SHIONOGI & CO., LTD.

Continually providing the superior medicines essential to people's health

Looking Forward

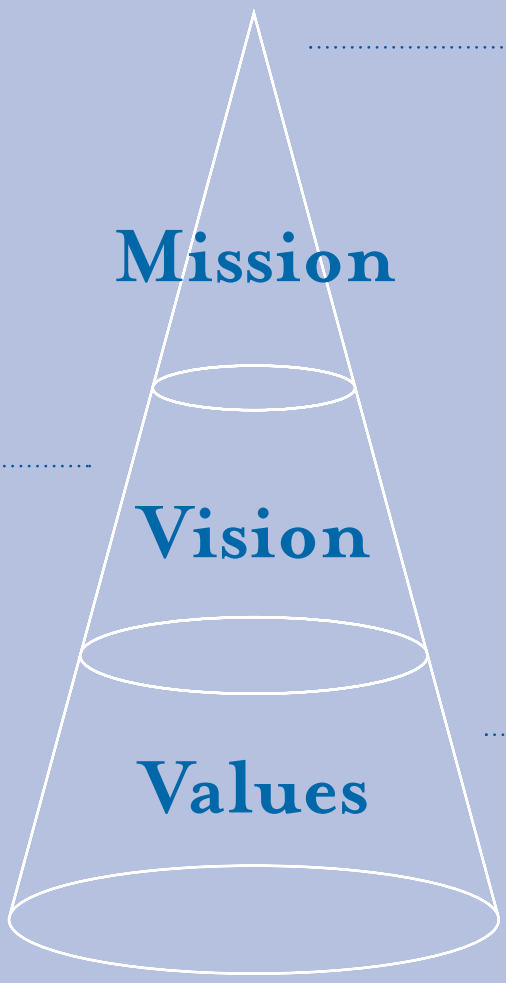
Annual Report 2006

Year ended March 31, 2006

Looking Forw

Shionogi's Purpose

Shionogi strives constantly to provide medicine of the best possible kind essential for protection of the health of the people.



Vision

A company with a strong presence
A company that has pride and dreams and embraces challenges

ard

Mission

We will deliver pharmaceuticals that offer an even higher level of satisfaction to patients, their families and healthcare providers and improve the quality of life for patients and their families.

Values

Customer Focus, Trust, Professionalism,
On-Site Orientation, Respect for Individuals

Contents

Forward-Looking Statements

This annual report contains forward-looking statements regarding the Company's plans, outlook, strategies and results for the future. All forward-looking statements are based on judgments derived from the information available to the Company at the time of publication.

Certain risks and uncertainties could cause the Company's actual results to differ materially from any projections presented in this report. These risks and uncertainties include, but are not limited to, the economic circumstances surrounding the Company's businesses; competitive pressures; related laws and regulations; product development programs; and changes in exchange rates.

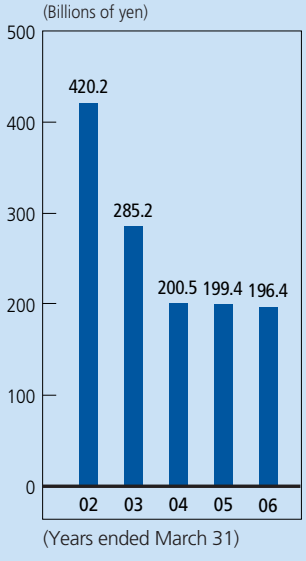
Financial Highlights

Shionogi & Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006, 2005 and 2004

	Millions of yen			Percentage change	Thousands of U.S. dollars
	2006	2005	2004	2006/2005	**2006**
For the years ended March 31:					
Net sales	**¥196,389**	¥199,365	¥200,485	(1.5)%	**$1,671,680**
Operating income	**29,226**	28,729	20,292	1.7	**248,774**
Income before income taxes and minority interests	**38,798**	31,655	5,178	22.6	**330,252**
Net income	**22,735**	18,942	2,204	20.0	**193,522**
Research and development expenses	**32,257**	29,409	29,808	9.7	**274,574**
Capital investments	**5,386**	5,424	4,404	(0.7)	**45,846**
Depreciation and amortization	**8,653**	9,412	9,705	(8.1)	**73,655**
As of March 31:					
Total assets	**¥427,683**	¥396,999	¥376,161	7.7 %	**$3,640,475**
Total shareholders' equity	**337,186**	299,847	292,187	12.5	**2,870,157**
Per share amounts (in yen and U.S. dollars):					
Net income	**¥ 66.55**	¥ 54.64	¥ 6.06	21.8 %	**$0.57**
Net assets	**989.76**	879.79	844.53	12.5	**8.42**
Cash dividends applicable to the year	**16.00**	12.00	8.50	33.3	**0.14**
Return on equity	**7.1 %**	6.4 %	0.8 %	0.7 points	
Number of employees	**4,997**	5,522	5,589	—	

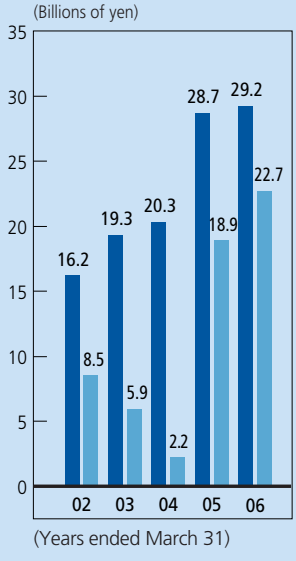
Note: The U.S. dollar figures have been calculated, for convenience only, at the rate of ¥117.48 = US$1, the approximate exchange rate on March 31, 2006.

