

Financial Section

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Report and Analysis of Operating Results and Financial Condition

OPERATING RESULTS

Net Sales

Sales of the Santen Group are comprised of four segments: prescription pharmaceuticals, over-the-counter (OTC) pharmaceuticals, medical devices and other.

Consolidated net sales for the year ended March 31, 2008 rose 2.9%, to ¥103,394 million, due mainly to sales increases in the Group's mainstay prescription segments.

● Prescription Pharmaceuticals

Santen's prescription pharmaceuticals are divided into three categories: ophthalmics, anti-rheumatics and other pharmaceuticals. In the year under review, demand rose for ophthalmic and anti-rheumatic products which contributed to a 3.8% increase in prescription pharmaceutical sales to ¥95,322 million, and represented 92.2% of consolidated net sales.

• Ophthalmics

In Japan, Santen utilizes a successful promotional campaign which provides individual medical facilities with scientific information tailored to their specific and changing needs. As a result of these efforts, domestic sales of prescription ophthalmic pharmaceuticals increased 1.5%, to ¥72,320 million.

Overseas, ophthalmics sales rose 20.5% after conversion to yen, to ¥13,106 million. Educational promotion campaigns were effective in European markets and, combined with beneficial exchange rates, contributed to sales growth in the region, especially Northern Europe, Eastern Europe and Germany. In the U.S., sales were higher, with growing market penetration by our anti-infective ophthalmic products. Sales in Asia also saw a year-on-year rise as promotional campaigns took effect and the Santen brand gained a more prominent profile in that market.

As a result, prescription ophthalmic pharmaceuticals net sales rose 4.0%, to ¥85,426 million.

• Anti-Rheumatics

Rimatil, *Azulfidine EN* and *Metolate* were highly recommended in the Guidelines for the Management of Rheumatoid Arthritis by the Japan College of Rheumatology in 2004. The rating of each of these products as "Grade A – Highly Recommended" has helped steadily raise their market profile. Consequently, net sales of anti-rheumatics grew 2.6%, to ¥9,627 million.

● OTC Pharmaceuticals

Effective promotional campaigns for our range of ophthalmic products for tired eyes, blurred vision and eye refreshment resulted in an increase in net sales of OTC pharmaceuticals of 2.7%, to ¥5,451 million.

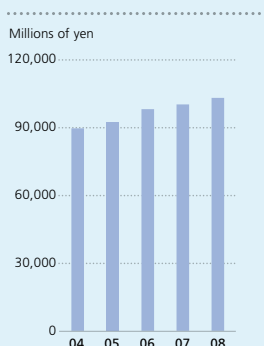
● Medical Devices

The number of cataract surgeries performed in Japan in the year under review rose slightly, but heightened competition led to a decline in IOL sales. Net sales of medical devices decreased 22.8%, to ¥415 million.

● Other

The primary component of our other business segment is the contract manufacturing of an anti-infective otic pharmaceutical product for sale in the U.S. As a result of a considerable decline in the level of orders from the contracting company, net sales decreased 21.0%, to ¥2,206 million.

Net Sales



Net Sales by Business Segment

Years ended March 31	Millions of yen		Change (%)
	2008	2007	
Prescription pharmaceuticals	¥ 95,322	¥ 91,849	3.8
Ophthalmics	85,426	82,152	4.0
Anti-rheumatics	9,627	9,379	2.6
Other pharmaceuticals	269	318	(15.3)
OTC pharmaceuticals	5,451	5,308	2.7
Medical devices	415	537	(22.8)
Other	2,206	2,792	(21.0)
Total	¥103,394	¥100,486	2.9

Cost of Sales

In line with increased net sales, cost of sales rose 2.9%, to ¥36,513 million. The ratio of cost of sales to net sales was roughly level with the previous period, at 35.3%.

Selling, General and Administrative Expenses

We implemented several activities during the year to encourage future sales growth, including defensive strategies to combat competition in the Japanese market, a disease awareness campaign for dry eye and sales promotions in Europe and Asia. As a result of these activities, selling, general and administrative expenses increased 4.3%, to ¥46,510 million.

Operating Income

Operating income declined 0.2%, to ¥20,371 million, and the ratio of operating income to net sales dropped slightly to 19.7%, from 20.3% in the previous year.

Other Income and Expenses

Other net income for the year ended March 31, 2008 was ¥112 million.

Other income rose ¥201 million, to ¥1,594 million, as a result of a year-on-year decline in profits from the sale of fixed assets, a rise in interest and dividend income and gain on sale of investment securities.

Other expenses increased ¥716 million, to ¥1,482 million. This result reflects a decrease in amortization of goodwill, a ¥317 million loss on impairment of fixed assets and a net foreign exchange loss.

Income Taxes

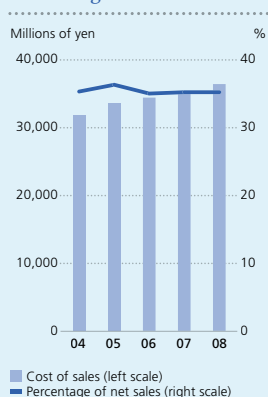
Income taxes totaled ¥7,832 million. The effective tax rate was 38.2%, compared with 37.5% for the previous year.

Net Income

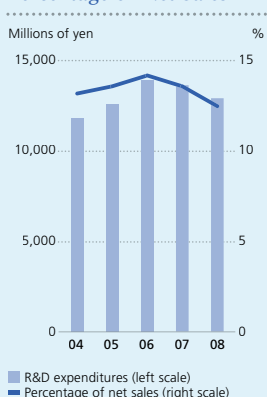
Net income was down 3.8%, to ¥12,651 million, in the year ended March 31, 2008. The ratio of net income to net sales was 12.2%, compared with 13.1% in the previous year.

Basic net income per share was ¥146.15, compared with ¥151.58 in the previous year, and diluted net income per share was ¥145.94, down from ¥151.31.

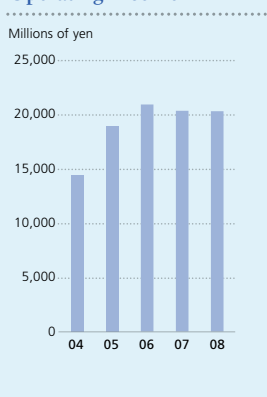
Cost of Sales and Percentage of Net Sales



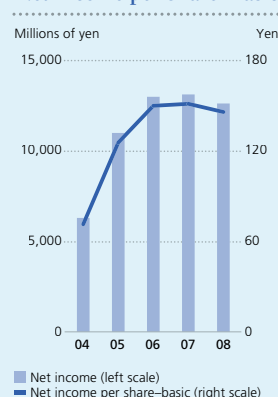
R&D Expenditures and Percentage of Net Sales



Operating Income



Net Income and Net Income per Share—Basic



FINANCIAL CONDITION

Assets

As of March 31, 2008, total assets were ¥156,547 million, down ¥2,552 million, or 1.6%, from the previous year-end. Return on assets (ROA) was down slightly at 8.0%, compared to 8.5% in the previous year. Total current assets were ¥102,754 million, and the ratio of total current assets to total assets rose 2.2 percentage points, to 65.6%, from 63.4% in the previous year. Within fixed assets, net property, plant and equipment totaled ¥29,849 million, and total investments and other assets amounted to ¥23,944 million.

Liabilities

Total liabilities at March 31, 2008 were ¥29,429 million, down ¥1,024 million, or 3.4%, from the previous year-end. Interest-bearing debt was ¥5,278 million, a year on year decline of ¥168 million, or 3.1%. Total current liabilities were ¥26,561 million and noncurrent liabilities were ¥2,868 million.

