

## Improve Earnings Power

Interview with Ichiro Otokozawa, Member of the Board



Ichiro Otokozawa  
Member of the Board and Senior Corporate Officer  
Head of Corporate Development and Administration Division, and Europe and the U.S. Operation

## Maximizing Growth Potential

In the year under review, which marks the second year of the 2003-2005 Medium-term Management Plan, we have attained our financial targets a year ahead of schedule, surpassing our profit targets of ¥18 billion in operating income and ¥10 billion in net income. This was the result of successfully moving forward with the three basic objectives of the Plan—restoration of profitability, strengthening of R&D, and reinforcement of organizational strength—at a pace that exceeded our initial projections.



Please explain the circumstances that led to the launch of the 2003-2005 Medium-term Management Plan and its key points.

Santen maintained double-digit annual growth during the 1990s. We introduced pioneering drugs into the prescription ophthalmics market in Japan, and innovation in Japanese ophthalmology went hand in hand with Santen's growth. In the year ended March 1996, our return on equity (ROE) reached 19% on a non-consolidated basis, making us one of the most profitable companies in the Japanese prescription pharmaceutical industry.

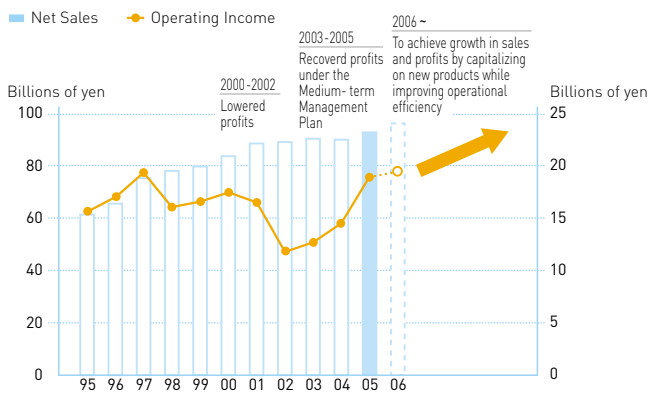
Since then, the Japanese market has been affected by the national policy to curb medical costs which led to a difficult pe-

riod for new drug development. As many Japanese pharmaceuticals companies began building their own sales networks abroad, Santen established a U.S. subsidiary in 1993 to begin research and development activities. In 1997, we acquired a European company in order to conduct local R&D for prescription ophthalmic pharmaceuticals and to enter the Northern European market and secure our first overseas production base. Then in 2000, we launched the full-scale operation of our international business by initiating direct sales of our products in the United States.

While our products boasted advantages over existing drugs, we experienced significant challenges in developing our business in the intensely competitive U.S. market, the world's largest, and incurred a considerable loss. Operating income, which had at one point reached ¥20 billion, dropped to ¥11.7 billion in 2002, and the company's stock price fell from its peak of over ¥3,000 to less than ¥1,000. We developed our Medium-term Management Plan to overcome this situation.

Our current Medium-term Management Plan consists of three basic objectives: restoration of profitability, strengthening R&D, and reinforcement of organizational strength. We aim to continue to work on these three objectives in a balanced and committed effort to reform our earnings structure and bolster R&D. By doing so, we will steadily establish a solid base for medium- to long-term growth.

Net Sales and Operating Income



Note: graph on this page are based on fiscal years ended March 31.

What have been the areas of focus for improving profitability?

We focused on three key areas. First, we sought an early recovery in the profitability of our U.S. ophthalmics business, which had been reporting losses of approximately ¥2 billion to ¥3 billion each year since 2000. Second, we took action to cut costs through business process reengineering (BPR). And

third, we sought to maintain and enhance our No. 1 position in the Japanese prescription ophthalmic pharmaceuticals market, which represents our largest source of earnings. We have concurrently implemented corresponding measures for these three tasks.



### What is the current state of the U.S. business?

We entered into a sales partnership with Johnson & Johnson Vision Care, Inc. (JJVCI) in December 2003, and transferred the sales activities of our U.S. subsidiary Santen Inc. to this

company in February 2004. As a result, we succeeded in significantly reducing selling expenses in our U.S. business and reported a profit before R&D expense for the year under review.



### How about cost reduction, the second key in improving profitability?

In the area of cost reduction, our target was to cut manufacturing and distribution costs by approximately ¥1.5 billion, with an additional ¥500 million reduction in SG&A expenses. For our R&D expenditures, which tend to increase in line with en-

hancements in the development pipeline, we endeavored to efficiently allocate our resources by prioritizing candidates for development and by pursuing both in-house development and joint development with other companies.