Net Sales



(Years ended March 31)

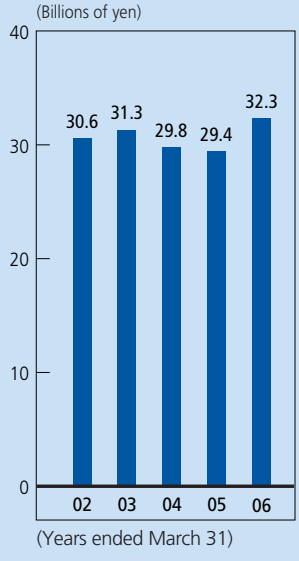
Operating Income / Net Income



(Years ended March 31)

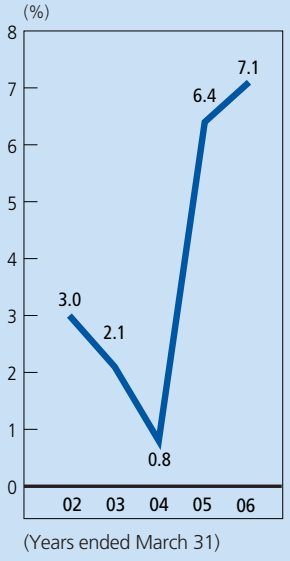
Operating income
Net income

Research and Development Expenses



(Years ended March 31)

Return on Equity



(Years ended March 31)

Second Medium-Term Management Plan
(April 2005-March 2010)

	Year ended March 31, 2006 (Actual)	Year ending March 31, 2010 (Target)
Net sales	¥196.4 billion	¥305 billion
Operating income	¥29.2 billion	¥98 billion
Net income	¥22.7 billion	¥59 billion
Return on equity (ROE)	7.1 %	14 %

Motozo Shiono
President and Representative Director

Under the first five-year medium-term management plan initiated in 2000, Shionogi divested non-core businesses and took other measures to successfully reinforce its management foundation with a focus on prescription drugs. These efforts set the stage for the second medium-term management plan, which started in April 2005 under the banner of "preparing for a significant leap forward."

In the second medium-term management plan, Shionogi has set three primary objectives to build on the foundation it strengthened in the first medium-term management plan:

- Aggressively conduct research and development in targeted areas
- Establish a strong marketing presence
- Steadily develop overseas business, starting in the area of infections

Accordingly, in our three targeted research areas of infections, pain and metabolic syndrome, we will focus resources, conduct discovery and development of original new drugs and work to support their acceptance by the healthcare community. By doing so, we aim to increase our corporate value.

All of these efforts are rooted in Shionogi's corporate mission of "continually providing the superior medicines essential to people's health." Keeping this objective in sight, we will remain true to our origins as a supplier of pharmaceutical products.

As the first year of the second medium-term management plan, fiscal 2005 was crucial in terms of future growth.

Performance in Fiscal 2005

In fiscal 2005, the year ended March 31, 2006, net sales decreased 1.5 percent year-on-year to ¥196.4 billion, operating income increased 1.7 percent to ¥29.2 billion and net income increased 20.0 percent to ¥22.7 billion.

Net sales included ¥167.5 billion in sales of prescription drugs, a year-on-year decrease of 0.3 percent. Although sales of Flomox, OxyContin, Imunace and other products increased compared with the previous fiscal year, sales of core antibiotics were negatively affected by market contraction. Sales of over-the-counter (OTC) drugs increased slightly, while sales of diagnostics decreased marginally. Shionogi sold its capsule business, which was removed from consolidated results as of the second half of the fiscal year. Royalty revenues from licensing fees increased 61.3 percent to ¥9.8 billion due to increased overseas sales of Crestor.

Operating income increased 1.7 percent year-on-year to ¥29.2 billion due to the increase in royalty revenues as well as an improved cost-of-sales ratio resulting from efforts to lower production costs, which offset an increase in research and development expenses. Net income increased 20.0 percent because of an extraordinary gain on the sale of the capsule business.

Progress toward Achieving the Objectives of the Second Medium-Term Management Plan

In fiscal 2006, the year ending March 31, 2007, we expect even more intense competition in the domestic pharmaceutical market. This is attributable to the April 2006 revision of National Health Insurance (NHI) drug prices, the expansion of the Diagnostic Procedure Combination (DPC) system for medical treatment fees and a government policy to promote generic drugs.

In such an environment, Shionogi will work to increase its corporate value by steadily executing measures to achieve the three primary objectives of the second medium-term management plan.

In research activities, we are concentrating resources more clearly on the three targeted research areas of infections, pain and metabolic syndrome, and making organizational changes to facilitate execution of our R&D strategy. At the same time, we are promoting original new drug discovery and development with an awareness of milestones based on a venturesome spirit. We are also carrying out an aggressive alliance strategy. Examples include our agreement with U.S.-based Purdue Pharma L.P. in January 2006 to conduct collaborative research on and co-market novel compounds globally for the treatment of pain, which will enhance our pipeline in this area. We are also creating biopharmaceuticals in collaboration with Professor Nishimura of Hokkaido

University, a world leader in the field of glyco-engineering research.

In overseas development activities, we are currently conducting Phase II clinical trials of S-2367 (obesity) and S-5751 (bronchial asthma) under the management of Shionogi USA, Inc. Doripenem, a carbapenem antibiotic, is being developed by Johnson & Johnson in the United States and Europe, and is currently in Phase III trials.

In Japan, following the recent approvals of Finibax 0.25g IV Solution Kit (carbapenem antibiotic; generic name doripenem hydrate) and Cetrotide (premature ovulation inhibitor; generic name cetrorelix acetate), we expect to acquire approval for immediate-release oxycodone hydrochloride and Claritin dry syrup. In Japan, Phase III clinical trials are proceeding smoothly on duloxetine hydrochloride (depression), irbesartan (antihypertensive) and pirfenidone (treatment for idiopathic interstitial pulmonary fibrosis), and we expect to submit New Drug Applications (NDAs) in fiscal 2006 and 2007.