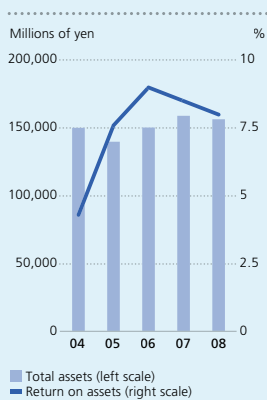
Net Assets

Net assets amounted to ¥127,118 million, down ¥1,528 million, or 1.2%, year on year, as increased treasury stock acquisition outweighed a rise in retained earnings. The equity ratio increased to 81.1%, from 80.8% in the previous year. Return on equity (ROE) fell to 9.9%, from 10.6% the previous year. Equity per share was ¥1,494.48, a rise of ¥12.65, or 0.9%, from the previous year.

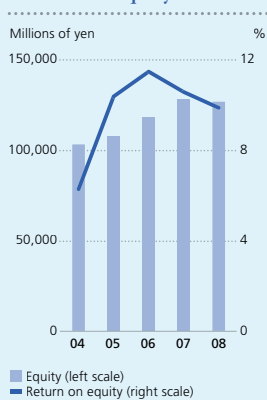
Capital and Liquidity

Santen strives to maintain a healthy balance sheet and to ensure it has an appropriate level of liquidity and sufficient resources to fund its business activities. Cash and cash equivalents at end of year amounted to ¥51,670 million, up ¥1,829 million, or 3.7%. Net cash provided by operating activities was ¥15,468 million, of which ¥2,083 million was used in investment activities and ¥11,415 million in financing activities.

Total Assets and Return on Assets



Equity and Return on Equity



Cash Flows

Net cash provided by operating activities was ¥15,468 million, a rise of ¥509 million year on year. This was largely due to a decline in the amount of taxes paid, against a fall in income before income taxes, increase in inventories and a fall in amounts due on purchases.

Net cash used in investment activities was ¥2,083 million, representing a drop of ¥3,763 million from the previous year. Main investments were of property, plant and equipment related to the construction of the Suzhou Plant of our subsidiary in China.

Net cash used in financing activities was ¥11,415 million, an increase of ¥5,724 million, which resulted primarily from repurchase of treasury stock, net, and dividends paid.

As a result, cash and cash equivalents at end of year was ¥51,670 million, a rise of ¥1,829 million.

Distribution of Profits

Santen views returns to shareholders as one of its most important management issues and has instituted the following fundamental policies for the distribution of profits:

- To enhance corporate value, we will focus on raising capital efficiency and on securing internal reserves to fund R&D and the implementation of growth strategies.
- We will strive to increase the level of dividends in line with such factors as the Company's demand for funds and financial position.
- We will consider repurchase and retirement of treasury stock as a flexible method of providing a return to shareholders.

To maintain a stable level of dividends, we employ the dividend on equity (DOE) ratio, which combines the dividend payout ratio and ROE. For fiscal 2010, the final year of the current Medium-term Management Plan, our DOE target is 5.0%.

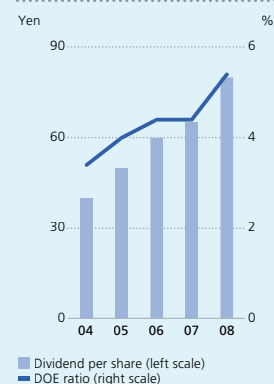
For fiscal 2007, the annual dividend per share was ¥80, an increase of ¥15, and the Company acquired ¥4,800 million in treasury stock. As a result, the DOE ratio was 5.4%, significantly exceeding the current plan's 5.0% target. In the future, we will maintain our DOE target at 5.0% and consider the possibility of further treasury stock repurchase and retirement.

Cash Flows Summary

Years ended March 31	Millions of yen		
	2008	2007	Change
Cash flows from operating activities	¥15,468	¥14,959	¥ 509
Cash flows from investing activities	(2,083)	(5,846)	3,763
Cash flows from financing activities	(11,415)	(5,691)	(5,724)
Cash and cash equivalents at end of year	51,670	49,841	1,829

Note: Figures in parentheses indicate a decrease.

Dividend per Share Dividend on Equity (DOE) Ratio



Risks Related to Our Business

Forward-Looking Information and Factors That Might Affect Future Results

Any statements that we make, other than historical facts, contain forward-looking information based on our business plans and assumptions at the time of disclosure. Such forward-looking information includes, but is not limited to, our expected growth strategies, projected operating results, market forecasts and anticipated timing for developing, obtaining approval and bringing products to market. Our business, as well as each product we develop and market, is subject to various risks and uncertainties beyond our control. Therefore, these forward-looking statements might differ substantially from actual results.

Risks and uncertainties that could affect the Company's future results and financial conditions include, but are not limited to, the factors described below.

External Factors

● Regulatory Controls

Our prescription pharmaceuticals business is subject to government regulatory controls regarding healthcare programs and drug prices in Japan and other countries. Although our current operating and / or financial projections were made fully in consideration of drug price revisions in Japan to the extent possible, those revisions that may take place beyond the scope of our anticipated projections or other revisions in healthcare programs might also affect our operating and/or financial results. In April 2008, NHI drug price revisions went into effect resulting in an average 3.8% reduction for the prescription ophthalmic pharmaceuticals industry. In other countries and markets where we manufacture and sell our products, we continue to face a variety of regulatory controls over prices of prescription pharmaceuticals and government pressures for drug price reduction.

● Social and Economic Conditions and Changes in the Law

Santen's future results might be affected by political and economic changes in key markets worldwide in which we operate. Our anticipated performance and financial conditions might also be affected by changes in applicable accounting principles, and laws and regulations concerning taxes, the Product Liability Law, the Antitrust Law, environmental laws and regulations and other factors.

● Foreign Exchange

Overseas sales and expenses, as well as assets of overseas subsidiaries, affect our sales, profits and financial conditions depending on foreign exchange rate fluctuations. Overseas sales for the year ended March 31, 2008, accounted for 14.3% of our consolidated net sales.

Dependency on Specific Products and Business Partners

● Dependency on Mainstay Products

Total sales of *Hyalein* and *Cravit* accounted for 30% of Santen's consolidated net sales for the year ended March 31, 2008.

Should any sales suspension or a decline in sales occur due to any unanticipated negative influences such as potential product defects or newly discovered side effects, our business results and financial performance might be negatively affected.

● Dependency on In-Licensed Products

Many products that the Santen Group sells are licensed by other companies. We hold exclusive rights to manufacture and sell ophthalmic formulations such as *Cravit* and *Detantol*. We also have sales rights in Japan for *Timoptol*, *Timoptol XE* and *Livostin*, and exclusive sales rights in Japan for *Azulfidine EN* and *Rescula*. Should changes be made in the terms and conditions after the expiration of such contracts or should the agreements not be renewed, our business performance might be affected.

● Dependency on Specific Business Partners

In the U.S., we have a distribution agreement with VISTAKON Pharmaceuticals, LLC, for certain prescription ophthalmics. In the event that VISTAKON Pharmaceuticals cannot achieve sufficient sales of such products we consigned, our financial results might be affected.

We depend on specific business partners for the supply of certain raw materials such as the active pharmaceutical ingredient for *Cravit* and containers for our OTC pharmaceuticals. If supply of these materials is interrupted or discontinued for any reason, our pharmaceutical production might be adversely affected. Should it subsequently affect the supply of our products and cause any interruption or discontinuance, it would adversely affect our business performance.

The percentage of our business conducted with the top 10 wholesalers in Japan has reached 70% of our consolidated net sales. If our wholesale partners experience bankruptcy leading to a lending loss, our business performance might be adversely affected.

Research and Development Activities

● **Uncertainties in New Product Development**

Years are required to bring new drugs from initial research and development to final approval and marketing. Various uncertainties exist at every stage in the development process that could sidetrack a new product such as discontinuance of development or disapproval after the application is filed. It is difficult for us to accurately predict when new products, new indications or formulations under development will reach the approval stage and be ready for launching manufacturing and sales. Forecasting a precise time line for project development and completion depends on a number of variable factors, including, but not limited to, delayed government reviews, conflicting or unusable clinical data that do not indicate differentiation from competitor products, safety and efficacy concerns, unexpected side effects, discontinued development and delayed product release, any of which might negatively affect projected sales of new drugs.

