Commitments and Contingent Liabilities (Notes 6 and 11)			
Shareholders' Equity:			
Common stock:			
Authorized: 987,900,000 shares at March 31, 2006 and 2005			
Issued: 434,243,555 shares at March 31, 2006 and 2005	26,745	26,745	227,675
Additional paid-in capital	43,186	43,185	367,634
Retained earnings (Note 16)	170,718	159,588	1,453,290
	240,649	229,518	2,048,599
Unrealized Gains on Available-for-Sale Securities (Note 4)	24,338	15,307	207,184
Translation Adjustments	(1,152)	(1,565)	(9,807)
Treasury Stock, at Cost, 11,447,609 shares at March 31, 2006	(8,028)	(7,821)	(68,340)
Total shareholders' equity	255,807	235,439	2,177,636
	¥384,381	¥374,493	$3,272,163

CONSOLIDATED STATEMENTS OF INCOME

KYOWA HAKKO KOGYO CO., LTD. and Its Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	2006	2005	2004	2006
Net Sales (Note 14)	¥353,440	¥358,963	¥348,838	$3,008,768
Cost of Sales (Notes 6, 8 and 12)	226,457	226,850	219,331	1,927,786
Gross profit	126,983	132,113	129,507	1,080,982
Selling, General and Administrative Expenses (Notes 6, 8 and 10)	101,448	98,606	102,671	863,607
Operating income (Note 14)	25,535	33,507	26,836	217,375
Other Revenue (Expenses):				
Interest and dividend income	995	686	781	8,470
Interest expenses	(186)	(240)	(804)	(1,583)
Gain on sale of investments in securities	97	131	12,978	826
Foreign exchange gain (loss)	454	202	(1,309)	3,864
Insurance premium received	359	380	405	3,056
Equity in gain of anonymous association	2,222	304	—	18,915
Gain on sale of property, plant and equipment	1,667	155	3,959	14,191
Reversal of reserve for cost of disposal of fixed assets	587	—	—	4,997
Equity in earnings of affiliates	680	564	552	5,789
Provision for doubtful receivables	—	(387)	—	—
Loss on sale of investment in consolidated subsidiary	—	(266)	—	—
Provision for loss on liquidation of business	—	(1,224)	—	—
Extraordinary depreciation of property and equipment	—	(165)	—	—
Provision for cost of disposal of fixed assets	—	(277)	—	—
Provision for loss on write-down of investments	—	(255)	—	—
Loss on impairment of fixed assets (Note 10)	(1,061)	—	—	(9,032)
Loss on restructuring of certain subsidiaries and affiliates (Note 10)	—	—	(843)	—
Amount arising from the lump-sum recognition of the previous years' unrecognized actuarial differences associated with cancellation of the Company's retirement benefit trust contract (Note 8)	—	—	(16,227)	—
Loss on disposal of fixed assets relevant to organizational restructuring (Note 10)	—	—	(3,225)	—
Loss on recalling products	—	—	(2,086)	—
Administrative fines in a cartel for sales of amino lysine within European Economic Area (Note 10)	—	—	(1,901)	—
Expenses on support for employees' early retirement	(4,640)	—	(1,464)	(39,499)
Loss on redemption of bond	—	—	(681)	—
Loss on disposal of inventory assets	(402)	(2,029)	(1,513)	(3,422)
Other, net	(1,435)	(1,183)	(81)	(12,216)
	(663)	(3,604)	(11,459)	(5,644)
Income before Income Taxes and Minority Interests	24,872	29,903	15,377	211,731
Income Taxes (Note 7):				
Current	6,887	11,334	9,463	58,628
Deferred	1,603	569	(3,936)	13,646
	8,490	11,903	5,527	72,274
	16,382	18,000	9,850	139,457
Minority Interests in (Earnings) Losses of Consolidated Subsidiaries	(109)	(68)	167	(928)
Net income	¥ 16,273	¥ 17,932	¥ 10,017	$ 138,529

	Yen			U.S. Dollars (Note 3)
Per Share Data (Note 15):				
Net income—basic	¥38.4	¥41.7	¥23.0	$0.327
Net income—diluted (*)	38.3	—	—	0.326
Cash dividends	10.0	10.0	7.5	0.085
Weighted Average Number of Shares (Thousands of shares)	422,920	427,636	431,497	

* Diluted net income per share for fiscal 2005 and 2004 is not disclosed because there were no residual securities.
The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

KYOWA HAKKO KOGYO CO., LTD. and Its Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

	Number of shares of common stock (thousands)	Millions of Yen		
		Common stock	Additional paid-in capital	Retained earnings
Balance at March 31, 2003	434,244	¥26,745	¥43,180	¥138,226
Net income for the year ended March 31, 2004	—	—	—	10,017
Cash dividends	—	—	—	(1,615)
Directors' and corporate auditors' bonuses	—	—	—	(82)
Interim cash dividends	—	—	—	(1,625)
Increase due to application of inflation accounting to the accounts of Mexican subsidiary	—	—	—	6
Gain on sale of treasury stock	—	—	2	—
Balance at March 31, 2004	434,244	26,745	43,182	144,927
Net income for the year ended March 31, 2005	—	—	—	17,932
Cash dividends	—	—	—	(1,614)
Directors' and corporate auditors' bonuses	—	—	—	(83)
Interim cash dividends	—	—	—	(1,614)
Increase due to subsidiaries newly included in consolidation	—	—	—	40
Gain on sale of treasury stock	—	—	3	—
Balance at March 31, 2005	434,244	26,745	43,185	159,588
Net income for the year ended March 31, 2006	—	—	—	16,273
Cash dividends	—	—	—	(2,645)
Directors' and corporate auditors' bonuses	—	—	—	(99)
Interim cash dividends	—	—	—	(2,115)
Decrease due to subsidiary newly included in consolidation	—	—	—	(284)
Gain on sale of treasury stock	—	—	1	—
Balance at March 31, 2006	434,244	¥26,745	¥43,186	¥170,718

	Number of shares of common stock (thousands)	Thousands of U.S. Dollars (Note 3)		
		Common stock	Additional paid-in capital	Retained earnings
Balance at March 31, 2005	434,244	$227,675	$367,626	$1,358,543
Net income for the year ended March 31, 2006	—	—	—	138,529
Cash dividends	—	—	—	(22,516)
Directors' and corporate auditors' bonuses	—	—	—	(843)
Interim cash dividends	—	—	—	(18,005)
Decrease due to subsidiary newly included in consolidation	—	—	—	(2,418)
Gain on sale of treasury stock	—	—	8	—
Balance at March 31, 2006	434,244	$227,675	$367,634	$1,453,290

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

KYOWA HAKKO KOGYO CO., LTD. and Its Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	2006	2005	2004	2006
Cash Flows from Operating Activities:				
Income before income taxes and minority interests	¥24,872	¥ 29,903	¥ 15,377	$ 211,731
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:				
Depreciation and amortization	9,789	10,565	11,358	83,332
(Decrease) increase in reserve for retirement benefits	(6,053)	(3,201)	16,408	(51,528)
(Decrease) increase in reserve for retirement benefits to directors and corporate auditors	(744)	60	(32)	(6,333)
Increase in accrued bonuses	3,304	—	—	28,126
(Decrease) increase in reserve for cost of disposal of fixed assets	(1,308)	(518)	1,826	(11,134)
(Increase) decrease in allowance for doubtful accounts	(23)	474	(153)	(195)
Interest and dividend income	(995)	(686)	(781)	(8,470)
Interest expenses	186	240	804	1,583
Equity in earnings of affiliates	(680)	(564)	(552)	(5,788)
Equity in gain of anonymous association	(2,222)	(304)	—	(18,915)
Loss on impairment of fixed assets	1,061	—	—	9,032
(Gain) loss on disposal of property, plant and equipment	(959)	780	(2,432)	(8,164)
Increase in reserve for guarantee of liabilities	—	17	—	—
Increase in reserve for loss on investment	—	255	—	—
Increase in reserve for loss on liquidation of business	—	1,224	—	—
Gain on sale of securities	(97)	(131)	(12,978)	(826)
Loss on sale of investment in consolidated subsidiary	—	266	—	—
Loss on restructuring of certain subsidiaries and affiliates	—	—	843	—
Loss on recalling products	—	—	2,086	—
Expenses on support for employees' early retirement	4,640	—	1,464	39,499
Loss on redemption of bond	—	—	681	—
Decrease (increase) in trade receivables	8,665	(361)	1,792	73,763
(Increase) decrease in inventories	(4,641)	(374)	407	(39,508)
(Decrease) increase in trade payables	(3,176)	2,176	1,554	(27,037)
Payment of bonuses to directors and corporate auditors	(109)	(93)	(90)	(928)
(Decrease) increase in consumption tax payables	(491)	268	(182)	(4,180)
Others	(4,826)	3,929	2,938	(41,083)
	26,193	43,925	40,338	222,977
Interest and dividend received	1,303	772	833	11,092
Interest expenses paid	(169)	(242)	(1,080)	(1,439)
Dividend of anonymous association received	2,590	—	—	22,048
Payment for administrative fines in a cartel for sales of amino lysine within European Economic Area	—	—	(2,074)	—
Compensation payment incurred in connection with recalling products	—	(1,897)	(359)	—
Payment of expenses on support for employees' early retirement	(4,318)	-	(1,454)	(36,758)
Income taxes paid	(11,296)	(12,454)	(1,940)	(96,161)
Net cash provided by operating activities	14,303	30,104	34,264	121,759
Cash Flows from Investing Activities:				
Increase in time deposits	(403)	(448)	(399)	(3,431)
Decrease in time deposits	431	456	633	3,669
Acquisition of property, plant and equipment	(9,001)	(7,265)	(9,202)	(76,624)
Proceeds from sale of property, plant and equipment	3,216	371	4,714	27,377
Acquisition of investments in securities	(63)	(116)	(227)	(536)
Proceeds from sale of investments in securities	4,117	179	15,613	35,047
Payment of sale of investment in consolidated subsidiary	—	(22)	(521)	—
Additional investments in consolidated subsidiaries	1,183	794	—	10,071
Net (increase) decrease in short-term loans receivable	(439)	(260)	113	(3,737)
Increase in long-term loans receivable	(169)	—	(238)	(1,439)
Decrease in long-term loans receivable	332	65	320	2,826
Others	(1,000)	(1,858)	(329)	(8,512)
Net cash (used in) provided by investing activities	(1,796)	(8,104)	10,477	(15,289)
Cash Flows from Financing Activities:				
Net proceeds from short-term debt	(141)	(319)	(4,006)	(1,201)
Repayment of long-term debt	(11)	(45)	(1,514)	(93)
Redemption of bond (Notes 5 and 13)	—	-	(33,681)	—
Acquisition of treasury stock	(234)	(5,525)	(1,790)	(1,992)
Proceeds from sale of treasury stock	16	20	17	136
Dividends paid	(4,755)	(3,233)	(3,243)	(40,478)
Dividends paid to minority	(14)	(14)	(9)	(119)
Net cash used in financing activities	(5,139)	(9,116)	(44,226)	(43,747)
Effect of Exchanges on Cash and Cash Equivalents	381	14	(192)	3,243
Increase in Cash and Cash Equivalents	7,749	12,898	323	65,966
Cash and Cash Equivalents at the Beginning of the Year	37,818	24,911	24,588	321,938
Increase in Cash and Cash Equivalents Due to Consolidation of Certain Subsidiary	253	9	—	2,154
Cash and Cash Equivalents at the End of the Year	¥ 45,820	¥ 37,818	¥ 24,911	$ 390,058