Clinical trials are also proceeding on schedule for S-013420 (novel macrolide antibiotic) and duloxetine hydrochloride as a treatment for diabetic peripheral neuropathic pain.

In marketing activities, we are working to strengthen our presence in the aforementioned three targeted areas by conducting promotional activities that accurately respond to the needs of healthcare providers.

Last year, Shionogi launched three products that will

New Products Expected to Contribute to Shionogi's Sales Growth

Fiscal 2005

Crestor® Hyperlipidemia	Launched April 2005
Finibax® Carbapenem antibiotic	Launched September 2005
Avelox® New quinolone antibiotic	Launched December 2005

Fiscal 2006 and Beyond

Finibax® 0.25g IV Solution Carbapenem antibiotic	Launched June 2006
Cetrotide® Gonadotropin-releasing hormone antagonist	Approved in April 2006
Oxycodone Immediate Release Formulation Cancer pain	NDA filed May 2004, Passed First Commitee on New Drugs of the Pharmaceutical Affairs and Food Sanitation Council in August 2006
Claritin® Dry Syrup Allergic rhinitis and itch caused by various dermatitis for pediatric use	NDA filed September 2004
Adapalene Acne Vulgaris	NDA filed by Galderma KK June 2006
Irbesartan Hypertension	Phase 3
Pirfenidone Idiopathic interstitial pulmonary fibrosis	Phase 3
Duloxetine Depression	Phase 3
Doripenem Carbapenem antibiotic	Phase 3 studies are conducted by Johnson & Johnson

Fiscal 2009

Consolidated Targets for Fiscal 2009 (Year ending March 31, 2010)

Net sales:	**¥305** billion
Operating income:	**¥98** billion
Net income:	**¥59** billion
ROE:	**14%**

drive future growth: the hyperlipidemia treatment Crestor, the new quinolone antibacterial Avelox and the carbapenem antibiotic Finibax. We plan to concentrate efforts on spreading their use.

Since launching Crestor in April 2005, we have been conducting joint post-marketing surveillance with AstraZeneca K.K. on Japanese patients, based on ICH-E2E guidelines, to enhance domestic safety data. Preliminary analysis of results undertaken recently showed good efficacy and safety that are consistent with overseas findings. These factors have convinced us that Crestor is indeed "the best statin." We fully expect these post-marketing surveillance initiatives to provide solid evidence that contributes to further sales growth.

In the core antibiotics market, Shionogi launched Finibax in September 2005 and Avelox in December 2005. These products are already highly regarded by many specialists as new treatment options. We consider it our mission to spread their use throughout the healthcare community as quickly as possible.

In the area of cancer pain, a new law on cancer treatment implementing palliative care from the early stages of treatment was enacted in June 2006, and it is expected to spur healthcare providers to step up efforts to alleviate pain. Shionogi will aggressively promote dissemination of the cancer pain management methods recommended by the World Health Organization (WHO) toward achieving our goal of complete elimination of pain. We believe this will ultimately lead to expanded sales of oral analgesics OxyContin and MS Contin.

In manufacturing activities, we will expand production facilities at the Kanegasaki Plant, where we plan to conduct contract manufacturing after Johnson & Johnson initiates sales of doripenem in the global market. We are also planning further expansion of contract manufacturing at our subsidiary Bushu Pharmaceuticals Ltd.

Outlook for Fiscal 2006

As a result of the measures outlined above, in fiscal 2006 we project a 6.9 percent year-on-year increase in net sales to ¥210 billion, a 9.5 percent increase in operating income to ¥32 billion and a 20.8 percent decrease in net income to ¥18 billion.

Included in this projection is the assumption that royalty revenues from licensing fees will increase further as a result of overseas expansion of Crestor sales by AstraZeneca plc.

To Our Shareholders and Other Stakeholders

As we continue to face a challenging operating environment, our first priority is achieving the goals of the second medium-term management plan. To do so, we will make aggressive investments for future business growth, including R&D investment in original new drugs as well as in- and out-licensing. Shionogi will constantly work to increase its corporate value by developing, manufacturing and selling superior medicines that serve people's health needs and provide an even higher level of satisfaction to patients, their families and healthcare providers.

We are committed to maintaining steady dividends to our shareholders over the long term, taking into account performance trends in each fiscal year. I ask for the continuing trust and support of shareholders and all our stakeholders as we work to meet your expectations.

July 2006

Motozo Shiono
President and Representative Director

Research and Development

Isao Teshirogi, Ph.D.

Senior Executive Officer,
Executive General Manager,
Pharmaceutical Research &
Development Division

Achievements in the First Year of the Second Medium-Term Management Plan

In fiscal 2005, the first year of the second medium-term management plan, Shionogi effectively allocated resources in its targeted research areas and implemented bold reforms to meet plan objectives. The Company has designated infections, pain and metabolic syndrome as its three targeted research areas and subsequently established a future-oriented frontier research area. Organizationally, Shionogi implemented reforms to establish a therapeutic area-based framework in both research and development, with the three target areas and the frontier research area as the core. In conjunction with these reforms, the Company established the Therapeutic Area Conference (TAC) to horizontally link research, development, manufacturing and marketing in each targeted research area, as well as the Product Strategy Conference, which is in charge of strategic functions as a senior organization to TAC and serves as a venue for creative discussion.