● **Potentially Insufficient Returns on R&D Investment**

The creation and development of new pharmaceuticals, as well as the development of new indications and formulations, are critical for the future growth of Santen. Every year we invest significantly in research and development, and there is a possibility that future investments will not result in sales of new products sufficient to provide an adequate return.

● **Issues of Alliances**

Forecasts for new pharmaceuticals include various assumptions of alliances in development and/or sales. Actual results of these alliances might affect our overall sales and financial conditions.

Other Factors

● **Production Interruptions or Delays**

The interruption or delay of production activities due to natural disasters or other catastrophes such as fire might affect our financial performance and conditions. Certain products are only manufactured at one location. If a specific plant is forced to halt production, supply of some products might be interrupted or delayed.

● **Cancellation of Sales and Product Withdrawals**

If sales of products are cancelled, or if we withdraw products due to a batch defect, unexpected side effects, tampering or other causes, our overall financial results might be negatively affected.

● **Litigation**

Our main business involves the production and sales of prescription pharmaceuticals. The nature of our business makes us vulnerable to litigation related to patents, the Product Liability Law, violation of the Antitrust Law and consumer-related and environmental lawsuits. If such legal actions take place, the proceedings might affect our overall performance and financial conditions. Currently, we are involved in no litigation that substantially impacts the management of the Company.

Eleven-year Summary of Selected Financial Data

Years ended March 31

	1998	1999	2000	2001
For the year:				
Net sales	¥ 77,957	¥ 79,639	¥ 83,577	¥ 88,449
Cost of sales	31,278	32,746	32,195	33,385
Selling, general and administrative expenses	30,535	30,294	33,894	38,546
Operating income	16,144	16,599	17,488	16,518
Interest expense	654	588	462	430
Income before income taxes	14,917	15,969	14,422	15,521
Income taxes	7,594	7,864	6,481	7,807
Net income	7,323	8,105	7,941	7,714
Capital expenditures	5,898	3,443	2,510	4,943
Depreciation and amortization	6,674	6,314	5,725	5,683
R&D expenditures	7,731	7,335	9,221	10,511
Per share data (yen and U.S. dollars):				
Net income—basic	¥ 77.06	¥ 85.27	¥ 83.54	¥ 81.32
Net income—diluted	71.01	78.63	77.04	75.01
Equity	862.88	935.71	1,006.48	1,022.99
Cash dividends, applicable to period	12.00	12.00	12.00	20.00
Cash flows:				
Net cash provided by operating activities	¥ 11,535	¥ 16,339	¥ 9,372	¥ 6,832
Net cash (used in) provided by investing activities	(9,537)	(8,305)	837	(3,172)
Net cash used in financing activities	(1,677)	(3,857)	(3,817)	(7,193)
Interest coverage ratio (times)	21.6	27.8	20.3	16.8
Debt to cash flow ratio (%)	270.6	173.8	274.7	367.3
At year-end:				
Total current assets	¥ 70,892	¥ 78,018	¥ 82,218	¥ 88,025
Net property, plant and equipment	43,425	39,638	37,416	36,684
Total assets	138,822	144,913	149,968	153,243
Long-term debt	31,168	27,496	26,491	25,482
Equity	81,998	88,950	95,669	94,834
Return on equity (ROE) (%)	9.3	9.5	8.6	8.1
Return on total assets (ROA) (%)	5.2	5.7	5.4	5.1
Equity ratio (%)	59.1	61.4	63.8	61.9
Equity ratio on stock price basis (%)	106.1	145.0	139.4	134.3
Price earnings ratio (PER) (times)	20.1	25.9	26.3	27.3
Dividend on equity (DOE) (%)	1.4	1.3	1.2	2.0
Issued shares (thousands)	95,075	95,075	95,075	92,721
Number of employees	2,010	2,037	2,093	2,167

- Notes: 1. U.S. dollar amounts have been translated from yen, solely for the convenience of the reader, at the rate of ¥100.19 to U.S. \$1 prevailing on March 31, 2008.
2. See Notes 2, 13) and 11 of Notes to Consolidated Financial Statements in respect of per share data.
3. Net sales in the eight years ended March 31, 2008 include royalty income which was presented as "Other, net" in "Other income (expenses)" through the year ended March 31, 2000.
4. Equity comprises shareholders' equity and total accumulated gains (losses) on evaluation and translation.

Millions of yen							Thousands of U.S dollars
2002	2003	2004	2005	2006	2007	2008	2008
¥ 88,966	¥ 90,253	¥ 89,858	¥ 92,696	¥ 98,398	¥ 100,486	¥ 103,394	\$ 1,031,980
32,701	32,272	31,859	33,710	34,535	35,484	36,513	364,441
44,475	45,284	43,475	40,004	42,868	44,590	46,510	464,219
11,790	12,697	14,524	18,982	20,995	20,412	20,371	203,320
465	480	366	182	94	91	97	965
12,679	9,947	13,775	18,436	20,342	21,039	20,483	204,438
7,373	1,444	7,454	7,413	7,319	7,891	7,832	78,172
5,306	8,503	6,321	11,023	13,023	13,148	12,651	126,266
6,586	7,046	3,226	4,907	2,106	3,556	3,151	31,451
5,334	4,311	4,521	4,750	4,824	4,761	4,593	45,846
12,187	12,719	11,853	12,620	13,971	13,663	12,942	129,170
¥ 57.34	¥ 93.67	¥ 71.65	¥ 125.85	¥ 150.26	¥ 151.58	¥ 146.15	\$ 1.46
53.07	85.97	71.64	125.71	150.01	151.31	145.94	1.46
1,048.51	1,104.21	1,176.83	1,249.32	1,368.27	1,481.83	1,494.48	14.92
20.00	20.00	40.00	50.00	60.00	65.00	80.00	0.80
¥ 6,941	¥ 15,808	¥ 23,196	¥ 6,619	¥ 20,879	¥ 14,959	¥ 15,468	\$ 154,387
(6,374)	(9,951)	5,246	(2,907)	(1,330)	(5,846)	(2,083)	(20,793)
(5,684)	(6,507)	(12,122)	(12,712)	(5,900)	(5,691)	(11,415)	(113,937)
14.9	34.5	70.6	36.1	218.7	164.3	163.6	
352.5	145.8	54.7	104.0	26.9	36.4	34.1	
¥ 86,064	¥ 83,431	¥ 91,231	¥ 82,735	¥ 93,893	¥ 100,820	¥ 102,754	\$ 1,025,596
42,159	40,850	37,237	32,676	30,395	30,485	29,849	297,921
152,103	147,148	150,238	139,980	150,458	159,099	156,547	1,562,504
24,467	23,047	12,686	6,882	5,614	5,446	5,278	52,680
95,101	97,126	103,500	108,240	118,637	128,587	126,998	1,267,574
5.6	8.8	6.3	10.4	11.5	10.6	9.9	
3.5	5.7	4.3	7.6	9.0	8.5	8.0	
62.5	66.0	68.9	77.3	78.9	80.8	81.1	
86.6	68.7	101.8	142.3	163.0	165.3	126.2	
25.3	12.3	24.3	18.3	18.8	20.0	15.9	
1.9	1.9	3.5	4.1	4.6	4.6	5.4	
90,704	90,704	87,963	86,659	86,751	86,825	86,867	
2,463	2,500	2,335	2,308	2,312	2,409	2,483	

Consolidated Balance Sheets

Santen Pharmaceutical Co., Ltd. and Subsidiaries
As of March 31, 2008 and 2007

Thousands of
U.S. dollars
(Note 3)