Relation between cash and cash equivalents at year-end and the account booked in the balance sheets

	Millions of Yen			Thousands of U.S. Dollars (Note 3)
	2006	2005	2004	2006
Cash and time deposits	¥26,019	¥36,139	¥25,240	$221,495
Time deposits whose maturity periods exceed three months	(293)	(320)	(329)	(2,494)
Investments in accounts receivable securitization	4,600	1,000	—	39,159
Marketable securities with original maturities of three months or less	15,494	999	—	131,898
	¥45,820	¥37,818	¥24,911	$390,058

The accompanying notes are an integral part of the statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

KYOWA HAKKO KOGYO CO., LTD. and Its Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared from accounts and records maintained by KYOWA HAKKO KOGYO CO., LTD. (the "Company") and its consolidated subsidiaries (hereinafter referred to in total as the "Companies"). The Company and its domestic consolidated subsidiaries have maintained their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and the Securities and Exchange Law and in conformity with generally accepted accounting principles and practices prevailing in Japan, which are different in certain respects as to application and disclosure requirements from International Financial Reporting Standards.

Certain items presented in the consolidated financial statements submitted to the Director of Kanto Finance Bureau in Japan have been reclassified for the convenience of readers outside Japan.

The Company's fiscal year is from April 1 to March 31. Therefore, "fiscal 2006" began on April 1, 2005 and ended on March 31, 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Principles of Consolidation

The Company had 43 subsidiaries as at March 31, 2006 (47 as at March 31, 2005). The consolidated financial statements include the accounts of the Company and 21 subsidiaries in fiscal 2006 (22 for fiscal 2005).

Effective from October 1, 2003, Fermentaciones Mexicanas, S.A. de C.V. (incorporated in Mexico and hereinafter referred to as "Fermex") was excluded from consolidation, as the Company transferred all of its holding shares in December 2003.

Effective from April 1, 2004, Kyowa Wellness Co., Ltd. (incorporated in Japan) was included in consolidation in view of the importance. Kyowa Foods (H.K.) Co., Ltd. (incorporated in China) was excluded from consolidation, as it was liquidated in April 2004. Agroferm Hungarian-Japanese Fermentation Industry Ltd. (incorporated in Hungary and hereinafter referred to as "Agroferm") was excluded from consolidation, as the Company transferred all of its holding shares in June 2004.

Effective from April 1, 2005, Kyowa Hakko Food Specialties Co., Ltd. (incorporated in Japan) was included in consolidation, because the Company separated its Food operations into Kyowa Hakko Food Specialties Co., Ltd. BioWa, Inc. (incorporated in the United States) was included in consolidation in view of the materiality. Kyusyu Kyowa Shokuhin Hanbai Co., Ltd. was excluded from consolidation, as it was merged with Kyowa Hakko Food Specialties Co., Ltd., a consolidated subsidiary, as of July 1, 2005. Its statement of income until July 1, 2005 was consolidated. Asahi Foods Products Co., Ltd. (incorporated in Japan) was excluded from consolidation, as the Company sold all of its shares in April 2005. Seifu Co., Ltd. was excluded from consolidation, as it was liquidated as of October 24, 2005. Its statement of income until the liquidation was consolidated.

Major subsidiaries are listed on the next page.

The remaining 22 (25 as at March 31, 2005) subsidiaries, whose combined total assets, net sales, net income and retained earnings are not significant in relation to those of the consolidated financial statements of the Companies, have been excluded from consolidation.

The accounts of 7 (6 as at March 31, 2005) overseas consolidated subsidiaries, including BioWa, Inc., Biokyowa Inc., Kyowa Hakko U.S.A., Inc., and Kyowa America, Inc. (all incorporated in the United States), Kyowa Hakko Europe GmbH (incorporated in Germany) , Kyowa Hakko (H.K.) Co., Ltd. (incorporated in China) and Kyowa Italiana Farmaceutici S.R.L. (incorporated in Italy), are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in their respective countries. Although certain differences exist in the accounting principles adopted by the overseas subsidiaries, essentially no adjustments have been made to their accounts in order to conform to Japanese accounting principles in the accompanying consolidated financial statements, as allowed under accounting principles and practices generally accepted in Japan.

The accounts of Fermex are based on inflation accounting as generally accepted in Mexico. Such inflation accounting includes the revaluation of fixed assets and the restatement of shareholders' equity adjusted by the National Consumer Price Index growth factor and the recognition of the effect of inflation on monetary assets and liabilities.

Financial statements of all overseas subsidiaries are prepared on a calendar year basis. For all domestic consolidated subsidiaries, they adopt a March 31 fiscal year-end basis.

Significant transactions that occurred between January 1 and March 31 are reflected in the accompanying consolidated financial statements.

Name of company	Direct and indirect equity ownership percentage	Capital stock (Millions)
Domestic subsidiaries:		
Kyowa Hakko Chemical Co., Ltd.	100.0%	¥5,300
Kyowa Hakko Food Specialties Co., Ltd.	100.0	3,000
Kyowa Medex Co., Ltd.	100.0	450
Kyowa Wellness Co., Ltd.	100.0	30
Kyowa F.D. Foods Co., Ltd.	100.0	100
Miyako Kagaku Co., Ltd.	52.9	111
Chiyoda Kaihatsu Co., Ltd.	100.0	113
Overseas subsidiaries:		
BioWa, Inc. (U.S.A.)	100.0	$10
Biokyowa Inc. (U.S.A.)	100.0	$20
Kyowa Hakko U.S.A., Inc. (U.S.A.)	100.0	$1
Kyowa Hakko Europe GmbH (Germany)	100.0	EURO1
Kyowa America, Inc. (U.S.A.)	100.0	$58

Any difference between the cost of an investment in a subsidiary and the amount of underlying equity in net assets of the subsidiary, if any at the date of establishment of control, has been amortized using a method which the Company determined based on the specific circumstances of each consolidated subsidiary.

All assets and liabilities of consolidated subsidiaries are revalued to fair market value as of the date of establishment of the control.

(2) Accounting for Investments in Unconsolidated Subsidiaries and Affiliates

The Company had 22 (25 at March 31, 2005) unconsolidated subsidiaries and 20 (21 at March 31, 2005) affiliates. The equity method is applied to the investments in 6 (6 at March 31, 2005) major domestic affiliates since the investments in the remaining unconsolidated subsidiaries and affiliates would not have had a material effect on the consolidated financial statements.

The 6 affiliates are accounted for using the equity method. The most significant affiliate is as follows:

Name of company	Equity ownership percentage	Capital stock (Millions of Yen)
J-PLUS Co., Ltd.	50.0%	¥480

The investments in the remaining unconsolidated subsidiaries and affiliates are stated at cost or less.

(3) Securities Valuation

Held-to-maturity debt securities are valued at amortized or accumulated cost.

Available-for-sale securities, for which market value is available, are valued at fair market value prevailing at the fiscal year-end.

Available-for-sale securities, for which market value is not available, are valued at cost, cost being determined by the moving average method.

Where fair market value has declined by more than 30%, which is deemed to be "significantly declined in value", the Company measures the recoverability of each security and recognizes a subsequent loss on write-down, if necessary.

See Note 4.

(4) Inventories Valuation

Inventories are valued at cost, cost being determined mainly by using the average cost method.

(5) Property, Plant and Equipment

Depreciation is computed mainly using the declining-balance method.

The Company and its domestic consolidated subsidiaries compute depreciation expense for buildings (other than related equipment and leasehold improvements) acquired on and after April 1, 1998 using the straight-line method.

The range of useful lives are principally as follows:

Buildings and structures:	15-50 years
Machinery and equipment:	4-15 years

(Additional Information)

For fiscal 2005, based on the Company's inquiry for the cancellation of rental agreements with tenants and prospective use of the property and equipment, the Company changed its useful life of certain rental property and equipment to the period until the tenants' exit, where the property and equipment is expected to be disposed of after the termination of the rental agreement with tenants. As a result, the depreciation of the property and equipment of ¥165 million was accounted for as extraordinary depreciation in "Other Expenses."

(6) Reserves and Allowances

Allowance for Doubtful Accounts

An allowance for doubtful accounts is made against potential losses on collection at an amount measured using a historical bad debt ratio, plus an amount individually measured on collectibility of receivables that are expected to be uncollectible due to bad financial condition or insolvency.

Reserve for Write-Down of Investments in Securities
A reserve for the write-down of investments in securities is measured on the basis of the financial positions of the investees, such as subsidiaries and other investments, and provided for any decline in value of those investments.