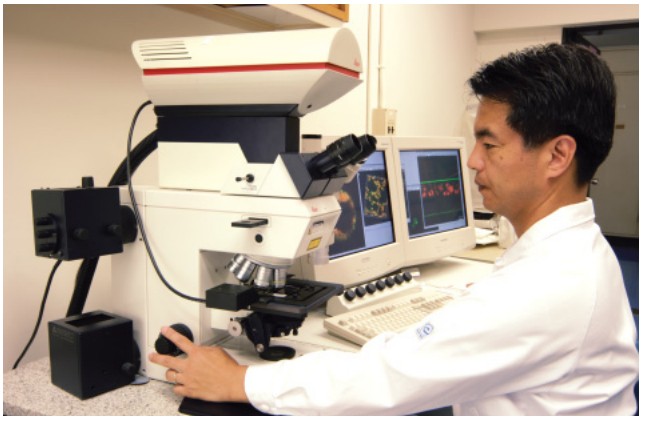
In this way, the Pharmaceutical Research and Development Division made effective use of research, development, manufacturing and marketing resources while conducting activities as the core of a company-wide, comprehensive pharmaceutical development framework encompassing product portfolio evaluation and performance monitoring based on strategies for each targeted research area. Results of these efforts in the first year of the second medium-term management plan were as follows.

In research activities, Shionogi worked to expedite acquisition of Proof of Concept (POC) by developing strict standards for moving forward from the drug discovery stage in order to improve the quality of development candidate selection. At the same time, it worked to maximize drug discovery output by using milestone management to improve allocation of drug discovery resources. The Company enhanced its in-house research program, primarily in the three targeted research areas, while proactively conducting collaborative research with external research institutions. Through these activities, Shionogi selected four compounds at the drug discovery stage as development candidates for clinical trials. It also advanced one candidate compound to the clinical research stage.

In the area of infections, Shionogi commenced clinical trials on S-364735 (antiviral agent), and advanced an injectable

Strategic Alliances for Joint Research

Research Field	Research Partner
Toxicogenomics	National Institute of Health Science of the Ministry of Health, Labour and Welfare
Glycoprotein synthesis	Nishimura Project (Hokkaido University)
Drug discovery	Kyoto University's Biosimulation Project
Osteoarthritis	Quark Biotech, Inc. (U.S.A.)
Cancer (lung, prostate, breast)	OncoTherapy Science, Inc.
Diabetic nephropathy	RIKEN Genomic Sciences Center
Drug discovery	Japan Health Science Foundation's Drug Discovery Proteome Factory Consortium
Pain	Purdue Pharma L.P. (U.S.A.)



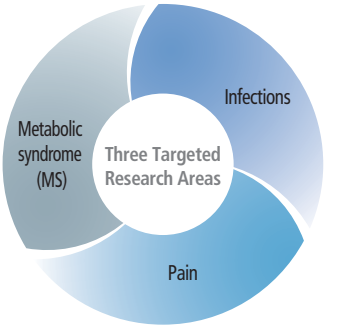
State-of-the-art laser microscope analysis equipment

broad-spectrum cephem antibiotic to the development candidate stage. In the area of pain, Shionogi began collaborative research targeting receptors that modulate pain and neural pathways under an agreement with U.S.-based Purdue Pharma L.P. Through in-house research, the Company also successfully created a candidate compound that relieves nausea and other side effects of opioids. In the area of metabolic syndrome, Shionogi added to its expertise in developing glycoconjugate-based glycoprotein synthesis technology through joint research with Professor Shinichiro Nishimura of Hokkaido University. Shionogi is expediting research on diabetes treatments using a jointly developed automated carbohydrate synthesizer to develop glycoconjugate-based pharmaceuticals. In the area of frontier research, the Company selected a candidate compound with a novel mechanism of action that relieves itchiness. It is therefore expected to be effective in treating eczema and dermatitis.

For the technology platform that supports drug discovery in every field, Shionogi enhanced its basic research to speed up verification of target molecules, measurement of efficacy markers and other aspects of drug discovery. These efforts included ongoing participation in toxicogenomic research under the National Institute of Health Sciences of the Ministry of Health, Labour and Welfare; in the Japan Health Science Foundation's Innovative Drug Proteome Factory Project Consortium; and in Kyoto University's Biosimulation Project. In addition, Shionogi in-licensed new technology for producing phage antibodies from the German company MorphoSys AG. Shionogi has also made significant advances in new target gene drug discovery through collaborative research with organizations such as U.S.-based Quark Biotech, Inc. (osteoarthritis), OncoTherapy Science, Inc. (lung cancer, prostate cancer and breast cancer) and RIKEN Genomic Sciences Center (diabetic nephropathy).

In development activities, Shionogi continued working to build a management structure that promotes global development and to raise productivity. In Japan, Shionogi established a new management function in the Clinical Research Department to oversee outsourcing of clinical testing. This enhanced support for monitors and increased efficiency, enabling Shionogi to implement clinical testing on schedule. In global development, Shionogi enhanced the management framework of Shionogi USA, Inc. and upgraded its infrastructure to increase the efficiency of application processing and clinical testing. Based on the introduction of the targeted research system and infrastructure upgrades, Shionogi aggressively conducted Phase II clinical trials of two global strategic development products in the United States and Europe in close collaboration with Shionogi USA. In Japan, three products that are currently in Phase III clinical trials are proceeding on schedule.

As a result of the above development activities, in Japan Shionogi launched Crestor (hyperlipidemia treatment) and Finibax and Avelox (both antibacterials), and acquired approval for Cetrotide (premature ovulation inhibitor). Aiming for NDA submission in 2006 or 2007, the Company continued Phase III clinical trials for irbesartan (antihypertensive), pirfenidone (treatment for idiopathic interstitial pulmonary fibrosis), and duloxetine hydrochloride (depression). Shionogi also advanced S-013420 (novel macrolide antibiotic), which was licensed from Enanta Pharmaceuticals, Inc. of the United States, to Phase II clinical trials. Overseas, S-5751 (bronchial



asthma) and S-2367 (obesity) are currently in Phase II (POC) clinical trials. S-2367, for which an early launch is expected due to high demand, proved to be effective and safe in POC clinical trials. For the first time in the world, clinical trials proved that this antagonist, which acts on the neuropeptide Y Y5 receptor, is effective in treating obesity. This marks a new phase in Shionogi's global research and development activities.