	Millions of yen		
ASSETS	2008	2007	2008
Current assets:			
Cash and cash equivalents (Note 4)	¥ 51,670	¥ 49,841	\$ 515,717
Short-term investments (Note 4)	182	1,868	1,812
Trade receivables:			
Notes	221	430	2,205
Accounts	35,393	34,604	353,267
Allowance for doubtful receivables	(1)	(0)	(15)
Net trade receivables	35,613	35,034	355,457
Inventories (Note 6)	11,333	10,358	113,112
Deferred tax assets (Note 14)	1,699	1,626	16,962
Other current assets	2,257	2,093	22,536
Total current assets	102,754	100,820	1,025,596
Property, plant and equipment (Notes 7 and 8):			
Land	8,558	8,843	85,418
Buildings and structures	39,860	39,523	397,843
Machinery and equipment	10,988	10,230	109,667
Tools, furniture and vehicles	10,628	10,961	106,079
Construction in progress	1,879	1,806	18,761
Total	71,913	71,363	717,768
Accumulated depreciation	(42,064)	(40,878)	(419,847)
Net property, plant and equipment	29,849	30,485	297,921
Investments and other assets:			
Investments in affiliates	480	—	4,791
Investment securities (Note 4)	16,470	21,020	164,383
Goodwill	301	385	3,001
Other intangibles	1,933	2,387	19,292
Deferred tax assets (Note 14)	1,822	—	18,190
Other assets	2,938	4,002	29,330
Total investments and other assets	23,944	27,794	238,987
Total assets	¥ 156,547	¥ 159,099	\$ 1,562,504

See accompanying notes to consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 3)
LIABILITIES AND NET ASSETS	2008	2007	2008
Current liabilities:			
Current portion of long-term debt (Note 9)	¥ 5,168	¥ 168	\$ 51,582
Trade accounts payable	5,634	6,089	56,232
Other payables	7,690	8,573	76,758
Accrued expenses	3,249	3,154	32,428
Income taxes payable (Note 14)	4,324	3,917	43,157
Other current liabilities	496	468	4,950
Total current liabilities	26,561	22,369	265,107
Noncurrent liabilities:			
Long-term debt (Note 9)	110	5,278	1,098
Retirement and severance benefits (Note 10)	2,302	1,919	22,982
Deferred tax liabilities (Note 14)	18	427	177
Other liabilities	438	460	4,368
Total noncurrent liabilities	2,868	8,084	28,625
Contingent liabilities (Note 15)			
Total liabilities	29,429	30,453	293,732
Net assets (Note 11):			
Common stock (Note 12):			
Authorized—220,000,000 shares (151,493,354 shares in 2007)			
Issued—86,866,703 shares (86,825,303 shares in 2007)	6,419	6,382	64,063
Capital surplus (Note 12)	7,114	7,077	71,002
Retained earnings	117,787	111,645	1,175,634
Treasury stock, at cost:			
1,888,743 shares in 2008 and 50,282 shares in 2007	(4,921)	(106)	(49,116)
Total shareholders' equity	126,399	124,998	1,261,583
Unrealized gains on securities, net of taxes (Note 4)	2,273	5,203	22,696
Unrealized gains on hedging derivatives, net of taxes (Note 5)	—	3	—
Foreign currency translation adjustments	(1,674)	(1,617)	(16,705)
Total accumulated gains on evaluation and translation	599	3,589	5,991
Stock subscription rights (Note 12)	120	59	1,198
Total net assets	127,118	128,646	1,268,772
Total liabilities and net assets	¥ 156,547	¥ 159,099	\$ 1,562,504

Consolidated Statements of Changes in Net Assets

Santen Pharmaceutical Co., Ltd. and Subsidiaries
For the years ended March 31, 2008, 2007 and 2006

	Millions of yen							
	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized gains on securities, net of taxes	Unrealized gains on hedging derivatives, net of taxes	Foreign currency translation adjustments	Stock subscription rights
Balance at March 31, 2005	¥ 6,248	¥ 6,943	¥ 95,902	¥ (75)	¥ 2,049	¥ —	¥ (2,827)	¥ —
Exercise of stock options	71	71						
Cash dividends paid			(4,766)					
Bonuses to directors and corporate auditors			(25)					
Net income			13,023					
Repurchase of treasury stock, net				(15)				
Other					1,947		91	
Balance at March 31, 2006	¥ 6,319	¥ 7,014	¥ 104,134	¥ (90)	¥ 3,996	¥ —	¥ (2,736)	¥ —
Exercise of stock options	63	63						
Cash dividends paid			(5,637)					
Net income			13,148					
Repurchase of treasury stock, net				(17)				
Retirement of treasury stock		0		1				
Other					1,207	3	1,119	59
Balance at March 31, 2007	¥ 6,382	¥ 7,077	¥ 111,645	¥ (106)	¥ 5,203	¥ 3	¥ (1,617)	¥ 59
Exercise of stock options	37	37						
Cash dividends paid			(6,509)					
Net income			12,651					
Repurchase of treasury stock, net				(4,816)				
Retirement of treasury stock		0		1				
Other					(2,930)	(3)	(57)	61
Balance at March 31, 2008	¥ 6,419	¥ 7,114	¥ 117,787	¥ (4,921)	¥ 2,273	¥ —	¥ (1,674)	¥ 120

	Thousands of U.S. dollars (Note 3)							
	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized gains on securities, net of taxes	Unrealized gains on hedging derivatives, net of taxes	Foreign currency translation adjustments	Stock subscription rights
Balance at March 31, 2007	\$ 63,700	\$ 70,637	\$ 1,114,334	\$ (1,062)	\$ 51,931	\$ 32	\$ (16,151)	\$ 594
Exercise of stock options	363	364						
Cash dividends paid			(64,966)					
Net income			126,266					
Repurchase of treasury stock, net				(48,062)				
Retirement of treasury stock		1		8				
Other					(29,235)	(32)	(554)	604
Balance at March 31, 2008	\$ 64,063	\$ 71,002	\$ 1,175,634	\$ (49,116)	\$ 22,696	\$ —	\$ (16,705)	\$ 1,198

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Santen Pharmaceutical Co., Ltd. and Subsidiaries
For the years ended March 31, 2008, 2007 and 2006

Thousands of
U.S. dollars
(Note 3)

	Millions of yen			
	2008	2007	2006	2008
Cash flows from operating activities:				
Income before income taxes	¥ 20,483	¥ 21,039	¥ 20,342	\$ 204,438
Depreciation and amortization	4,593	4,761	4,824	45,846
Loss on impairment of fixed assets (Note 8)	317	—	909	3,162
Increase (decrease) in retirement and severance benefits	412	160	(212)	4,111
Interest and dividend income	(607)	(460)	(262)	(6,058)
Interest expense	97	91	94	965
(Increase) decrease in trade receivables	(587)	(414)	1,407	(5,856)
Increase in inventories	(1,006)	(357)	(18)	(10,041)
Increase (decrease) in trade accounts payable	(430)	401	(495)	(4,297)
Other, net	(562)	(1,717)	626	(5,600)
Subtotal	22,710	23,504	27,215	226,670
Interest and dividend income received	611	460	266	6,094
Interest expense paid	(95)	(91)	(95)	(943)
Income taxes paid	(7,758)	(8,914)	(6,507)	(77,434)
Net cash provided by operating activities	15,468	14,959	20,879	154,387
Cash flows from investing activities:				
Capital expenditures	(3,151)	(3,556)	(2,106)	(31,451)
Purchase of investment securities	(3,266)	(2,209)	(58)	(32,604)
Proceeds from sale of investment securities	2,660	—	20	26,554
Proceeds from sale of property, plant and equipment	5	601	29	52
Purchase of short-term investments	(1,518)	(1,223)	(804)	(15,160)
Proceeds from sale of short-term investments	3,160	554	1,547	31,542
Other, net	27	(13)	42	274
Net cash used in investing activities	(2,083)	(5,846)	(1,330)	(20,793)
Cash flows from financing activities:				
Repayment of long-term debt	(168)	(168)	(1,268)	(1,677)
Repurchase of treasury stock, net	(4,815)	(17)	(15)	(48,061)
Dividends paid	(6,506)	(5,632)	(4,760)	(64,936)
Other, net	74	126	143	737
Net cash used in financing activities	(11,415)	(5,691)	(5,900)	(113,937)
Effect of exchange rate changes on cash and cash equivalents	(141)	314	75	(1,406)
Net increase in cash and cash equivalents	1,829	3,736	13,724	18,251
Cash and cash equivalents at beginning of year	49,841	46,105	32,381	497,466
Cash and cash equivalents at end of year	¥ 51,670	¥ 49,841	¥ 46,105	\$ 515,717

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Santen Pharmaceutical Co., Ltd. and Subsidiaries

1. Basis of Presentation of Consolidated Financial Statements

The consolidated financial statements of Santen Pharmaceutical Co., Ltd. (the "Company") have been prepared in accordance with the provisions set forth in the Japanese Financial Instruments and Exchange Act and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan ("Japanese GAAP"), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accounts of the Company's overseas subsidiaries have been prepared based on the generally accepted accounting principles prevailing in their respective countries of domicile.