Reserve for Accrued Sales Rebates
A reserve for accrued sales rebates is provided at an amount determined based on the balance of receivables for pharmaceutical products from the sales agents and distributors at the year-end and the estimated rebate rates to be applied under the agreements.

Reserve for Accrued Sales Returns
A reserve for accrued sales returns is provided on the basis of the maximum amount deductible under Japanese income tax laws. The amount of the reserve is determined based on the past years' experience of the Companies.

Reserve for Accrued Sales Promotion Expenses
A reserve for accrued sales promotion expenses is provided at an amount equivalent to probable sales promotion expenses related to pharmaceutical inventories held by distributors. The amount of the reserve is determined based on the balance of inventories at year-end and the Companies' past experience ratio for such expenses.

Accrued Bonuses to Employees
Accrued bonuses to employees is provided for bonuses payable to employees based on the amount expected to be paid at the year-end.

(Additional Information)
For fiscal 2006, the Company accounted for accrued bonuses to employees as "Accrued bonuses" in accordance with "Financial Statement Titles To Be Used for Accrued Bonuses for Employees (the JICPA published Research Center Review Guidance No. 15)," which had been previously included in "Other current liabilities," because bonuses to employees were not finally determined at the year-end. For fiscal 2005, the amount of accrued bonuses for employees included in "Other current liabilities" was ¥3,656 million.

Reserve for Retirement Benefits to Employees
A reserve for retirement benefits to employees is provided at an amount equal to the present value of the projected benefit obligation less fair value of the plan assets at the year-end.

Unrecognized prior service costs are amortized on a straight-line basis over five years from the year they occur.

Unrecognized actuarial differences are amortized on a straight-line basis over ten years from the year after they occur.

(Additional Information)
For fiscal 2004, the Company cancelled its corporate pension trust contract on September 25, 2003, with the approval of the trust administrator, beneficiary (employees and the employees' pension fund) and trustee (trust bank), and contributed to unfunded pension cost in connection with the welfare pension fund. Due to a significant revision in April 2004 and the Company's own organizational restructuring and establishment of an operating holding company, the Company determined that the division management of the corporate pension fund was difficult to maintain.

The Company fully amortized unrecognized actuarial losses associated with the cancellation of the corporate pension trust and accounted for other expense of ¥16,227 million.

Reserve for Retirement Benefits to Directors and Corporate Auditors
A reserve for retirement benefits to directors and corporate auditors is provided in accordance with the Company's internal rule.

(Additional Information)
On July 28, 2005, at the shareholders' meeting, the retirement benefits plan to directors and corporate auditors was terminated as a result of a change to the directors' compensation plan as a part of the restructuring plan of management. Prior to June 28, 2005, directors, including executive directors, and corporate auditors were covered by the retirement benefits plan to directors and corporate auditors and a reserve for retirement benefits to directors and corporate auditors was provided in accordance with the Company's internal rule. The benefits granted prior to the termination date of ¥404 million ($3,439 thousand) were recorded as "Other Non-current Liabilities."

Reserve for Cost of Disposal of Fixed Assets
Through the establishment of an operating holding company, the Company comprehensively examined the utilization of fixed assets after an organizational restructuring and determined the disposal of certain fixed assets and estimated the related loss.

Reserve for Loss on Liquidation of Business
Reserve for loss on liquidation of business provides for losses related to the restructuring in accordance with the Company's business plan. An amount rationally estimated for such losses is recognized.

Reserve for Loss on Guarantee of Liabilities
The Company has provided for loss on guarantee of liabilities, determined with respect to the financial position and other conditions of the guarantees.

(7) Foreign Currency Translation
All monetary assets and liabilities of the Company and its domestic consolidated subsidiaries denominated in foreign currencies are translated into yen at the spot rate prevailing at the year-end. Resulting translation gains or losses are charged or credited to income.

Assets and liabilities of overseas subsidiaries are translated into yen at the spot rate prevailing at the respective year-end of overseas subsidiaries, while income and expenses are translated at the annual average rate. Resulting translation adjustments are included in "Shareholders' Equity."

(8) Accounting for Leases

Leases that transfer substantially all the risks and rewards of ownership of the assets are accounted for as capital leases, except that leases that do not transfer ownership of the assets at the end of the lease term are accounted for as operating leases, in accordance with accounting principles and practices generally accepted in Japan.

See Note 6.

(9) Accounting for Hedging

Gains or losses arising from changes in the fair value of the derivatives designated as "hedging instruments" are deferred as an asset or liability and included in net income for the same year during which the gains or losses on the hedged items or transactions are recognized. However, certain foreign currency receivables and payables covered by forward exchange contracts are translated at the contract rate, if applicable.

The derivatives designated as hedging instruments by the Companies are principally currency swap and forward exchange contracts for receivables/payables denominated in foreign currency.

The Companies have a policy to utilize the above hedging instruments in order to reduce the Companies' risk of fluctuation in interest and exchange rates. Therefore, the Companies' purchase of the hedging instruments are limited to, at maximum, the amounts of the hedged items.

The Companies evaluate the effectiveness of their hedging activities by reference to the accumulated gains or losses on the hedging instruments and the related hedged items from the commencement of the hedges.

See Note 9.

(10) Income Taxes

Income taxes of the Company and its domestic consolidated subsidiaries consist of corporate income taxes, local inhabitant taxes and enterprise taxes.

Income taxes are determined using the asset and liability method, where deferred tax assets and liabilities are recognized for temporary differences between the tax basis of assets and liabilities and their reported amount in the financial statements.

See Note 7 for details of deferred tax assets / liabilities.

(11) Cash and Cash Equivalents

Cash and cash equivalents in the consolidated statements of cash flows comprise cash on hand, bank deposits, which can be withdrawn on demand at any time, and short-term investments with an original maturity of three months or less, which are readily convertible into cash and considered to represent a low risk of market price fluctuation.

(12) Accounting for Consumption Taxes

In Japan, consumption taxes are imposed at a flat rate of five percent on all domestic consumption of goods and services, with certain exemptions. Consumption taxes imposed on the Companies' domestic sales to customers are withheld by the Companies at the time of sale and are paid to the national government and the local public body subsequently. The consumption tax withheld upon sale and the consumption tax paid by the Company and its domestic consolidated subsidiaries on the purchases of goods and services are not included in the related amounts in the accompanying consolidated statements of income.

(13) Appropriation of Retained Earnings

Under the Japanese Commercial Code and the Articles of Incorporation of the Company, the plan for appropriation of retained earnings (including cash dividend payments) proposed by the Board of Directors should be approved at the shareholders' meeting, which must be held within three months after the end of each fiscal year. The appropriation charged to retained earnings, as reflected in the accompanying consolidated statements of shareholders' equity, represents that applicable to the immediately preceding fiscal year that was approved at the shareholders' meeting and disposed of during the year.

As is customary in Japan, the payment of bonuses to directors and corporate auditors is made out of retained earnings instead of being charged to income for the year, which constitutes a part of the appropriation mentioned above.

(14) Net Income and Dividends per Share

Net income per share of common stock is based upon the weighted average number of shares of common stock outstanding, exclusive of treasury stock, during each year. Cash dividends per share represent dividends declared as applicable to the respective period.

(15) Reclassification

Certain fiscal 2005 and 2004 figures have been reclassified to conform to the current year representation.

(New Accounting Standard)

Accounting for Impairment of Fixed Assets

On August 9, 2002, the Business Accounting Council issued a new accounting standard, "Accounting Standard for Impairment of Fixed Assets," and on October 31, 2003, the Accounting Standards Board of Japan issued the Financial Accounting Standards Implementation Guidance No. 6, "Implementation Guidance for Accounting Standard for Impairment of Fixed Assets." The Companies applied the adoption of the new accounting standard for impairment of fixed assets in the fiscal year beginning on April 1, 2005. As a result of adopting the new accounting standard, income before taxes and minority interests for the year ended March 31, 2006, decreased ¥1,061 million ($9,032 thousand). Accumulated impairment losses are deducted directly from related fixed assets.

3. UNITED STATES DOLLAR AMOUNTS

The consolidated financial statements are prepared in Japanese yen. The dollar amounts included in the consolidated financial statements and notes thereto represent the arithmetical results of translating yen to dollars on the basis of ¥117.47=U.S.$1, the approximate exchange rate at March 31, 2006. The inclusion of such dollar amounts is solely for convenience and is not intended to imply that yen amounts can be converted into dollars at ¥117.47=U.S.$1 or at any other rate.

4. SECURITIES

a) Available-for-sale securities for which market value is available as of March 31, 2006 and 2005 are as follows:

	2006		
	Millions of Yen		
	Historical cost	Fair market value	Unrealized gain (loss)
Securities with unrealized gain:			
Shares	¥7,533	¥48,572	¥41,039
Securities with unrealized loss:			
Shares	16	14	(2)

	2006		
	Thousands of U.S. Dollars		
	Historical cost	Fair market value	Unrealized gain (loss)
Securities with unrealized gain:			
Shares	$64,127	$413,484	$349,357
Securities with unrealized loss:			
Shares	136	119	(17)

	2005		
	Millions of Yen		
	Historical cost	Fair market value	Unrealized gain (loss)
Securities with unrealized gain:			
Shares	¥7,211	¥33,184	¥25,973
Other securities, excluding bonds	20	20	0
Securities with unrealized loss:			
Shares	330	259	(71)

b) Amount of available-for-sale securities sold in fiscal 2004:

	Millions of Yen
	2004
Amount sold	¥15,572
Realized gain	12,965
Realized loss	(21)

Note: Amount of available-for-sale securities sold in fiscal 2005 is omitted because it is immaterial.

c) Details of investments in securities without market quotation in 2006 and 2005:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Held-to-maturity debt securities:			
Commercial paper	¥15,494	¥1,000	$131,898
Available-for-sale securities:			
Unlisted shares	8,855	9,897	75,381
Other securities	1,006	1,375	8,564

d) The maturity schedule of available-for-sale securities with scheduled maturity as at March 31, 2006:

	Millions of Yen
	2006
Less than one year	¥15,494
More than one year, less than five years	6
More than five years, less than ten years	—
Thereafter	—

	Thousands of U.S. Dollars
	2006
Less than one year	$131,898
More than one year, less than five years	51
More than five years, less than ten years	—
Thereafter	—

e) Assets pledged as collateral and relevant debt as at March 31, 2006 and 2005 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Investments in securities	¥642	¥178	$5,465
Accounts and notes payable—trade	619	281	5,269

f) Investments in unconsolidated subsidiaries and affiliates as at March 31, 2006 and 2005 were:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Investments in shares	¥13,797	¥16,768	$117,451
Participations	3,716	2,649	31,634

5. SHORT-TERM AND LONG-TERM DEBT

Short-term debt consists principally of bank overdrafts bearing interest of 0.76% and 0.75%, the weighted-average interest rate on outstanding balances as at March 31, 2006 and 2005, respectively. It is a normal business custom in Japan for short-term bank loans to be rolled over each year.