From the perspective of strategic product life cycle management, Shionogi vigorously conducted clinical testing to add indications. Phase II clinical trials are under way for duloxetine hydrochloride as a treatment for diabetic peripheral neuropathic pain, and a controlled-release injectable dosage form of Cetrotide (cetrorelix pamoate) to treat benign prostatic hypertrophy. In addition, Shionogi has filed NDAs for an additional indication of pediatric use for Claritin in a dry syrup formulation developed by Shionogi and an immediate-release formulation of oxycodone hydrochloride, and recently received approval for Finibax 0.25g IV Solution Kit.

In licensing activities, in addition to conducting collaborative research with Purdue Pharma, Shionogi executed a sales and marketing alliance with the French company Galderma S.A. for Adapalene (topical treatment of acne vulgaris). Galderma submitted an NDA for Adapalene in June 2006.

In parallel with these R&D activities, the Pharmaceutical Research and Development Division places importance on developing its human resources, which are the source of Shionogi's value. As the first step of the second medium-term management plan, the Division conducted a thorough review of its human resource development plan. Coordinating its plan with the Company's overall human resource development plan, the Division expedited the establishment of a program to develop next-generation leaders. The outcome was an extensive training menu that forms the basis of development plans in which many employees in R&D are currently participating.

In these ways, Shionogi's Pharmaceutical Research and Development Division made steady progress in the first year of the second medium-term management plan, based on measures that balanced strategy and organization.

Commitment to Achieving the Second Medium-Term Management Plan

The goal of Shionogi's research activities is to aggressively maintain a continuous supply of new drug candidates for development. Based on this bold, venturesome spirit, Shionogi has set medium- and short-term goals toward achieving the second medium-term management plan, as well as challenging long-term goals for the period beyond the plan.

Milestones to be achieved in fiscal 2006 under the second medium-term management plan include advancing three of the four candidate compounds to the clinical trial stage within the fiscal year and advancing at least four compounds in the late discovery stages to the candidate compound stage by the end of the fiscal year.

As a long-term challenge, Shionogi aims to generate high-quality candidate compounds by focusing on enhancing its technology platform and licensing new technologies while applying strict program selection that employs target validation when moving from the early target identification period to later discovery program stages. In other words, Shionogi aims to generate new drugs in rapid succession on a global scale by conducting collaborative research with external research organizations, primarily in the three targeted research areas and the frontier research area.

In development activities, Shionogi is working to meet the following goals in target areas and other key fields.

In the area of infections, since the start of fiscal 2006

Shionogi created doripenem (Finibax) and developed it in Japan. Shionogi has also licensed it to U.S. firm Peninsula Pharmaceuticals, Inc. (now a subsidiary of Johnson & Johnson) to make effective use of its assets and expand its international presence.

Finibax®

Carbapenem antibiotic

- **Launched:** September 2005
- **Origin:** Shionogi

A rotary evaporator is used to safely remove the solution from a chemical compound dissolved in it, leaving only the compound.

Shionogi has launched Finibax 0.25g IV Solution Kit, following on the launch of Finibax and Avelox in fiscal 2005. The novel macrolide antibiotic S-013420 is currently in Phase IIa clinical trials and is expected to advance to Phase IIb trials during fiscal 2006. Shionogi is also developing an injectable wide-spectrum cephem antibiotic, aiming for clinical trials within the current fiscal year as well. Plans are also set to advance S-364735, an HIV integrase inhibitor that commenced Phase I trials in March, to Phase IIa during the same period.

In the area of pain, during fiscal 2006 Shionogi plans to launch immediate-release oxycodone hydrochloride, for which an NDA has been filed, and expects to receive the results of Phase IIa clinical testing of the new indication of duloxetine hydrochloride as a treatment for diabetic peripheral neuropathic pain.

In the area of metabolic syndrome, everyone at Shionogi is working together to maximize the value of Crestor. The Pharmaceutical Research and Development Division is also making a concerted effort through a cooperative framework centered on the TAC. During fiscal 2006, Shionogi plans to submit an NDA for irbesartan, an angiotensin II receptor antagonist for treatment of hypertension. It also plans to concentrate efforts on testing toward developing the obesity treatment S-2367 for the U.S. and European markets by accelerating the schedule for Phase IIb clinical trials in the United States based on the evidence of its effectiveness in POC clinical trials.

In the area of frontier research, in fiscal 2006 Shionogi plans to launch Claritin for pediatric use (with a new dry syrup formulation) and submit an NDA for pirfenidone, a treatment for idiopathic interstitial pulmonary fibrosis, which is currently proceeding smoothly through Phase III trials. The bronchial asthma treatment S-5751, which is currently undergoing clinical testing overseas, moved to Phase IIa in fiscal 2005. Shionogi plans to consider advancing it to Phase IIb in the second half of fiscal 2006. In addition, the Company is concentrating efforts aimed at bringing an antipruritic agent with a new mechanism of action developed in-house to the clinical testing stage during the current fiscal year. Shionogi's aim is to further expand its presence in the field of dermatology, which has already been established by Rinderon and Claritin.

Other key products include the premature ovulation inhibitor Cetrotide, which received marketing approval in April 2006 and which Shionogi plans to launch in September, and Adapalene, for which the licensor submitted an NDA in June 2006, as previously mentioned. Cetrorelix pamoate, code number NS75B, is scheduled to begin Phase IIa clinical trials as a treatment for benign prostatic hypertrophy during fiscal 2006 as well. The antidepressant duloxetine hydrochloride is currently in Phase III clinical trials, and Shionogi plans to submit an NDA during fiscal 2007.