### Tell us about your accomplishments in reducing costs in the year under review.

First, with regard to manufacturing, we introduced the *Dimple Bottle*, an innovative container for prescription ophthalmic pharmaceuticals, and we completed the conversion of all related products to the new bottle in the year under review, as originally planned. Along with optimized production processes, our cost reduction exceeded our target of ¥1.5 billion in just two years.



▲ *Dimple Bottle*

We also reduced SG&A expenses by more than ¥300 million. This was achieved by switching our conventional sales offices to satellite offices and cen-

tralizing our sales support operations. We previously had approximately 60 sales offices nationwide, which were relocated closer to medical institutions, and increased the number to approximately 90 offices. Through standardization of the satellite offices and other measures, we managed to raise cost efficiency across the entire sales network. At the same time, we concentrated sales assistants in seven offices and established a call center at our head office to improve the efficiency of responding to queries from medical professionals, thereby achieving overall improvements in convenience and cost reduction. To further reduce SG&A expense we introduced electronic purchasing for our maintenance, repair and operations (MRO) items.



### Please outline the role of the Business Process Reengineering Division

The Business Process Reengineering Division was established in April 2004 utilizing state-of-the-art information technology on a cross-divisional basis. For example, the Division has designed and proposed BPR in the Product Supply Division for the planning of manufacturing, the optimal management of production facilities and the enhanced efficiency of distribution functions. These plans are currently being implemented by the

Product Supply Division in close collaboration with the Business Process Reengineering Division.

Furthermore, in order to achieve greater efficiency in head office and administrative functions, we are aggressively pursuing BPR through such measures as electronic documentation. The Business Process Reengineering Division will continue to seek ways to offer support across divisions.

### What are your thoughts on efficient R&D investment?

As an example, the development of rheumatoid arthritis treatments requires considerable cost, and Santen is also currently placing top priority on developing ophthalmologic drugs centered on treatment for glaucoma, corneal and conjunctival disorder, and retinal disorder. Thus in November 2004, we

licensed Japanese development rights to anti-APO-1 antibody, a promising candidate for treating rheumatoid diseases, to Argenes, Inc., a drug development venture led by the St. Marianna University School of Medicine. We are working to optimize R&D expenditures through such new measures.

### What are your plans for strengthening financial conditions?

As I have mentioned, our U.S. ophthalmic pharmaceuticals business is now positioned to generate profits, and thus I believe we have cleared a major hurdle to restore profitability. As part of our next move, we worked on the measures to strengthen our financial condition during the year.

We made an early repayment of part of our debt to ¥6.6 billion, attaining below 0.1 for our debt-to-equity ratio. In addition, we have cleared the way for streamlining our assets through the retirement of repurchased stock, and through a new retirement benefit scheme which combines lump-sum severance plan, cash balance and defined contribution pension plan. Under the new scheme, we established a retirement benefit trust to cover the lump-sum severance portion.

As a result we attained 10.4% return on equity (ROE) for the year under review, meeting our target of 10% under the Medium-term Management Plan. Given the strength of our

balance sheet, I believe that future improvements in ROE and return on assets (ROA) will have to come from sales growth and improved operating expense control.

With respect to our costs, there is room for improvement in the areas of production and administration. I also believe we can improve our cost-to-sales ratio in order to further strengthen our financial position. Although our product mix and production process differ from other major Japanese pharmaceuticals companies, and US companies have a significant advantage of higher prices which helps lower their cost-to-sales ratio, our cost-to-sales ratio is relatively high at 35% to 36%, when compared to lower than 30% for Japanese companies and lower than 20% for some top-ranking overseas ophthalmics companies. The combination of cost reduction programs already in progress and the launch of new drugs currently in development will help us to improve our cost-to-sales ratio in the near future.

### As Head of Europe and the United States, what are your business strategies for these regions?

Clinical trials of DE-085 (generic name: tafluprost) and DE-092 (olmesartan), both glaucoma drug candidates, are well underway. As we are planning to launch them in not only Japan but also overseas where the glaucoma treatment market is expanding, I expect that they will make important contributions to both sales and profits.

In the United States, while we are in a marketing partnership with JJVCI for our existing products, we are also planning sales of new drugs for glaucoma during the next Medium-term Management Plan. We must first assess the competitiveness of our new products in the U.S. market and then choose the best marketing course from a variety of options.

Currently, our European business is centered on branded

generics, mainly in northern European countries. With respect to sales networks, we have direct sales in northern and eastern Europe, Russia and Germany, but do not have

our own network in countries such as the United Kingdom, France, Italy and Spain. Future sales of our new drugs in Europe will require an optimal combination of direct sales and partnerships, with due consideration of regional characteristics and market size, as we transition into a business focused on new drugs targeting the entire European market.