Short-term borrowings as at March 31, 2006 and 2005 are summarized as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Short-term bank loans	¥12,198	¥12,068	$103,839
Current portion of long-term borrowings	6	39	51
	¥12,204	¥12,107	$103,890

Long-term debt as at March 31, 2006 and 2005 consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Loans from banks, other financial institutions, etc., due from 2007 to 2012 with mortgage and collateral (Note 2)	¥12	¥86	$102

Notes: 1. The interest rate on long-term loans (excluding current portion) from banks was 5.53%, the weighted average interest rate on outstanding balances at the year-end.

2. The bond was accounted for as redeemed due to a debt assumption contract. The debt assumption contract requires a counterparty to assume obligations of paying principal and interest on the bond.
See Note 11 for underlying obligations of the Company.

Annual maturities of long-term debt, except for bonds, are as follows:

	Millions of Yen	Thousands of U.S. Dollars
Within one year	¥ 6	$ 51
More than one year, less than two years	4	34
More than two years, less than three years	3	25
More than three years, less than four years	2	17
More than four years, less than five years	2	17
More than five years	1	9
	¥18	$153

6. LEASE TRANSACTIONS

(1) Finance Leases

Information relating to finance leases, excluding those for which the ownership of the leased assets is considered to the lessee as of, and for the years ended March 31, 2006 and 2005 is as follows.

The acquisition cost, accumulated depreciation, net book value of leased assets, at March 31, 2006 and 2005, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Acquisition cost	¥1,882	¥1,788	$16,021
Accumulated depreciation	1,032	960	8,785
Net book value	¥ 850	¥ 828	$ 7,236

Lease payments and depreciation for the years ended March 31, 2006 and 2005, amounted to ¥378 million ($3,218 thousand) and ¥370 million, respectively.

Depreciation is calculated using the straight-line method over the lease term of the leased assets assuming no residual value.

The scheduled maturities of future lease rental payments of finance leases as of March 31, 2006 and 2005 were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Due within one year	¥323	¥329	$2,750
Due over one year	527	499	4,486
	¥850	¥828	$7,236

(2) Operating Leases

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	2006
Due within one year	¥3	¥159	$26
Due over one year	0	133	0
	¥3	¥292	$26

7. INCOME TAXES

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities as of March 31, 2006, 2005 and 2004 are as follows:

	March 31, 2006	
	Millions of Yen	Thousands of U.S. Dollars
Deferred tax assets:		
Reserve for bonuses	¥ 1,343	$ 11,433
Non-deductible portion of reserve for retirement benefits to employees	9,983	84,983
Prepaid expense in tax accounting	1,840	15,664
Non-deductible portion of depreciation of property, plant and equipment	1,224	10,419
Loss on write-down of fixed assets held by overseas subsidiaries	955	8,130
Others	8,252	70,248
Sub-total	23,597	200,877
Valuation allowance	(5,000)	(42,564)
Total deferred tax assets	¥ 18,597	$ 158,313
Deferred tax liabilities:		
Deferred gain, mainly related to expropriation of fixed assets	¥ (2,188)	$ (18,626)
Unrealized gains on available-for-sale securities	(16,653)	(141,764)
Others	(429)	(3,652)
Total deferred tax liabilities	(19,270)	(164,042)
Deferred tax assets, net	¥ (673)	$ (5,729)

Classification of "Deferred tax assets, net" on the consolidated balance sheet as of March 31, 2006 is as follows:

		Millions of Yen	Thousands of U.S. Dollars
Current assets	Deferred tax assets	¥ 6,366	$ 54,193
Non-current assets	Deferred tax assets	343	2,920
Non-current liabilities	Deferred tax liabilities	(7,382)	(62,842)
		¥ (673)	$ (5,729)

Note: Deferred tax assets relating to operating losses are recorded in accordance with the Japanese accounting standards which require that the benefit of tax loss carryforwards be estimated and recorded as an asset, with the deduction of a valuation allowance if it is expected that some portion or all of the deferred tax assets will not be realized.

	March 31, 2005
	Millions of Yen
Deferred tax assets:	
Reserve for bonuses	¥ 1,486
Enterprise taxes payable	765
Non-deductible portion of reserve for accrued sales rebates, discounts and sales promotion	925
Non-deductible portion of reserve for retirement benefits to employees	11,585
Reserve for retirement benefits to directors and corporate auditors	343
Tax loss carried forward	292
Loss on write-down of investments in securities	308
Prepaid expense in tax accounting	1,615
Non-deductible portion of depreciation of property, plant and equipment	1,396
Loss on write-down of golf membership	400
Loss on write-down of fixed assets held by overseas subsidiaries	922
Reserve for loss on disposal of fixed assets	532
Others	4,218
Sub-total	24,787
Valuation allowance	(4,975)
Total deferred tax assets	¥ 19,812
Deferred tax liabilities:	
Deferred gain, mainly related to expropriation of fixed assets	¥ (1,919)
Unrealized gains on available-for-sale securities	(10,496)
Others	(302)
Total deferred tax liabilities	(12,717)
Deferred tax assets, net	¥ 7,095

Classification of "Deferred tax assets, net" on the consolidated balance sheet as of March 31, 2005 is as follows:

		Millions of Yen
Current assets	Deferred tax assets	¥ 6,868
Non-current assets	Deferred tax assets	2,237
Non-current liabilities	Deferred tax liabilities	(2,010)
		¥ 7,095

Note: Deferred tax assets relating to operating losses are recorded in accordance with the Japanese accounting standards which require that the benefit of tax loss carryforwards be estimated and recorded as an asset, with the deduction of a valuation allowance if it is expected that some portion or all of the deferred tax assets will not be realized.

	March 31, 2004 Millions of Yen
Deferred tax assets:	
Non-deductible portion of reserve for bonuses	¥ 1,345
Enterprise taxes payable	906
Non-deductible portion of reserve for accrued sales rebates, discounts and sales promotion	766
Non-deductible portion of reserve for retirement benefits to employees	12,002
Reserve for retirement benefits to directors and corporate auditors	318
Tax loss carried forward	581
Loss on write-down of investments in securities	538
Prepaid expense in tax accounting	1,370
Non-deductible portion of depreciation of property, plant and equipment	1,343
Loss on write-down of golf membership	393
Impairment on investments in certain consolidated subsidiaries	416
Loss on write-down of fixed assets held by overseas subsidiaries	1,187
Reserve for loss on disposal of fixed assets	743
Others	4,828
Sub-total	26,736
Valuation allowance	(5,708)
Total deferred tax assets	¥ 21,028
Deferred tax liabilities:	
Deferred gain, mainly related to expropriation of fixed assets	¥ (2,347)
Unrealized gains on available-for-sale securities	(10,082)
Others	(199)
Total deferred tax liabilities	(12,628)
Deferred tax assets, net	¥ 8,400

Classification of "Deferred tax assets, net" on the consolidated balance sheet as of March 31, 2004 is as follows:

		Millions of Yen
Current assets	Deferred tax assets	¥6,529
Non-current assets	Deferred tax assets	1,957
Non-current liabilities	Deferred tax liabilities	(86)
		¥8,400

Note: Deferred tax assets relating to operating losses are recorded in accordance with the Japanese accounting standards which require that the benefit of tax loss carryforwards be estimated and recorded as an asset, with the deduction of a valuation allowance if it is expected that some portion or all of the deferred tax assets will not be realized.

Reconciliation between the statutory tax rate and the effective tax rate as at March 31, 2006, 2005 and 2004 is as follows:

	2006	2004
Statutory tax rate	40.7%	41.7%
Permanent differences:		
Non-deductible expenses such as entertainment expenses	5.8	10.1
Equity in earnings of affiliates	(1.1)	(1.5)
Future tax benefits deemed not to be realized	(5.2)	(37.7)
Special corporate tax credit	(3.5)	(9.1)
Non-taxable income such as dividend income	(0.9)	(1.8)
Impairment on investments in certain consolidated subsidiaries	—	38.3
Others	(1.7)	(4.1)
Effective tax rate	34.1%	35.9%

For fiscal 2005, a reconciliation is not required to be disclosed because the difference between the rates is less than 5%.

8. RESERVE FOR RETIREMENT BENEFITS TO EMPLOYEES

The Company and its domestic consolidated subsidiaries operate various defined benefit plans, including a corporate pension plan (the so-called cash-balanced plan), a group contributory plan, a tax-qualified pension plan and a severance payment plan.