Toward Sustainable Growth

Through its research and development activities, Shionogi aims to develop safe, original ethical drugs under a corporate mission of "continually providing the superior medicines essential to people's health." Through close collaboration with other divisions and effective use of limited management resources, the Pharmaceutical Research and Development Division will continue working to fulfill its goal of continually developing new drugs. By doing so, it will enable the Company to survive in an increasingly competitive global business environment and to continue creating and providing ethical drugs that contribute to the health of people around the world. Based on this concept, Shionogi's Pharmaceutical Research and Development Division will work to achieve overall Company strategies under the second medium-term management plan and expedite measures focused on global development.

Overview of Intellectual Property

Patent Application Strategy and Status

A single patent in the pharmaceutical industry affects a

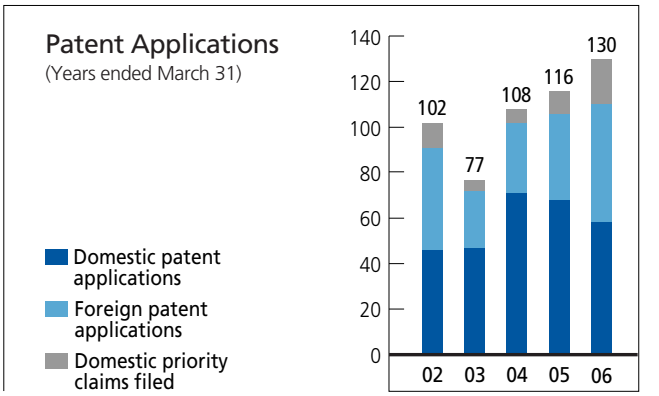
company's ability to compete and is extremely valuable compared to patents in other industries. Shionogi's patent application strategy entails first gaining an accurate awareness of other companies' patent applications in regard to promising drug discovery targets selected in the research process. Shionogi then focuses on efficiently acquiring strong, comprehensive patents for broad classes of compounds among the drug creation targets that demonstrate an activity. As part of efforts to strengthen protection of its own products, Shionogi carefully considers ways to extend the life cycle of products after their launches, and also aggressively acquires patents in areas including production processes, intermediates, uses (e.g., additional indications), formulations and crystalline structures. At the same time, Shionogi extends the life of the patents the Company holds for the maximum period allowed by the patent systems of various countries.

To implement this strategy, Shionogi works to educate researchers according to their level in order to raise their awareness of intellectual property; to identify inventions at early stages of research through the participation of Intellectual Property personnel in cross-functional teams that span internal and external organizations, including collaborative research between private corporations and educational institutions; and to search prior arts in a trustworthy manner. As a result, Shionogi has facilitated efficient patent applications (130 patent applications in fiscal 2005, 40 percent of which were filed overseas).

Patent Portfolio Management

Shionogi responds to changes in research and development and operating strategy, and periodically reviews its portfolio of patents on products and on products under development to optimize the patents the Company holds. As of the end of fiscal 2005, Shionogi held approximately 240 patents in Japan and a family of approximately 300 patents overseas. Income from licensing patents during fiscal 2005 totaled approximately ¥9.8 billion, an increase of about 60 percent compared with income of approximately ¥6.1 billion in fiscal 2004.

In 2006, Shionogi won the Japan Patent Office Commissioner's "Intellectual Property Award of Distinction." Reasons cited for the award include the highest rate of patents granted in the pharmaceutical product industry; the Company's enhancement of the linkage between R&D strategy and intellectual property strategy by reorganizing the Intellectual Property Department, formerly a separate head office function, within the Pharmaceutical Research and Development Division; its active disclosure of the intellectual property portfolio to the Company's management through measures such as placing the focus of intellectual property strategy decisions on the officers in charge of intellectual property and convening an intellectual property evaluation committee to strictly review and decide the necessity of patent examination and renewal requests; and its vigorous efforts to educate employees about intellectual property.



Management of Trade Secrets

Advances in information technology in recent years have increased the importance of managing intellectual assets, especially for trade secrets of companies engaged in manufacturing. Shionogi works to educate its employees about information security and prevent information outflow in situations such as when employees leave the Company for other employment or retire.

Invention Reward System

Since 1988, Shionogi has implemented an internal invention reward system to create fertile ground for new breakthrough drugs by enhancing the motivation of its researchers and engineers to conduct creative research and technology development, in compliance with Article 35 of the Japanese Patent Law. In fiscal 2005, Crestor® fulfilled the conditions of the performance-based bonus system that the Company introduced in 2001. Based on this, in 2006 Shionogi will pay the inventors a maximum of 0.05 percent of fiscal 2005 worldwide product sales, including licensee's sales.