2. Summary of Significant Accounting Policies

1) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries (the "Companies"). All significant intercompany balances and transactions are eliminated on consolidation.

Investment in an affiliated company is stated at cost due to immateriality.

2) Use of estimates

The preparation of the consolidated financial statements in conformity with Japanese GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

3) Short-term investments, investment securities and golf membership rights (see Note 4)

The Company and its domestic subsidiary have adopted "Accounting Standard for Financial Instruments" which was issued by the Business Accounting Council in Japan. In accordance with this standard, securities are classified into three categories; trading, held-to-maturity, or other securities.

Based on this classification, all trading securities and, any held-to-maturity and other securities with a maturity of less than one year, are included in current assets. All other securities are included in investment securities as noncurrent assets.

Those classified as other securities with an available market value are reported at fair value with unrealized holding gains, net of related taxes reported as a separate component of net assets. Realized gains and losses on sales of such securities are determined by the moving average cost method. Other securities with no available market value are carried at cost, which is determined by the moving average cost method.

In addition, this standard also requires the recognition of an impairment loss on golf membership rights, included in other assets, on the consolidated balance sheets, when the market value shows a substantial decline and is not anticipated to recover.

The consolidated financial statements have been restructured and translated into the English (with certain expanded disclosure and the inclusion of the consolidated statements of changes in net assets for 2006) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Financial Instruments and Exchange Act. Certain supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the consolidated financial statements.

4) Derivative instruments (see Note 5)

Derivative instruments are stated at fair value, and accounted for using deferred hedge accounting. Recognition of gains or losses resulting from changes in fair values of derivative financial instruments are deferred until the related losses or gains on the hedged items are recognized if derivative financial instruments are used as hedges and meet certain hedging criteria. Foreign exchange contracts that meet the criteria are accounted for under the allocation method. The allocation method requires recognized foreign currency receivables or payables to be translated using the corresponding foreign exchange contract rates. Interest rate swaps that meet the criteria are accounted for under the special method, as regulated in the accounting standard, as if the interest rates under interest rate swaps were originally applied to underlying borrowings.

The Company has also developed a hedging policy to control various aspects of derivative instruments including authorization levels and transaction volumes. Based on this policy, the Company hedges the exposure risk arising from fluctuations in foreign currency exchange rates, interest rates, and prices of securities. The Company evaluates hedge effectiveness by comparing the cumulative changes in cash flows from hedged items and corresponding changes in hedging derivative instruments. With respect to interest rate swaps under the special method, the evaluation of hedge effectiveness is omitted.

5) Allowance for doubtful receivables

Allowance for doubtful receivables is provided principally at an amount determined based on the historical experience of bad debts in the past and the estimated uncollectible amounts based on the specific analysis of receivables with default possibility.

6) Inventories (see Note 6)

Inventories are stated at cost, determined principally by the average method.

7) Property, plant and equipment

Property, plant and equipment is stated at cost. Depreciation of buildings, acquired prior to April 1, 1998, and other property, plant and equipment is computed over the estimated useful lives of the assets using the declining-balance method for the Company and its domestic subsidiary. Buildings (other than leasehold improvements), which were acquired on or after April 1, 1998, are depreciated using the straight-line method for the Company and its domestic subsidiary. Depreciation is computed over the estimated useful lives of the assets using the straight-line method for all overseas subsidiaries.

The principal estimated useful lives are as follows:

Buildings and structures	31 to 50 years
Machinery and equipment	7 years
Tools, furniture and vehicles	4 to 10 years

Change in accounting method

Effective April 1, 2007, the Company and its domestic subsidiary adopted the new depreciation method to comply with Corporate Tax Law revised in 2007 for property, plant and equipment acquired after April 1, 2007. The effect of this adoption was to decrease operating income and income before income taxes by ¥48 million (\$477 thousand). The effect of this adoption to segment information is described in Note 16.

Additional information

Prior to the amendment of the Corporate Tax law, all tangible fixed assets must have a 5% residual value. Subsequent to the amendment of the Corporate Tax Law effective April 1, 2007, Japanese domiciled companies are permitted to fully depreciate tangible fixed assets. Hence the Company and its domestic subsidiaries have taken advantage of this amendment and are depreciating the remaining residual of eligible assets over 5 years. The straight line depreciation starts from the next year, when the book value of tangible assets acquired on and before March 31, 2007 reaches 5% of the acquisition cost. As a result, for the year ended March 31, 2008, operating income and income before income taxes were down ¥126 million (\$1,259 thousand) each, compared to the previous method. For the impact that these changes had on segment information is described in Note 16.

8) Leases (see Note 7)

In Japan, finance leases other than those that are deemed to transfer the ownership of the leased assets to lessees are accounted for as operating leases.

9) Impairment of fixed assets (see Note 8)

In accordance with "Accounting Standards for Impairment of Fixed Assets" which was issued by the Business Accounting Council in Japan, fixed assets, such as property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset, or group of assets, to estimated undiscounted future cash flows expected to be generated. If the carrying amount of an asset, or group of assets, exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the greater of its net realizable value or value in use.

10) Retirement and severance benefits (see Note 10)

Employees of the Company and all domestic subsidiaries are generally entitled to lump-sum severance and, in certain cases, annuity payments on retirement, based on current rates of pay, length of service and certain other factors.

The Company and all domestic subsidiaries have adopted "Accounting Standard for Retirement Benefits" which was issued by the Financial Accounting Deliberation Council. In accordance with this standard, the allowance for retirement benefits for employees is provided based on the estimated retirement benefit obligation and the pension assets. Actuarial gains and losses are amortized, from the year in which the actuarial gains and losses are incurred, using the straight-line method, over the estimated average remaining service years of employees.

The Company has a retirement benefit scheme, which is a combination of lump-sum severance plan, cash balance and defined contribution pension plan. The Company also has a retirement benefits trust.

In addition, the Company has an unfunded retirement benefit plan for directors and corporate auditors. The amounts required under the plan have been fully accrued. Accrued severance indemnities for the members of the board and corporate auditors of the Company are provided based on internal regulations. The accrued provision for severance indemnities for members of the board and corporate auditors is not funded.

Certain overseas subsidiaries have defined contribution plans covering substantially all of their employees. The amounts contributed under the plans are charged to income.

11) Foreign currency translation

All monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange prevailing on the balance sheet date, except for those items covered by forward exchange contracts.

The Company and all domestic subsidiaries have adopted "Accounting Standard for Foreign Currency Transactions" which was issued by the Business Accounting Council in Japan.

Financial statements of overseas subsidiaries are translated into Japanese yen at year-end rates for all assets and liabilities and at weighted average rates for income and expense accounts. Adjustments resulting from the translation of financial statements are reflected under the caption, "Foreign currency translation adjustments", in net assets.

12) Research and development and computer software (see Note 13)

Research and development expenditures are charged to income when incurred.

Expenditures relating to computer software developed for internal use are charged to income when incurred except if they contribute to the generation of income or to future cost savings. Such expenditures are capitalized as an asset and are amortized using the straight-line method over their estimated useful life, five years.

13) Net income and dividends per share (see Note 11)

The computation of basic net income per share is based on the weighted average number of shares of common stock outstanding during each period. The average number of shares used in the computation is 86,561 thousand, 86,735 thousand and 86,662 thousand for the years ended March 31, 2008, 2007 and 2006, respectively.