The group contributory pension plan obtained approval from Japan's Ministry of Health, Labour and Welfare for return of the past portion of the contributory pension plan that the Company and its domestic subsidiaries operate on behalf of the Government (the so-called substitutional portion) as of April 1, 2004.

a) The reserve for retirement benefits as of March 31, 2006, 2005 and 2004 is analyzed as follows:

	Millions of Yen			Thousands of U.S. Dollars
	2006	2005	2004	2006
Projected benefit obligations	¥(61,680)	¥(63,854)	¥(70,112)	$(525,070)
Plan assets	38,157	31,270	26,551	324,823
Unfunded benefit obligations	(23,523)	(32,584)	(43,561)	(200,247)
Unrecognized actuarial differences	2,578	7,017	10,352	21,946
Unrecognized prior service costs (Note 2)	(3,572)	(5,004)	(560)	(30,408
	¥(24,517)	¥(30,571)	¥(33,769)	$(208,709)

Notes: 1. Certain subsidiaries calculate the projected benefit obligation by the simple method permitted under the accounting standards generally accepted in Japan.
2. The Company and certain of its domestic consolidated subsidiaries transferred from the employees' pension plan to the corporate pension plan and the revised severance payment plan in fiscal 2005. These amendments resulted in a recognition of prior service cost.

b) The net periodic pension expense related to the retirement benefits for fiscal 2006, 2005 and 2004 is as follows:

	Millions of Yen			Thousands of U.S. Dollars
	2006	2005	2004	2006
Service cost (Notes 1 and 2)	¥2,595	¥2,650	¥2,795	$22,090
Interest cost	1,575	1,583	1,794	13,408
Expected return on plan assets	(1,011)	(736)	(648)	(8,606)
Amortization of unrecognized actuarial differences	1,457	1,628	3,002	12,403
Amortization of unrecognized prior service costs	(1,432)	(1,431)	(257)	(12,190)
Special severance payment	4,364	—	1,623	37,150
	¥7,548	¥3,694	¥8,309	$64,255
Amount arising from the lump-sum recognition of the previous years' unrecognized actuarial differences associated with cancellation of the Company's retirement benefit trust contract	—	—	16,227	—
	¥7,548	¥3,694	¥ 24,536	$64,255

Notes: 1. Excludes employees' contributions made to the contributory pension plan operated by the Company.
2. Includes net periodic pension expense incurred by the subsidiaries which apply the simple method.

c) Assumptions used in the calculation of the above information are as follows:

	As of March 31, 2006	As of March 31, 2005	As of March 31, 2004
Method of attributing the projected benefits to periods of services	Benefit/year of service approach	Benefit/year of service approach	Benefit/year of service approach
Discount rate	2.5%	2.5%	2.5%
Expected rate of return	3.3%	2.8%	2.8%

9. DERIVATIVE TRANSACTIONS

(1) Conditions of Derivative Financial Instruments

In the normal course of business, the Companies use various financial instruments, including derivative financial instruments, to manage their exposures to market risks. The Companies do not use derivative financial instruments for speculative purposes. These instruments include foreign currency swap, foreign exchange contracts and interest rate swap and cap agreements.

All such instruments involve risk, including the credit risk of nonperformance by counterparties. However, at March 31, 2006, in the management's opinion, there was no significant risk of loss in the event of non-performance of the counterparties on these financial instruments, because all counterparties were major financial institutions and securities companies with high credit ratings. Also, the Companies do not use derivative financial instruments for highly leveraged transactions.

(2) Fair Value Information of Derivative Financial Instruments

Under the Japanese Regulation for Consolidated Financial Statements, fair value information is not required for outstanding derivative financial instruments which are hedged for exposure to losses from market volatility. All outstanding derivative financial instruments have been hedged by the Companies.

Therefore, no item was required to be disclosed in this section as of March 31, 2006.

10. SUPPLEMENTARY STATEMENTS OF INCOME

a) The major elements of selling, general and administrative expenses for each of the three years in the periods ended March 31, 2006, 2005 and 2004 are as follows:

	Millions of Yen			Thousands of U.S. Dollars
	2006	2005	2004	2006
Research and development expenses	¥32,318	¥28,325	¥28,724	$275,117
Salaries	17,018	17,342	17,449	144,871
Sales promotion	8,186	7,016	8,104	69,686
Bonuses to employees	5,980	7,786	7,092	67,047
Transportation expense	4,061	4,677	4,872	34,571
Provision for accrued bonuses	1,896	—	—	16,140

b) Loss on impairment of fixed assets

For the fiscal year ended March 31, 2006, the Companies recognized impairment loss for the following group of assets.

Location	Description	Classification	Millions of Yen	Thousands of U.S. Dollars
Houki Town, Saihaku County Tottori Prefecture and five other places	Idle assets	Land	187	1,592
Toxicological Research Laboratories	Idle assets	Buildings	551	4,690
Company housing of Kyowa Hakko Chemical Co., Ltd.	Assets scheduled for disposal	Buildings, other	323	2,750

The Companies have made a group of the fixed assets for the impairment testing by the management accounting unit. However, the Company classifies certain assets as a separate unit for the impairment testing. The assets include assets held for lease, idle assets and assets held for sale or disposition.

The Companies wrote down the book value to recovery value and accounted for its diminution in "Loss on impairment of fixed assets." The reason was that the market price of idle land (six places) fell down significantly, a part of the buildings of Toxicological Research Laboratories had been idle, and its purpose for future use had not been determined, and the Company's housing of Kyowa Hakko Chemical Co., Ltd. was determined to be disposed of. The recovery value was measured by the net sales value. The idle land was valued by the adjusted assessed value of fixed assets based on the valuation for property taxes. The idle building which would be difficult to dispose of and assets scheduled for disposal were valued at a nominal price.

c) Loss on disposal of fixed assets relevant to organizational restructuring is a loss related to the disposal of fixed assets which were identified through a review of the utilization of the Company's fixed assets after organizational restructuring. Details are as follows:

	Millions of Yen
	2004
Provision for cost of disposal of fixed assets	¥1,826
Loss on disposal of fixed assets	1,399
	¥3,225

d) Details of the administrative fines in a cartel for sales of amino lysine within the European Economic Area (EEA) are as follows:

On June 7, 2000, the Company and Kyowa Hakko Europe GmbH ("KHEG") had a fine of 13,200 thousand Euro imposed on them by a decision of the European Commission with allegations that the Company and KHEG had violated EU competition law due to their involvement in a cartel for the sale of amino acid lysine within the EEA prior to June 7, 1995. On August 25, 2000, the Company and KHEG lodged an appeal to the Court of the European Communities with regard to the amount of the fine. However, the Company decided to accept the ruling of the European first court of instance on July 9, 2003, to recognize that the European Commission's verdict in question was appropriate and to pay the above-mentioned fine (13,200 thousand Euro). The amount accounted for as a fine regarding amino lysine sales within the EEA is the difference between the fine and accrued liability accounted in fiscal 2001 (1,120 thousand Euro) and interest for delay of payment of the fine.

e) Loss on restructuring of certain subsidiaries and affiliates consisted of the following:

	Millions of Yen
	2004
Provision for loss on write-down of investments	¥ 35
Loss on sale of investment in affiliates	550
Other	258
	¥843

11. CONTINGENT LIABILITIES

(1) The Companies and its consolidated subsidiaries had contingent liabilities arising from notes discounted by banks in the amount of ¥87 million ($741 thousand) at March 31, 2006.

The Company and its consolidated subsidiaries are contingently liable for guarantees of loans borrowed by Shanghai Kyowa Amino Acid Co., Ltd. and others in the amounts of ¥587 million ($4,997 thousand) and ¥842 million ($7,168 thousand), respectively, at March 31, 2006.

(2) Contingent liabilities under a debt assumption agreement totaled ¥33,000 million ($280,923 thousand).

12. RELATED PARTY TRANSACTIONS

The Company discloses material transactions of the Company with its related companies, representing more than 10 percent of the consolidated sales or the total amount of the consolidated cost of sales and the consolidated selling, general and administrative expenses, excluding transactions with consolidated subsidiaries which are eliminated in the consolidated financial statements for the years ended March 31.

Also, the Company discloses material balances and transactions with related companies where such balances and transactions, including the related amount in the footnote, represent more than one percent of the consolidated total assets, excluding transactions with consolidated subsidiaries which are eliminated in the consolidated financial statements. No such transaction occurred in fiscal 2006, 2005 and 2004.

Material transactions and balances of the Company with its related individuals, including shareholders and directors, representing more than ¥1 million shall be disclosed, but are not applicable for the years ended March 31, 2006, 2005 and 2004.

13. CASH FLOW INFORMATION

(1) Summary of assets and liabilities excluded following the transfer of Agroferm:

	Millions of Yen	Thousands of U.S. Dollars
	2005	
Current assets	¥2,144	$19,965
Fixed assets	941	8,762
Total assets	¥3,085	$28,727
Current liabilities	¥ 399	$ 3,715
Non-current liabilities	—	—
Total liabilities	¥ 399	$ 3,715

(2) Payment information of principal and interest on the 15th, 16th and 17th unsecured corporate bond were transferred on a debt assumption contract.

14. SEGMENT INFORMATION

(1) Industry Segment Information

The Companies operate principally in the following five industry segments:

Industry segments:	Major products:
(1) Pharmaceuticals Division	Ethical drugs and diagnostic reagents
(2) Bio-Chemicals Division	Bulk pharmaceuticals, health care products, animal health products and agrochemicals and alcohol
(3) Chemicals Division	Solvents, plasticizers and their raw materials and specialty chemicals
(4) Food Division	Seasonings, confectionery and baking ingredients and processed foods
(5) Other Division	Transportation, design and installation of equipment and facilities

	Millions of Yen							
	Industry segment							
Year ended March 31, 2006	Pharmaceuticals	Bio-Chemicals	Chemicals	Food	Other	Total	Corporate, elimination and other	Consolidated total
I. Sales and Operating Income:								
Sales:								
Sales to outside customers	¥149,147	¥48,347	¥80,231	¥37,930	¥37,785	¥353,440	¥ —	¥353,440
Inter-segment sales/transfers	388	9,077	5,604	4,510	17,583	37,162	(37,162)	—
Total sales	149,535	57,424	85,835	42,440	55,368	390,602	(37,162)	353,440
Operating expenses	135,305	53,341	81,334	40,838	54,213	365,031	(37,126)	327,905
Operating income	¥ 14,230	¥ 4,083	¥ 4,501	¥ 1,602	¥ 1,155	¥ 25,571	¥ (36)	¥ 25,535
II. Assets, Depreciation and Amortization, Loss on Impairment of Fixed Assets and Capital Expenditures:								
Assets	¥118,981	¥76,213	¥73,381	¥31,962	¥34,290	¥334,827	¥49,554	¥384,381
Depreciation and amortization	3,914	2,617	2,283	806	184	9,804	(15)	9,789
Loss on impairment of fixed assets	738	—	323	—	—	1,061	—	1,061
Capital expenditures	3,899	2,272	3,407	1,216	77	10,871	(12)	10,859