Status of Products under Development

Stage	Code No./Generic Name	Indication/Category	Origin/Status
In Japan			
Approved	► NS75A (Cetrorelix acetate)	Gonadotropin releasing hormone antagonist - injection [Prevention of premature ovulation during a controlled ovarian stimulation followed by assisted reproductive technology (ART)]	Co-developed with Nippon Kayaku Co., Ltd.; Licensed from Zentaris AG (Germany)
Application filed	► S-8116 (Oxycodone hydrochloride)	Immediate-release oxycodone - oral [Cancer pain]	Licensed from Mundipharma AG (Netherlands)
	► SCH29851 (Loratadine)	Histamine H_1 receptor antagonist - oral [Additional indication: pediatric use (allergic rhinitis and itch caused by various types of dermatitis)]	Co-developed with Schering-Plough K.K.; Licensed from Schering-Plough Corp. (U.S.)
Phase III	► SR47436 (Irbesartan)	Angiotensin II receptor antagonist - oral [Hypertension]	Co-developed with Bristol Pharmaceuticals K.K.; Licensed from Sanofi-Aventis SA (France)
	► LY248686 (Duloxetine hydrochloride)	SNRI (serotonin & norepinephrine reuptake inhibitor - oral) [Depression]	Licensed from Eli Lilly and Co. (U.S.)
	► S-7701 (Pirfenidone)	Anti-fibrosis - oral [Idiopathic interstitial pulmonary fibrosis]	Licensed from Marnac, Inc. (U.S.)
Phase II	► NS75A (Cetrorelix acetate)	Gonadotropin releasing hormone antagonist - injection [Uterine myoma]	Co-developed with Nippon Kayaku Co., Ltd.; Licensed from Zentaris AG (Germany)
	► LY248686 (Duloxetine hydrochloride)	SNRI (serotonin & norepinephrine reuptake inhibitor) - oral	Licensed from Eli Lilly and Company (U.S.) [Diabetic peripheral neuropathic pain]
	► S-013420	Novel macrolide antibiotic - oral [Bacterial infection]	Licensed from Enanta Pharmaceuticals, Inc. (U.S.)
Phase I/II	► NS75B (Cetrorelix pamoate)	Gonadotropin releasing hormone antagonist - injection [Benign prostatic hypertrophy]	Co-developed with Nippon Kayaku Co., Ltd. Licensed from Zentaris AG (Germany)
Phase I (including Phase I preparation)	► S-777469	Antipruritic agent - oral [Pruritus with atopic dermatitis]	Created in-house
	► S-0373	Non-peptide mimetic of TRH - oral [Spinocerebellar ataxia, Parkinson's disease]	Created in-house
Outside Japan			
	► S-5751	Prostaglandin D2 receptor antagonist - oral [Bronchial asthma]	Created in-house Japan: Phase I, / U.S./Europe: Phase II
	► S-2367	Neuropeptide y y5 receptor antagonist - oral [Obesity]	Created in-house U.S.: Phase II
	► S-0139	Endothelin A receptor antagonist - injection [Cerebrovascular diseases]	Japan: Phase IIa, Europe: Phase I
Shionogi-GSK			
	► S-364735	HIV integrase inhibitor - oral [HIV infection]	U.S.: Phase I
Out-Licensing Activity			
Licensed to Peninsula Pharmaceuticals, Inc. (U.S.) (Johnson & Johnson (U.S.) merged PPI in June 2005)	S-4661 (Doripenem hydrate)	Carbapenem antibiotic - injection [Bacterial infection]	Phase III
In-Licensed Drug without Development By Shionogi			
Galderma S.A.	Adapalene gel	Retinoic acid nuclear receptor agonist-topical [Aene vulgaris]	NDA submission

► **In-House** ► **Licensed** ► **Licensed & Co-Developed**

(As of July 2006)

Marketing

Takuo Fukuda

Executive Officer,
Executive General Manager,
Human Health Care Division

Achievements in the First Year of the Second Medium-Term Plan

In fiscal 2005, the first year of the second medium-term management plan, Shionogi's Human Heath Care Division increased market share of Flomox, OxyContin and other products through focused resource allocations in the three targeted areas of infections, pain and metabolic syndrome. Overall sales of prescription drugs declined slightly, however, due to contraction of the market for antibiotics, a core product line.

In the area of infections, Shionogi launched the injectable carbapenem antibiotic Finibax in September 2005 and the new quinolone antibacterial Avelox in December 2005. These two products truly satisfy the needs of the current healthcare environment and patients. Finibax has a better product profile than existing carbapenem products on the market and its lower cost helps counter rising medical expenses. Avelox is acknowledged as having high clinical efficacy as a respiratory quinolone, and contributes to patient compliance because it is a once-daily dose. Market share of these products is expanding steadily due to their inherent advantages and concentrated resource allocations.

In the area of pain, sales of core product OxyContin grew steadily. However, Shionogi is aware that it is only halfway toward achieving its goal of complete elimination of pain. The Company intends to continue actively providing healthcare professionals with detailed information while working to raise awareness and understanding among cancer patients, their families and other people outside the healthcare profession of the possibility of complete relief from cancer pain for all patients.

Fiscal 2005 was a key year for expanding the Company's presence in the area of metabolic syndrome. Shionogi conducted extensive post-marketing surveillance to confirm the safety and efficacy of Crestor for use by Japanese patients to compile evidence and establish trust for this product as quickly as possible. As a result of these efforts, the Company expects Crestor to be available for use by most hyperlipidemic patients in Japan at the end of September 2006.

Working toward the Goals of the Second Medium-Term Management Plan

Establishing a Strong Marketing Presence

In the first medium-term plan, Shionogi implemented measures to further expand its presence in the area of infections. In the second medium-term management plan,

Avelox Tablet, a respiratory quinolone, was developed by Bayer HealthCare AG. It has demonstrated an excellent antibacterial effect on all the major bacterial causes of respiratory tract infections. First approved in 1999 in Europe and the United States, Avelox has been used to date to treat more than 40 million patients in 85 countries over its full range of indications.

Avelox®

New quinolone antibacterial

- **Launched:** December 2005
- **Origin:** Bayer Yakuhin, Ltd.
- **Fiscal 2005 sales:** ¥1.8 billion

Shionogi is committed to an objective of establishing a stronger marketing presence in the areas of pain and metabolic syndrome toward achieving its ultimate goal of freedom from infections, pain and cardiovascular events. Shionogi believes that the new products it expects to launch during the period of the plan will be effective in achieving this objective.

In the area of infections, the launches of Finibax and Avelox strengthened the product lineup, which now includes the injectable antibiotics Flumarin, Broact, Finibax and Vancomycin and oral antibiotics Flomox and Avelox. This will enable Shionogi to provide even more detailed information tailored to the specific characteristics of patients' infections, such as bacterial strain, infected region and immunity level. Shionogi aims to further strengthen its product lineup to increase its presence in this area.

In the area of pain, Shionogi has filed an application for an immediate-release formulation of oxycodone hydrochloride. The addition of this product to controlled-release OxyContin and MS Contin will further increase the Company's contribution to the treatment of cancer-related pain. Shionogi MRs will work to establish the Company's presence in this area by conducting extensive information activities focused on total pain relief for cancer patients.