The diluted net income per share assumes the dilution that could occur if securities or other contracts to issue common

stock were exercised or converted into common stock or resulted in the issuance of common stock. The average number of shares used in the computation is 86,683 thousand, 86,891 thousand and 86,808 thousand for the years ended March 31, 2008, 2007 and 2006, respectively.

Cash dividends per share shown in the accompanying consolidated statements of income are the amounts applicable to the respective years.

14) Income taxes (see Note 14)

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, operating loss carry forwards and foreign tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

15) Cash and cash equivalents

Cash and cash equivalents mainly include cash on hand, readily available deposits and all highly liquid debt investments, generally with a maturity of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value.

16) Reclassifications

Certain reclassifications have been made to prior years' consolidated financial statements to conform with the presentation used for the year ended March 31, 2008.

3. Translation into United States Dollars

The accompanying consolidated financial statements are expressed in Japanese yen and, solely for the convenience of the reader, have been translated into United States dollars at the rate of ¥100.19=US\$1, the approximate exchange rate prevail-

ing on March 31, 2008. The translation should not be construed as a representation that the Japanese yen have been, could have been, or could in the future be converted into United States dollars at that rate or any other rate.

4. Short-term Investments and Investment Securities

The following is a summary of held-to-maturity debt securities and other securities with a market value at March 31, 2008 and 2007:

	Millions of yen							
	2008				2007			
	Held-to-maturity debt securities				Held-to-maturity debt securities			
	Book value (Carrying amount)	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Book value (Carrying amount)	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Bonds and debentures	¥ —	¥ —	¥ —	¥ —	¥ 1,000	¥ 2	¥ —	¥ 1,002
	Other securities				Other securities			
	Cost	Gross unrealized gains	Gross unrealized losses	Book value (Estimated fair value)	Cost	Gross unrealized gains	Gross unrealized losses	Book value (Estimated fair value)
Equity securities	¥ 10,829	¥ 3,830	¥ —	¥ 14,659	¥ 10,904	¥ 8,669	¥ —	¥ 19,573

	Thousands of U.S. dollars			
	2008			
	Held-to-maturity debt securities			
	Book value (Carrying amount)	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Bonds and debentures	\$ —	\$ —	\$ —	\$ —
	Other securities			
	Cost	Gross unrealized gains	Gross unrealized losses	Book value (Estimated fair value)
Equity securities	\$ 108,087	\$ 38,227	\$ —	\$ 146,314

Maturities of investments at March 31, 2008 and 2007 are as follows:

	Millions of yen				Thousands of U.S. dollars	
	2008		2007		2008	
	Bonds and debentures	Other securities	Bonds and debentures	Other securities	Bonds and debentures	Other securities
Cash equivalents	¥ 13,500	¥ —	¥ 15,000	¥ —	\$ 134,744	\$ —
Due within one year	—	—	—	—	—	—
Due after one year through five years	1,500	—	—	—	14,972	—
	¥ 15,000	¥ —	¥ 15,000	¥ —	\$ 149,716	\$ —

5. Derivative Instruments

The Company principally utilizes derivative instruments such as foreign exchange contracts and interest rate swaps to hedge the exposure risk arising from fluctuations in foreign currency exchange rates, interest rates and market price of securities.

The Company is exposed to the risk that the counterparties will not be able to fully satisfy their obligations under contracts,

but the Company believes that such risk is mitigated by the high credit ratings of the counterparties.

There is no outstanding derivative transaction for which hedge accounting was not applied at March 31, 2008 and 2007.

6. Inventories

Inventories at March 31, 2008 and 2007 consist of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Merchandise	¥ 3,339	¥ 2,973	\$ 33,321
Finished goods	5,227	4,948	52,175
Work in process and semi-finished goods	1,081	910	10,791
Raw materials and supplies	1,686	1,527	16,825
	¥ 11,333	¥ 10,358	\$ 113,112

7. Leases

Finance leases, except for those in which ownership is deemed to be transferred to the lessee, are accounted for as operating leases.

Finance leases:

Equivalent purchase amount, accumulated depreciation and future minimum lease payments on an "as if capitalized" basis at March 31, 2008 and 2007 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Machinery and equipment:			
Equivalent purchase amount	¥ 12,577	¥ 12,755	\$ 125,528
Equivalent accumulated depreciation amount	11,453	10,828	114,311
Equivalent balance at year-end	1,124	1,927	11,217
Tools:			
Equivalent purchase amount	558	615	5,572
Equivalent accumulated depreciation amount	346	393	3,460
Equivalent balance at year-end	212	222	2,112
Total:			
Equivalent purchase amount	13,135	13,370	131,100
Equivalent accumulated depreciation amount	11,799	11,221	117,771
Equivalent balance at year-end	¥ 1,336	¥ 2,149	\$ 13,329
Future minimum lease payments:			
Due within one year	¥ 872	¥ 951	\$ 8,700
Due after one year	581	1,319	5,802
	¥ 1,453	¥ 2,270	\$ 14,502

Lease payments, equivalent depreciation and equivalent interest expense for the three years ended March 31, 2008 are as follows:

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
Lease payments	¥ 1,013	¥ 1,032	¥ 1,035	\$ 10,110
Equivalent depreciation	¥ 942	¥ 970	¥ 969	\$ 9,402
Equivalent interest expense	¥ 33	¥ 47	¥ 61	\$ 333

Operating leases:

Future minimum rents under non-cancellable operating leases at March 31, 2008 and 2007 consist of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Due within one year	¥ 112	¥ 134	\$ 1,119
Due after one year	124	161	1,237
	¥ 236	¥ 295	\$ 2,356

8. Impairment of Fixed Assets

The Company and all domestic subsidiaries account for impairment of fixed assets in accordance with the Financial Accounting Standard on Accounting for Impairment of Assets.

The Company and all domestic subsidiaries review the recorded value of their property, plant and equipment and intangible assets to determine if the future cash flows to be derived from these properties will be sufficient to recover the remaining recorded asset values.

The impairment losses recognized for the three years ended March 31, 2008 are as follows:

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
Land	¥ 253	¥ —	¥ 433	\$ 2,528
Buildings and structures	64	—	372	634
Others	—	—	104	—
	¥ 317	¥ —	¥ 909	\$ 3,162

The Company recorded impairment losses related to land and buildings for dormitory due to the Company's decision to close down during the year ended March 31, 2008. The fair value of the land, buildings and structures was based on local tax authority's valuation.

The Company and certain subsidiaries recorded impairment losses related to land and buildings in connection with the cessation of logistics operations in the western area of Japan as a result of an outsourcing plan for the year ended March 31, 2006. The fair value of the land and buildings was determined by specific appraisal.

9. Long-term Debt

Long-term debt at March 31, 2008 and 2007 consists of the following:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Unsecured yen syndicated loans from domestic banks, due in 2008, interest 1.4%	¥ 5,000	¥ 5,000	\$ 49,905
Unsecured yen loans from domestic banks, due in installments through 2009, interest 4.8%	278	446	2,775
Total	5,278	5,446	52,680
Current portion shown in current liabilities	(5,168)	(168)	(51,582)
	¥ 110	¥ 5,278	\$ 1,098

As is customary in Japan, long-term bank loans are made under general agreements which provide that under certain circumstances, additional security and guarantees for present and future indebtedness will be given upon request by the bank and

that the bank shall have the right, as the obligations become due, or in the event of their default, to offset cash deposits against the obligations due to the bank. To date, the Company has not received such a request from its banks.

The aggregate annual maturities of long-term debt at March 31, 2008 are as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
2009	¥ 5,168	\$ 51,582
2010	110	1,098
Total	¥ 5,278	\$ 52,680

In 2006, the Company entered into a commitment line contract with seven domestic banks. The maximum aggregate credit facility available to the Company is ¥16,000 million. The credit facility has not been used as of March 31, 2008.