Year ended March 31, 2006	Thousands of U.S. Dollars							
	Industry segment						Corporate, elimination and other	Consolidated total
	Pharmaceuticals	Bio-Chemicals	Chemicals	Food	Other	Total		
I. Sales and Operating Income:								
Sales:								
Sales to outside customers	$1,269,660	$411,569	$682,991	$322,891	$321,657	$3,008,768	$ —	$3,008,768
Inter-segment sales/transfers	3,303	77,271	47,706	38,393	149,680	316,353	(316,353)	—
Total sales	1,272,963	488,840	730,697	361,284	471,337	3,325,121	(316,353)	3,008,768
Operating expenses	1,151,826	454,082	692,381	347,646	461,505	3,107,440	(316,046)	2,791,394
Operating income	$ 121,137	$ 34,758	$ 38,316	$ 13,638	$ 9,832	$ 217,681	$ (307)	$ 217,374
II. Assets, Depreciation and Amortization, Loss on Impairment of Fixed Assets and Capital Expenditures:								
Assets	$1,012,863	$648,787	$624,679	$272,086	$291,904	$2,850,319	$421,844	$3,272,163
Depreciation and amortization	33,319	22,278	19,435	6,861	1,567	83,460	(128)	83,332
Loss on impairment of fixed assets	6,282	—	2,750	—	—	9,032	—	9,032
Capital expenditures	33,191	19,341	29,003	10,352	656	92,543	(102)	92,441

Effective from fiscal 2006, some of the deferred tax assets which were accounted for in "Corporate, elimination and other" in the fiscal year ended March 31, 2005, were changed to industry segment, because individual industry segment information is disclosed more clearly. The industry-segment information for fiscal 2005 has been restated accordingly.

Year ended March 31, 2005	Millions of Yen							
	Industry segment						Corporate, elimination and other	Consolidated total
	Pharmaceuticals	Bio-Chemicals	Chemicals	Food	Other	Total		
I. Sales and Operating Income:								
Sales:								
Sales to outside customers	¥155,870	¥50,354	¥73,148	¥39,266	¥40,325	¥358,963	¥ —	¥358,963
Inter-segment sales/transfers	556	7,413	4,835	5,234	17,459	35,497	(35,497)	—
Total sales	156,426	57,767	77,983	44,500	57,784	394,460	(35,497)	358,963
Operating expenses	138,326	50,880	72,644	42,838	56,150	360,838	(35,382)	325,456
Operating income	¥ 18,100	¥ 6,887	¥ 5,339	¥ 1,662	¥ 1,634	¥ 33,622	¥ (115)	¥ 33,507
II. Assets, Depreciation and Amortization and Capital Expenditures:								
Assets	¥128,723	¥75,862	¥66,976	¥33,188	¥37,839	¥342,588	¥ 31,905	¥374,493
Depreciation and amortization	4,371	2,684	2,344	1,075	110	10,584	(19)	10,565
Capital expenditures	2,733	2,216	1,622	491	586	7,648	(1)	7,647

Year ended March 31, 2004	Millions of Yen							
	Industry segment						Corporate, elimination and other	Consolidated total
	Pharmaceuticals	Bio-Chemicals	Chemicals	Food	Other	Total		
I. Sales and Operating Income:								
Sales:								
Sales to outside customers	¥141,382	¥60,905	¥61,829	¥41,394	¥43,328	¥348,838	¥ —	¥348,838
Inter-segment sales/transfers	1,499	8,290	5,070	4,518	19,578	38,955	(38,955)	—
Total sales	142,881	69,195	66,899	45,912	62,906	387,793	(38,955)	348,838
Operating expenses	130,938	60,348	64,006	44,258	61,139	360,689	(38,687)	322,002
Operating income	¥ 11,943	¥ 8,847	¥ 2,893	¥ 1,654	¥ 1,767	¥ 27,104	¥ (268)	¥ 26,836
II. Assets, Depreciation and Amortization and Capital Expenditures:								
Assets	¥120,086	¥72,131	¥59,494	¥34,102	¥32,471	¥318,284	¥ 42,812	¥361,096
Depreciation and amortization	4,577	3,016	2,658	1,009	114	11,374	(16)	11,358
Capital expenditures	3,603	1,875	1,758	1,769	101	9,106	(65)	9,041

(2) Geographic Segment Information

Areas other than Japan are classified into "Americas," "Europe" and "Asia":

Classification:	Area:
(1) Americas	North America, Latin America
(2) Europe	All of Europe
(3) Asia	All of Asia

Note: Sales and assets in the Americas, Europe and Asia consist of less than 10% of total sales and total assets, respectively, therefore, all are totally referred to as "Other areas."

Year ended March 31, 2006 and 2005

For fiscal 2006 and 2005 geographic segment information has been omitted because both domestic sales and assets located in Japan are more than 90% of those for all segments.

	Millions of Yen				
	Geographic segment			Corporate, elimination and other	Consolidated total
Year ended March 31, 2004	Japan	Other areas	Total		
I. Sales and Operating Income:					
Sales:					
Sales to outside customers	¥315,262	¥33,576	¥348,838	¥ —	¥348,838
Inter-segment sales/transfers	16,509	5,663	22,172	(22,172)	—
Total sales	331,771	39,239	371,010	(22,172)	348,838
Operating expenses	307,629	35,638	343,267	(21,265)	322,002
Operating income	¥ 24,142	¥ 3,601	¥ 27,743	¥ (907)	¥ 26,836
II. Assets:					
Assets	¥289,031	¥21,190	¥310,221	¥ 50,875	¥361,096

(3) Overseas Sales

The classification of overseas sales is as follows:

Classification:	Area:
(1) Americas	North America, Latin America
(2) Europe	All of Europe
(3) Asia	All of Asia
(4) Other areas	Oceania, Africa

Year ended March 31, 2006	Millions of Yen				
	Americas	Europe	Asia	Other areas	Total
I. Overseas sales	¥15,138	¥13,608	¥25,548	¥644	¥ 54,938
II. Consolidated net sales					353,440
III. Ratio of overseas sales to consolidated net sales	4.3%	3.9%	7.2%	0.2%	15.6%

Year ended March 31, 2006	Thousands of U.S. Dollars				
	Americas	Europe	Asia	Other areas	Total
I. Overseas sales	$128,867	$115,842	$217,485	$5,482	$ 467,676
II. Consolidated net sales					3,008,768
III. Ratio of overseas sales to consolidated net sales	4.3%	3.9%	7.2%	0.2%	15.6%

Year ended March 31, 2005	Millions of Yen				
	Americas	Europe	Asia	Other areas	Total
I. Overseas sales	¥12,883	¥16,563	¥23,655	¥925	¥ 54,026
II. Consolidated net sales					358,963
III. Ratio of overseas sales to consolidated net sales	3.6%	4.6%	6.6%	0.3%	15.1%

Year ended March 31, 2004	Millions of Yen				
	Americas	Europe	Asia	Other areas	Total
I. Overseas sales	¥19,712	¥17,717	¥20,629	¥210	¥ 58,268
II. Consolidated net sales					348,838
III. Ratio of overseas sales to consolidated net sales	5.6%	5.1%	5.9%	0.1%	16.7%

Note: Overseas sales are sales by the Companies to customers outside of Japan.

15. PER SHARE DATA

	Yen			U.S. Dollars
	2006	2005	2004	2006
Net assets per share	¥604.9	¥556.3	¥522.6	$5.149
Net income—basic	38.4	41.7	23.0	0.327
Net income—diluted (*)	38.3	—	—	0.326

* Diluted net income per share information for fiscal 2005 and 2004 is not disclosed because there were no residual securities.

The basis for the calculation of net income per share data is as follows:

	Millions of Yen			Thousands of U.S. Dollars
	2006	2005	2004	2006
Net income	¥16,273	¥17,932	¥10,017	$138,529
Less: Components not pertaining to common shareholders				
Bonuses to directors and corporate auditors	(51)	(109)	(93)	(434)
Net income pertaining to common shareholders	¥16,222	¥17,823	¥ 9,924	$138,095

	2006	2005	2004
Average outstanding shares to common stock	422,919,680	427,635,631	431,497,240 shares

16. SUBSEQUENT EVENT

a) Subsequent to March 31, 2006, the Company's Board of Directors, with the approval by shareholders on June 28, 2006, declared a cash dividend of ¥2,114 million ($17,996 thousand), equal to ¥5.00 ($0.04) per share, which was applicable to earnings for the year ended March 31, 2006 and payable to shareholders on the register on March 31, 2006.

b) The Company's Board of Directors' meeting held on April 28, 2006 approved to transfer all shares of the affiliate, Musashino Chemical Laboratory, Ltd.

1) Reason for transfer of shares

The Company decided to transfer its all shares of the said affiliate in light of a comprehensive review of the affiliate's status within the Group that stemmed from a reduction in transactions between the Company and the affiliate.

2) Transferee of shares

Name: Musashino Chemical Laboratory, Ltd.

3) Scheduled date of transfer: June 2006

4) Summary of the transferred affiliate

a) Name: Musashino Chemical Laboratory, Ltd.
b) Address: Chuo-ku, Tokyo
c) Representative: Kazue Hamano, president
d) Capital: ¥237 million
e) Description of business: Manufacture and sale of organic synthetic chemicals

5) Summary of transferred shares, price, income, and share ratio after transfer

a) Transferred number of shares: 1,188,000 shares (all shares the Company held)
b) Transfer price: ¥3,801 million
c) Loss on transferred shares: ¥2,626 million
d) Equity ownership percentage before transfer: 25.0%
e) Equity ownership percentage after transfer: –%

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of
KYOWA HAKKO KOGYO CO., LTD.

We have audited the accompanying consolidated balance sheets of KYOWA HAKKO KOGYO CO., LTD. and its subsidiaries as of March 31, 2005 and 2006, and the related consolidated statements of income, shareholders' equity, and cash flows for the three years ended March 31, 2006, all expressed in Japanese Yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of KYOWA HAKKO KOGYO CO., LTD. and its subsidiaries as of March 31, 2005 and 2006, and the consolidated results of their operations and their cash flows for the three years ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

As described in Note 2(14), effective for the year ended March 31, 2006, the Company and its subsidiaries has adopted the new accounting standard for accounting for impairment of fixed assets.
As described in Note 13, effective for the year ended March 31, 2006, the Company and its subsidiaries changed their segment.
As described in Note 16, the Company's Board of Directors meeting held on April 28, 2006 approved to transfer all shares of the affiliate, Musashino Chemical Laboratory, Ltd.

The amounts expressed in U.S. dollars, which are provided solely for the convenience of the reader, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

Chuo Aoyama PricewaterhouseCoopers

Tokyo, Japan
June 28, 2006

PRINCIPAL SUBSIDIARIES AND AFFILIATES

(As of March 31, 2006)

Name of Company	Percentage Owned Directly or Indirectly by the Company	Capital Stock (Millions)	Principal Business
Pharmaceuticals			
Kyowa Medex Co., Ltd.[1]	100.0%	¥450	Manufacture and sale of diagnostic reagents
BioWa, Inc.[1]	100.0	$10	Licensing of antibody technology, development of therapeutic antibodies
Shinwa Pharmaceutical Co., Ltd.[1]	100.0	¥95	Manufacture and sale of herbal medicines and health foods
Kyowa Medical Promotion Co., Ltd.[1]	100.0	¥50	Sales promotion of pharmaceuticals
Kyowa Warehouse & Transportation Co., Ltd.[1]	100.0	¥70	Warehousing and transportation
Bio-Chemicals			
Kyowa Hakko U.S.A., Inc. (U.S.A.)[1]	100.0	$1	Sale of pharmaceuticals, fine chemicals, foods, and chemicals
Kyowa Hakko Europe GmbH (Germany)[1]	100.0	Euro1	Sale of pharmaceuticals, fine chemicals, and chemicals
Kyowa Italiana Farmaceutici S.R.L. (Italy)[1]	100.0	Euro1	Sale of pharmaceuticals and fine chemicals
Biokyowa Inc. (U.S.A.)[1]	100.0	$20	Manufacture and sale of amino acids
Kyowa Hakko (H.K.) Co., Ltd. (Hong Kong)[1]	100.0	HK$1	Sale of pharmaceuticals, foods, and chemicals
Kyowa Wellness Co., Ltd.[1]	100.0	¥30	Sale of health care products
Chemicals			
Kyowa Hakko Chemical Co., Ltd.[1]	100.0	¥5,300	Manufacture and sale of chemicals
J-PLUS Co., Ltd.[2]	50.0	¥480	Manufacture and sale of plasticizers
Kurogane Kasei Co., Ltd.[2]	40.0	¥90	Manufacture and sale of chemicals
Food			
Kyowa Hakko Food Specialties Co., Ltd.[1]	100.0	¥3,000	Manufacture and sale of seasonings and bakery products and ingredients
Riken Kagaku Co., Ltd.[1]	100.0	¥30	Manufacture and sale of seasonings and health foods
Kyowa F.D. Foods Co., Ltd.[1]	100.0	¥100	Manufacture and sale of freeze-dried foods
Ohland Foods Co., Ltd.[1]	100.0	¥50	Manufacture and sale of foods
Kyowa HiFoods Co., Ltd.[1]	100.0	¥60	Import and sale of foods
Aji-Nihon Co., Ltd.[2]	46.3	¥95	Manufacture and sale of foods and seasonings
Zenmi Foods Inc.[2]	50.0	¥190	Manufacture and sale of seasonings
Other			
Miyako Kagaku Co., Ltd.[1]	52.9	¥111	Wholesale of pharmaceuticals, chemicals, and foods
Chiyoda Kaihatsu Co., Ltd.[1]	100.0	¥113	Transportation, trading, and insurance
Kyowa Engineering Co., Ltd.[1, 3]	100.0	¥70	Design and installation of equipment and facilities
Kyowa America, Inc. (U.S.A.)[1]	100.0	$53	Coordination and monitoring of subsidiaries in the United States
Japan Synthetic Alcohol Co., Ltd.[2]	33.3	¥480	Manufacture and sale of various types of alcohol
Musashino Chemical Laboratory, Ltd.[2, 4]	25.0	¥238	Manufacture and sale of organic synthetic chemicals

Notes: 1. Consolidated subsidiary
2. Affiliate accounted for by the equity method
3. Transferred from Other Segment to Bio-Chemicals Segment on April 1, 2006
4. All shares held by the Company were sold to Musashino Chemical Laboratory, Ltd., on June 29, 2006.

OVERSEAS NETWORK

(As of June 30, 2006)

AMERICAS

Kyowa America, Inc.
767 Third Avenue, 19th Floor,
New York, NY 10017, U.S.A.
TEL: 1-212-319-5353
FAX: 1-212-421-1283

Biokyowa Inc.
5469 Nash Road, P.O. Box 1550,
Cape Girardeau, MO 63702-1550,
U.S.A.
TEL: 1-573-335-4849
FAX: 1-573-335-1466

Kyowa Hakko U.S.A., Inc.
767 Third Avenue, 19th Floor,
New York, NY 10017, U.S.A.
TEL: 1-212-319-5353
FAX: 1-212-421-1283
West Coast Office
85 Enterprise, Suite 430,
Aliso Viejo, CA 92656, U.S.A.
TEL: 1-949-425-0707
FAX: 1-949-425-0708

Kyowa Pharmaceutical, Inc.
212 Carnegie Center, Suite 101,
Princeton, NJ 08540, U.S.A.
TEL: 1-609-919-1100
FAX: 1-609-919-1111

BioWa, Inc.
212 Carnegie Center, Suite 101,
Princeton, NJ 08540, U.S.A.
TEL: 1-609-580-7500
FAX: 1-609-919-1108

Select Supplements, Inc.
5800 Newton Drive,
Carlsbad, CA 92008, U.S.A.
TEL: 1-760-431-7509
FAX: 1-760-804-8073

EUROPE

Kyowa Hakko Europe GmbH
Immermannstrasse. 3,
D-40210, Düsseldorf, Germany
TEL: 49-211-17-728-0
FAX: 49-211-17-728-41

Kyowa Hakko U.K. Ltd.
258 Bath Road, Slough,
Berkshire SL1 4DX, United Kingdom
TEL: 44-1753-566000
FAX: 44-1753-566010

Kyowa Italiana Farmaceutici S.R.L.
Viale Fulvio Testi 280,
20126, Milano, Italy
TEL: 39-02-644-704-1
FAX: 39-02-644-704-44

ASIA

Kyowa Hakko Industry (Singapore) Pte Ltd.
260 Orchard Road, #12-04,
The Heeren, Singapore 238855
TEL: 65-6733-4948
FAX: 65-6733-0819

Kyowa Hakko (Malaysia) SDN BHD.
20, Jalan SS 19/5, 47500 Subang Jaya,
Selangor, Darul Ehsan, Malaysia
TEL: 60-3-5634-0669
FAX: 60-3-5634-0990

Kyowa Hakko Kogyo Co., Ltd.
Beijing Representative Office
Room 701, No. 5, Beijing Fortune Bldg.,
Dong San Huan Bei Lu,
Chao Yang District, Beijing 100004,
People's Republic of China
TEL: 86-10-6590-8515
FAX: 86-10-6590-8517

Kyowa Hakko Kogyo Co., Ltd.
Shanghai Representative Office
Room 1712,
205 Maoming Nan lu Ruijin Bridge,
Shanghai 200020,
People's Republic of China
TEL: 86-21-6466-1222
FAX: 86-21-6415-6022

Kyowa Hakko Kogyo Co., Ltd.
Guangzhou Representative Office
Room 701, Yi An Plaza No. 33,
Jianshe 6 Ma Lu, Guangzhou 510060,
People's Republic of China
TEL: 86-20-8364-4123
FAX: 86-20-8364-4131

Shanghai Kyowa Amino Acid Co., Ltd.
No. 158 Xintuan Road,
Qingpu Industrial Zone, Shanghai 201700,
People's Republic of China
TEL: 86-21-5970-1988
FAX: 86-21-5970-1135

Kyowa Hakko (H.K.) Co., Ltd.
Room 2103, Hang Lung Centre,
2-20 Paterson Street, Causeway Bay,
Hong Kong, People's Republic of China
TEL: 852-2895-6795
FAX: 852-2576-6142
Guangzhou Representative Office
Room 411, China Hotel Office Tower,
Liu Hua Road, Guangzhou 510015,
People's Republic of China
TEL: 86-20-8667-5381
FAX: 86-20-8667-5472

Kyowa Pharmaceutical (H.K.) Co., Ltd.
Room 2103, Hang Lung Centre,
2-20 Paterson Street, Causeway Bay,
Hong Kong, People's Republic of China
TEL: 852-2576-4113
FAX: 852-2576-6191

Kyowa Hakko Pharmaceuticals (Suzhou) Co., Ltd.
No. 115, Qingqju Street,
Suzhou Industrial Park, Jiang Su 215021,
People's Republic of China
TEL: 86-512-6283-1082
FAX: 86-512-6283-1083

Wuxi Kyowa Food Co., Ltd.
No. 158, Xu Xiang Lane,
Li Yuan, Wuxi 214072,
People's Republic of China
TEL: 86-510-8512-9781
FAX: 86-510-8510-9484

Yantai Kyowa Foods Co., Ltd.
Zhao Wang Zhuang Town, Laiyang City,
Shangdong 265225,
People's Republic of China
TEL: 86-535-761-5778
FAX: 86-535-761-1787

PRINCIPAL PRODUCTS

PHARMACEUTICALS

Antibiotics
Pasetocin®, Fortimicin®, Sagamicin®

Anticancer Agents
Mitomycin, 5-FU, Leunase®, Adriacin®, Hysron® H-200, Dacarbazine, Farmorubicin®, Platosin®, Navelbine®