10. Retirement and Severance Benefits

As noted in Note 2, 10), the Company has a retirement benefit scheme, which is a combination of lump-sum severance plan, cash balance and defined contribution pension plan. The Company also has a retirement benefit trust.

The following table sets forth the details of benefit obligation, plan assets and funded status of the Companies at March 31, 2008 and 2007.

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
For employees:			
Benefit obligation at end of year	¥ (12,613)	¥ (11,371)	\$ (125,893)
Fair value of plan assets at end of year	9,427	9,356	94,090
Funded status (benefit obligation in excess of plan assets)	(3,186)	(2,015)	(31,803)
Unrecognized actuarial loss	1,371	610	13,686
For directors and corporate auditors:			
Accrued retirement benefit	(487)	(514)	(4,865)
Retirement and severance benefits recognized in the consolidated balance sheets	¥ (2,302)	¥ (1,919)	\$ (22,982)

Retirement and severance costs of the Companies include the following components for the three years ended March 31, 2008.

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
For employees:				
Service cost	¥ 802	¥ 701	¥ 673	\$ 8,001
Interest cost	226	218	208	2,253
Expected return on plan assets	(187)	(179)	(154)	(1,868)
Recognized actuarial loss	143	79	76	1,432
Contribution to defined contribution pension plan	901	807	770	8,993
Net periodic benefit cost	¥ 1,885	¥ 1,626	¥ 1,573	\$ 18,811
For directors and corporate auditors:				
Accrual for retirement benefit	¥ 17	¥ 79	¥ 60	\$ 167

Assumptions used in the accounting for retirement and severance benefits for the three years ended March 31, 2008 are as follows:

	2008	2007	2006
Method of attributing benefit to period of service	Straight-line basis	Straight-line basis	Straight-line basis
Discount rate	2.00%	2.00%	2.00%
Expected return on plan assets	2.00%	2.00%	2.00%
Amortization period for actuarial losses*	14 years	14 years	14 years

* Amortized on a straight-line basis over the average remaining service period for employees in service starting from the year in which the losses occur.

All domestic subsidiaries have adopted the permitted alternative treatment, accruing for 100% of the amount required if all employees were to voluntarily terminate their employment as of

the balance sheet date, in accordance with the accounting standard for retirement benefits for small business entities.

11. Net Assets

Under the Japanese laws and regulations, the entire amount paid for new shares is required to be designated as common stock. However, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one-half of the price of the new shares as additional paid-in capital, which is included in capital surplus.

Under the Japanese Corporate Law ("The Law"), in cases where dividend distribution of surplus is made, the smaller of an amount equal to 10% of the dividend and the excess, if any, of 25% of common stock over the total of additional paid-in capital and legal earnings reserve must be set aside as additional paid-in capital or legal earnings reserve. Legal earnings reserve is included

in retained earnings in the accompanying consolidated balance sheets and amounted to ¥1,551 million (\$15,485 thousand) and ¥1,551 million as of March 31, 2008 and 2007, respectively.

Cash dividends charged to retained earnings during the three years ended March 31, 2008 represent dividends paid out during the periods. The accompanying consolidated financial statements do not include any provision for the year end dividend of ¥40 (\$0.40) per share, aggregating ¥3,399 million (\$33,927 thousand) which was approved at the Company's shareholders' meeting on June 25, 2008 in respect of the year ended March 31, 2008.

12. Stock Options

The Company has stock-based compensation plans under which stock options are granted annually to directors and corporate officers at the market price on the date of the grant. The stock

options are fully exercisable after two years and have a span ten years from the date of grant.

Stock options existing as of March 31, 2008 are as follows:

Stock options granted	2007	2006	2005	2004
Persons granted	Directors and corporate officers: 12	Directors and corporate officers: 15	Directors and corporate officers: 15	Directors and corporate officers: 11
Number of shares	Common Stock 99,300	Common Stock 102,700	Common Stock 129,200	Common Stock 78,200
Date of grant	July 3, 2007	July 4, 2006	July 4, 2005	July 5, 2004
Vesting conditions	No provisions	No provisions	No provisions	No provisions
Service period	No provisions	No provisions	No provisions	No provisions
Exercise period	From June 27, 2009 to June 26, 2017	From June 28, 2008 to June 24, 2016	From June 25, 2007 to June 23, 2015	From June 26, 2006 to June 24, 2014
Stock options granted	2003	2002	2001	2000
Persons granted	Directors and corporate officers: 12	Directors and corporate officers: 14	Directors and corporate officers: 14	Directors and corporate officers: 16
Number of shares	Common Stock 137,600	Common Stock 92,000	Common Stock 55,000	Common Stock 60,000
Date of grant	July 4, 2003	July 5, 2002	July 9, 2001	July 10, 2000
Vesting conditions	No provisions	No provisions	No provisions	No provisions
Service period	No provisions	No provisions	No provisions	No provisions
Exercise period	From June 27, 2005 to June 25, 2013	From June 27, 2004 to June 25, 2012	From June 29, 2003 to June 27, 2011	From June 30, 2002 to June 28, 2010
Stock options granted	1999	1998		
Persons granted	Directors: 10 Management: 6	Directors: 12		
Number of shares	Common Stock 66,000	Common Stock 106,000		
Date of grant	July 8, 1999	July 1, 1998		
Vesting conditions	No provisions	No provisions		
Service period	No provisions	No provisions		
Exercise period	From June 30, 2001 to June 28, 2009	From June 27, 2000 to June 25, 2008		

Number, movement and price of stock options as of March 31, 2008 are as follows:

Before vesting options (Number of shares):

Stock options granted	2007	2006	2005	2004	2003
Balance at April 1, 2007	—	—	—	—	—
Granted	99,300	—	—	—	—
Vested	99,300	—	—	—	—
Balance at March 31, 2008	—	—	—	—	—

Stock options granted	2002	2001	2000	1999	1998
Balance at April 1, 2007	—	—	—	—	—
Granted	—	—	—	—	—
Vested	—	—	—	—	—
Balance at March 31, 2008	—	—	—	—	—

After vesting options (Number of shares):

Stock options granted	2007	2006	2005	2004	2003
Balance at April 1, 2007	—	102,700	129,200	73,900	72,900
Vested	99,300	—	—	—	—
Exercised	—	—	1,700	7,800	17,700
Balance at March 31, 2008	99,300	102,700	127,500	66,100	55,200

Stock options granted	2002	2001	2000	1999	1998
Balance at April 1, 2007	32,100	38,600	48,200	48,000	24,000
Vested	—	—	—	—	—
Exercised	1,200	—	2,000	11,000	—
Balance at March 31, 2008	30,900	38,600	46,200	37,000	24,000

Price information (yen):

Stock options granted	2007	2006	2005	2004	2003
Option price	3,050	2,715	2,480	1,743	1,176
Weighted-average stock price	—	—	2,870	2,557	2,819
Fair value at grant date*	609.45	579.05	—	—	—

Stock options granted	2002	2001	2000	1999	1998
Option price	1,326	2,299	2,705	2,480	1,540
Weighted-average stock price	2,850	—	3,310	2,933	—
Fair value at grant date*	—	—	—	—	—

* Omitted due to stock options which had been granted before the Law became effective on May 1, 2006.

On June 25, 2008, the Company's shareholders' meeting approved that the Company's stock subscription rights for allotment as stock options to directors and corporate officers of the Company. These stock subscription rights are exercisable from

June 28, 2010 to June 25, 2018. The maximum number of stock subscription rights that can be exercised is 161,700 common shares.

13. Research and Development Expenditures

Research and development expenditures charged to income for the years ended March 31, 2008, 2007 and 2006 amounted to ¥12,942 million (\$129,170 thousand), ¥13,663 and ¥13,971 million, respectively.

14. Income Taxes

The Company and its domestic subsidiaries are subject to a number of taxes based on earnings which, in the aggregate, resulted in an average normal tax rate of approximately 40.4% for the

three years ended March 31, 2008. Overseas subsidiaries are subject to income taxes of the countries in which they operate.