Central Nervous System Agents
Depakene®, EC-Doparl, Doparl®, Benozil®

Cardiovascular Agents
Meditrans® Tape, Inovan®, Apiracohl®, Coniel®, Pre Dopa®, Dobupum™

Gastrointestinal Agents
Nauzelin®, Glumin®, Glumal®, Navoban®

Antiallergic Agents
Allelock®, Celtect®

Hormones
Desmopressin, Hysron®

Other Metabolic Agents
Gludiase®, ATP Kyowa, Activacin®

Agents for Blood and Fluid Disorders
Neu-up®, Emeradole®, Leukoprol®

Ointment
Propaderm®

Transdermal Analgesic Agent
Durotep® Patch

Diagnostic Medical Devices
Clinical Chemistry Diagnostic Reagents (Determiner® L HDL-C, MetaboRead® RemL-C), Immunological Reagents (Determiner® HbA1c, Chemilumi series), Reagent strips for urinanalysis (Uropiece®S), Controls (Accurun series Infectrol), Full Auto Micro Plate EIA Analyzer (AP series), Fecal Occult Blood Test Analyzer (HM-JACK® series), Diabetes Mellitus Test Analyzer (DM-JACK® series)

BIO-CHEMICALS

Fine Chemicals for Pharmaceutical and Industrial Use
Amino Acids (L-Alanine, L-Arginine, L-Glutamine, L-Histidine, L-Isoleucine, L-Ornithine, L-Aspartate, L-Proline, L-Serine, L-Threonine, L-Valine, etc.), Nucleic Acids (ATP, Orotic Acid, etc.), L-Malic Acid, Enzymes, Sodium Hyaluronate

Bulk Pharmaceuticals
Citicoline, Dacarbazine, Minocycline HCl, Ubidecarenone (Coenzyme Q10)

Health Care Products
Vitamins, Minerals, Carotenoids, Probiotics, Peptides, Remake series, Enguard series

Agrochemicals
Plant Growth Regulators (Gibberellin, Fulmet®)

Animal Health Products
Nanaomycin, Polyup®, Atomolate®, Benesal®, Lysozyme Chloride for Pisciculture, Fantacin® for Pisciculture, Ampicirin for Pisciculture

Feeds and Feed Additives for Fish and Animals
Evian® Kyowa, Fry Feed Kyowa, Aminoplus®, Driselase®, Phytase

Pet Care Products
Elendaite®, E&D Shampoo and Rinse, Amino Glutamine Kyowa (H), Green Mussel E

Alcohol
For use in refined sake, food preservatives, and disinfectants

CHEMICALS

Solvents
Butyl Alcohol, Acetone, Butyl Glycol Ether, Ethyl Acetate, Butyl Acetate, PM (Propylene Glycol Monomethyl Ether)

Plasticizers and Their Raw Materials
DOP (Di-2-Ethylhexyl Phthalate), DINP (Di-Isononyl Phthalate), DIDP (Di-Isodecyl Phthalate), 2-Ethylhexyl Alcohol, Oxocol® 900 (Isononyl Alcohol)

Organic Acids
Acetic Acid, 2-Ethyl Hexanoic Acid, Isononanoic Acid

Diols
1-3 Butylene Glycol, 2,4-DiEthyl-1,5 Pentanediol, Butyl Ethyl Propanediol

FOOD

Natural Seasonings
Hydrolyzed vegetable and animal proteins; Animal, vegetable, fish, shellfish, and yeast extracts; Soup stocks

Kokumi Seasonings
Simmerin®

Umami Seasonings
MSG (Monosodium glutamate), IMP (Sodium 5′-inosinate), WMP (Mix of IMP and Sodium 5′-guanylate)

Bakery Products and Ingredients
Baker's yeast, Prepared mixes, Baking improvers, Activated gluten, Fermented flavor enhancers

Processed Foods
Instant egg-drop soup, Various food materials

MANAGEMENT MEMBERS

(As of June 28, 2006)

MEMBERS OF THE BOARD

President
Yuzuru Matsuda*

Yoshito Imai*

Tomonori Yuji

Kazuhiko Yamanoe

Nobuo Kanda

Yukinobu Kotani

Hiroyuki Kuniyasu

** Representative director*

Corporate Auditors
Takeshi Asaoka

Masahiro Kawaguchi

Akira Taniguchi

Kozo Fujita

MANAGING OFFICERS

President and Chief Executive Officer
Yuzuru Matsuda

Executive Vice President
Yoshito Imai
President of Pharmaceuticals Business Unit

Senior Executive Managing Officers
Tomonori Yuji

Kazuhiko Yamanoe

Executive Managing Officers
Nobuo Kanda

Yukinobu Kotani
President of Bio-Chemicals Business Unit

Hiroyuki Kuniyasu

Yutaka Yoshida

Fumio Norimatsu

Managing Officers
Shoji Hari
President and Chief Executive Officer, Kyowa Hakko Chemical Co., Ltd.

Takeyuki Yoshida
President and Chief Executive Officer, Kyowa Hakko Food Specialties Co., Ltd.

Toshifumi Asada

Masaji Kasai

Yoshiki Tsunekane

Mitsuru Takahashi

Akio Ozaki

Kazuyoshi Tachibana

Nobuo Hanai

Akira Karasawa

CORPORATE DATA

(As of March 31, 2006)

KYOWA HAKKO KOGYO CO., LTD.

Head Office

1-6-1, Otemachi, Chiyoda-ku,
Tokyo 100-8185, Japan
TEL: 81-3-3282-0007
FAX: 81-3-3284-1968
URL: http://www.kyowa.co.jp/

Number of Employees

5,800 [Parent Company: 3,717]

Date of Foundation

July 1, 1949

Paid-in Capital

¥26,745 million

Principal Plants

Domestic
Hofu, Ube, Sakai, Fuji,
Kyowa Hakko Chemical Co., Ltd. (Yokkaichi, Chiba),
Kyowa Hakko Food Specialties Co., Ltd. (Tsuchiura),
Kyowa Medex Co., Ltd. (Fuji)
Overseas
Biokyowa Inc. (U.S.A.), Shanghai Kyowa Amino Acid Co., Ltd. (China)

Principal Laboratories

BioFrontier Laboratories
Pharmaceutical Research Center
Technical Research Laboratories
Healthcare Products Development Center
Kyowa Hakko Chemical Co., Ltd., Yokkaichi Research Laboratories
Kyowa Hakko Food Specialties Co., Ltd., Food Creation Center
Kyowa Medex Co., Ltd., Research Laboratories

INVESTOR INFORMATION

(As of March 31, 2006)

Stock Listing

Tokyo

Securities Code Number

4151

Transfer Agent of Common Stock

The Chuo Mitsui Trust and Banking Company, Limited
33-1, Shiba 3-chome, Minato-ku, Tokyo 105-8574, Japan

Number of Shares of Common Stock

Authorized: 987,900,000
Issued: 434,243,555

Number of Shareholders

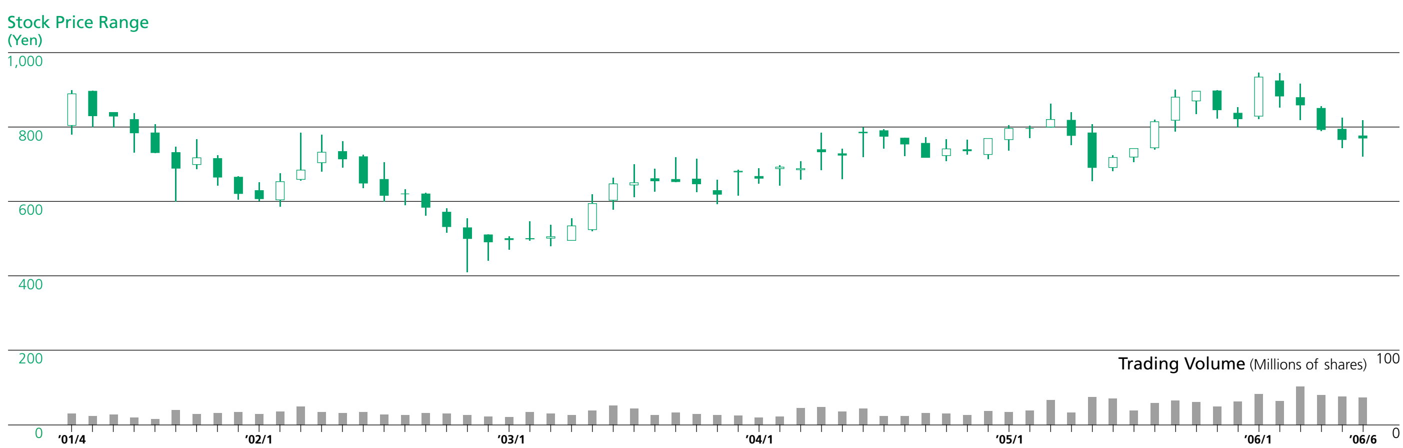
68,633

Principal Shareholders

	Number of Shares Held (Thousands)	Percentage of Total Shares Issued
The Master Trust Bank of Japan, Ltd. (Trust account)	37,100	8.54%
Japan Trustee Services Bank, Ltd. (Trust account)	29,629	6.82
The Dai-ichi Life Mutual Insurance Co.	24,661	5.67
The Norinchukin Bank	18,083	4.16
Mizuho Trust & Banking Co., Ltd. (Retirement Benefit Trust for Mizuho Bank, Ltd.)	8,075	1.85
Mizuho Bank, Ltd.	7,126	1.64
The State Street Bank and Trust Company 505103	5,861	1.34
NIPPONKOA Insurance Company, Limited	5,483	1.26
Kyowa Fund	5,323	1.22
SOMPO JAPAN INSURANCE INC.	5,296	1.21

Note: The Company had 11,365 thousand shares of treasury stock as of March 31, 2006, which are not included in the above list.

Stock Price



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Non Volatile Organic Compounds

This report is printed on recycled paper using non-VOC (non-volatile organic compound) ink for waterless printing.

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