The effective rates for the years ended March 31, 2008, 2007 and 2006 differ from the normal tax rates for the following reasons:

	2008	2007	2006
Normal tax rate	40.4 %	40.4 %	40.4 %
Change in valuation allowance allocated to income tax expenses	1.6	1.5	0.6
Expenses not deductible for tax purposes	1.6	1.4	1.7
Lower tax rates of subsidiaries	(0.2)	(0.4)	(0.7)
Tax credit for research and development expenses	(5.5)	(5.8)	(6.4)
Others	0.3	0.4	0.4
Effective tax rate	38.2 %	37.5 %	36.0 %

The tax effects of temporary differences and tax loss carryforwards that give rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2008 and 2007 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Deferred tax assets:			
Tax loss carryforwards	¥ 6,074	¥ 6,430	\$ 60,628
Retirement and severance benefits	2,487	2,319	24,825
Accrued expenses	1,072	994	10,700
Depreciation and amortization	892	827	8,899
Deferred assets for tax purposes	458	480	4,571
Accrued enterprise taxes	363	316	3,623
Loss on impairment of fixed assets	272	148	2,715
Loss on impairment of golf membership rights	208	208	2,076
Loss on valuation of inventories	84	73	838
Loss on valuation of securities	43	44	429
Other	925	995	9,237
Subtotal	12,878	12,834	128,541
Valuation allowance	(7,674)	(7,907)	(76,592)
Total gross deferred tax assets	5,204	4,927	51,949
Deferred tax liabilities:			
Net unrealized holding gains on securities	(1,551)	(3,532)	(15,480)
Reserve for special depreciation	(131)	(176)	(1,308)
Other	(19)	(20)	(186)
Total gross deferred tax liabilities	(1,701)	(3,728)	(16,974)
Net deferred tax assets	¥ 3,503	¥ 1,199	\$ 34,975

Net deferred tax assets at March 31, 2008 and 2007 are reflected in the accompanying consolidated balance sheets under the following captions:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Current assets – deferred tax assets	¥ 1,699	¥ 1,626	\$ 16,962
Investments and other assets – deferred tax assets	1,822	—	18,190
Noncurrent liabilities – deferred tax liabilities	(18)	(427)	(177)
Net deferred tax assets	¥ 3,503	¥ 1,199	\$ 34,975

15. Contingent Liabilities

At March 31, 2008, the Company has provided guarantees to financial institutions covering employee loans totaling ¥369 million (\$3,682 thousand).

16. Segment Information

The Companies operate predominantly in a single industry segment: the production, sale and marketing of pharmaceuticals.

Intercompany sales between geographic areas are recorded at cost plus a markup and intercompany sales and profits are

eliminated on consolidation. Corporate assets are composed mainly of cash and cash equivalents, short-term investments and investment securities.

Information by geographic area and overseas sales are as follows:

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
Geographic areas:				
Net sales:				
Japan:				
External customers	¥ 92,098	¥ 90,695	¥ 89,882	\$ 919,234
Intersegment	1,978	1,167	986	19,738
Total	94,076	91,862	90,868	938,972
Europe:				
External customers	10,617	9,186	8,156	105,972
Intersegment	2,041	2,028	1,988	20,367
Total	12,658	11,214	10,144	126,339
Other:				
External customers	679	605	360	6,774
Intersegment	2,761	2,611	2,859	27,561
Total	3,440	3,216	3,219	34,335
Corporate and eliminations	(6,780)	(5,806)	(5,833)	(67,666)
Consolidated	¥ 103,394	¥ 100,486	¥ 98,398	\$ 1,031,980

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
Operating income (loss):				
Japan	¥ 22,633	¥ 21,768	¥ 22,623	\$ 225,902
Europe	555	980	951	5,536
Other	(819)	(755)	(708)	(8,179)
Corporate and eliminations	(1,998)	(1,581)	(1,871)	(19,939)
Consolidated	¥ 20,371	¥ 20,412	¥ 20,995	\$ 203,320
Assets:				
Japan	¥ 129,610	¥ 125,822	¥ 127,647	\$ 1,293,641
Europe	10,908	10,635	8,744	108,872
Other	5,745	4,880	5,217	57,344
Corporate and eliminations	10,284	17,762	8,850	102,647
Consolidated	¥ 156,547	¥ 159,099	¥ 150,458	\$ 1,562,504

The main countries included in Europe and Other are as follows:

Europe: Finland, Germany and Sweden

Other: United States of America, China, Korea and Taiwan

As discussed in Note 2, 7), the Company and its domestic subsidiary adopted new depreciation method for the year ended March 31, 2008 for property, plant and equipment acquired after April 1, 2007. The effect of this adoption was to decrease operating income of Japan segment by ¥48 million (\$477 thousand).

As discussed in Note 2, 7), prior to the amendment of the Corporate Tax law, all tangible fixed assets must have a 5% residual value. Subsequent to the amendment of the Corporate Tax Law effective April 1, 2007, Japanese domiciled companies are permitted to fully depreciate tangible fixed assets. Hence the Company and its domestic subsidiary have taken advantage of this amendment and are depreciating the remaining residual of eligible assets over 5 years. The straight line depreciation starts from the next year, when the book value of tangible assets acquired on and before March 31, 2007 reaches 5% of the acquisition cost. As a result, for the year ended March 31, 2008, operating income of Japan segment was down ¥126 million (\$1,259 thousand) each, compared to the previous method.

Overseas sales:

Europe	¥ 8,533	¥ 6,917	¥ 6,089	\$ 85,167
North America	1,951	2,129	1,916	19,478
Asia	4,326	4,247	3,554	43,182
Other	17	41	54	169
Total	¥ 14,827	¥ 13,334	¥ 11,613	\$ 147,996
Consolidated net sales	¥ 103,394	¥ 100,486	¥ 98,398	\$ 1,031,980
Percentage of overseas sales to consolidated net sales	14.3%	13.3%	11.8%	

The main countries included in Europe, North America, Asia and Other are as follows:

Europe: Finland, Russia, Sweden, Germany and Norway

North America: United States of America

Asia: Korea, China, Vietnam and Taiwan

Other: Australia

Overseas sales represent the total amount of export sales of the Company and domestic subsidiaries and sales of overseas subsidiaries (intercompany sales between consolidated subsidiaries are eliminated upon consolidation).

17. Subsequent Event

The Company entered into a R&D collaboration and licensing agreement ("The Agreement") with MacuSight, Inc. on May 30, 2008. The Agreement grants the Company the right to develop and commercialized sirolimus (development code: DE-109) in the Japanese and Asian market. Sirolimus, originally known as rapamycin, is a highly-potent, broad-acting compound that has demonstrated the ability to treat ocular diseases and conditions including wet age related macular degeneration and diabetic macular edema. The Agreement also requires the Company to

make a non-refundable initial payment of \$50,000 thousand toward MacuSight's R&D and clinical development of sirolimus. Additionally, the Company will provide MacuSight with milestone payments and a royalty on future sirolimus sales in Japanese and Asian markets. The initial payment and ancillary expenses, amounting to a total of approximately ¥5,400 million, (\$53,898 thousand) will be recorded as R&D expenditures in selling, general and administrative expenses for the year ended March 31, 2009.

Independent Auditors' Report



To the Board of Directors of
Santen Pharmaceutical Co., Ltd.:

We have audited the accompanying consolidated balance sheets of Santen Pharmaceutical Co., Ltd. and subsidiaries as of March 31, 2008 and 2007, and the related consolidated statements of income, changes in net assets and cash flows ("consolidated financial statements") for each of the years in the three-year period ended March 31, 2008, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall 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 Santen Pharmaceutical Co., Ltd. and subsidiaries as of March 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2008, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following:

As described in Note 17 to the consolidated financial statements, Santen Pharmaceutical Co., Ltd. entered into an R&D collaboration and licencing agreement with MacuSight, Inc. on May 30, 2008.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2008 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 3 to the consolidated financial statements.

KPMG AZSA & Co.

Osaka, Japan
June 25, 2008