In the area of metabolic syndrome, Shionogi plans to increase its presence by concentrating efforts on the prevention of cardiovascular events, with a focus on the hyperlipidemia treatment Crestor as well as products such as Longes, Landel and the angiotensin receptor blocker (ARB) irbesartan, which is currently under development. As part of these efforts, Shionogi is conducting JATOS, a large-scale clinical study on the relationship between blood pressure and the frequency of complications in elderly patients. Results are expected during fiscal 2006. The findings of this study will form the basis for the creation of new guidelines on the future treatment of high blood pressure in elderly patients. Shionogi is working to maximize Crestor's future value in Japan by analyzing and evaluating post-marketing surveillance data to establish evidence of its efficacy and safety for use by Japanese patients. In collaboration with its diagnostics operations, Shionogi & Co., Ltd. also intends to contribute to society from the standpoint of diagnosis, prevention and treatment of metabolic syndrome. Efforts will focus on expanding the market for Precision Xceed, a blood glucose monitor, and SHIONOSPOT, a rapid BNP test.

Shionogi is increasing its staff of medical representatives (MRs) while improving their knowledge and skills to better meet the needs of doctors and healthcare facilities.

Increasing the number of MRs will be crucial to maximizing Shionogi's presence in these three areas. Shionogi plans to shift from the current level of 1,350 MRs to an organization of 1,500 MRs in the near future. More than merely increasing the number of MRs, Shionogi will improve their knowledge of products as well as peripheral knowledge and information throughput skills in response to changes in the healthcare system so that MRs can meet the needs of the healthcare facilities and doctors they serve. Toward that end, Shionogi is simultaneously enhancing sales support by creating an organization-wide sales support system and reinforcing MR training to ensure a focus on current healthcare needs.

Shionogi will supplement these efforts with an aggressive alliance and in-licensing strategy to fill gaps in its development and sales pipelines and further expand its sales portfolio. Based on these measures, Shionogi will work to achieve net sales of ¥305 billion in fiscal 2009.

Manufacturing

Ryuichi Kume, Ph.D.

Executive Officer,
Executive General Manager,
Manufacturing Division

In the Manufacturing Division, Shionogi's second medium-term management plan focuses on "working to maintain competitiveness and reducing risks in order to overcome environmental changes and ensure Shionogi's future success." To accomplish this, the Manufacturing Division is working to achieve the following goals as quickly as possible:

- Attain a high level of manufacturing technology
- Promote the shift of manufacturing expenses to variable costs while continuing to retain manufacturing technology; and
- Establish a system to enable a spin-off into a solutions-based contracting company.

To attain a high level of manufacturing technology, Shionogi is conducting product development with product lifecycle management in mind, and promoting contract manufacturing through development of new manufacturing technologies and strong technological capabilities. For the second goal, Shionogi is promoting the shift of manufacturing expenses to variable costs while building a production system that allows Shionogi to retain its manufacturing technologies and structurally improve quality control and cost reduction management as a contract giver. For the third goal, Shionogi will conduct contract manufacturing, which will improve its capacity utilization rate and manufacturing technology strengths, as well as further reduce costs. Contract manufacturing is currently under way at consolidated subsidiaries Bushu Pharmaceuticals Ltd. and Nichia Pharmaceutical Industries Ltd. Based on the manufacturing and quality management functions of these two companies, Shionogi will consider using its strengths in production technology development to provide support as packaged total solutions.

In the area of manufacturing technology, Shionogi aims to contribute to global pharmaceutical development and manufacturing through a high level of technological strength. Shionogi will handle integrated end-to-end projects from the initial stages of development to commercial production. In addition, Shionogi is building a Chemistry, Manufacturing and Control (CMC) system that is globally competitive in terms of quality, cost and development.

Our Manufacturing Motto: SQDCE (Safety, Quality, Delivery, Cost, Environment)

Day-to-day activities are conducted by combining technology, people, materials and equipment to

S (Safety): Secure the safety of people, materials and equipment,
Q (Quality): Manufacture high-quality products with a sophisticated quality management system,
D (Delivery): Bring new products to market on the expected launch day without delay, in addition to safely supplying existing products,
C (Cost): Work to reduce costs through reduction of raw material costs and process improvements, and
E (Environment): Promote waste reduction and ISO 14001.

In fiscal 2005, Shionogi commenced production aligned with the start of sales of Finibax (doripenem hydrate), a product developed in-house, which it began supplying to the market without delay on the launch day. Shionogi is also continuing preparations to supply this product to overseas markets. For other upcoming new products, Shionogi is making ongoing supply preparations at the Kanegasaki Plant and Settsu Plant. In addition, with the revision of the Pharmaceutical Affairs Law, Shionogi has begun improving the efficiency of its manufacturing system by switching from partial to full outsourcing of the production processes for some products. Shionogi is also making an ongoing effort to reduce inventories through supply chain management. These initiatives made a substantial contribution to reducing the cost of sales ratio to 35.0 percent in fiscal 2005 from 37.2 percent in the previous year.

Shionogi is confident that by attaining the goals described above, its manufacturing operations will contribute to the achievement of the targets of the second medium-term management plan and the Company's further growth.

Robotic equipment seals cartons in a high-speed tablet and capsule filling and press-through packaging (PTP) line.

Corporate Governance

Sachio Tokaji

Corporate Officer, Corporate Business Management Executive and General Manager, Accounting & Financial Department

Yasuhiro Mino

Corporate Officer, Corporate Strategic Planning Executive and General Manager, Corporate Planning Department

In line with its corporate mission, Shionogi recognizes that it has a social mission to continually discover, develop and provide effective, safe medicines. Shionogi is also aware that continually fulfilling this social mission will lead to high corporate value, and has therefore given first priority to carrying out sound, transparent management through the corporate governance framework it has established.

Organizational Entities within the Company

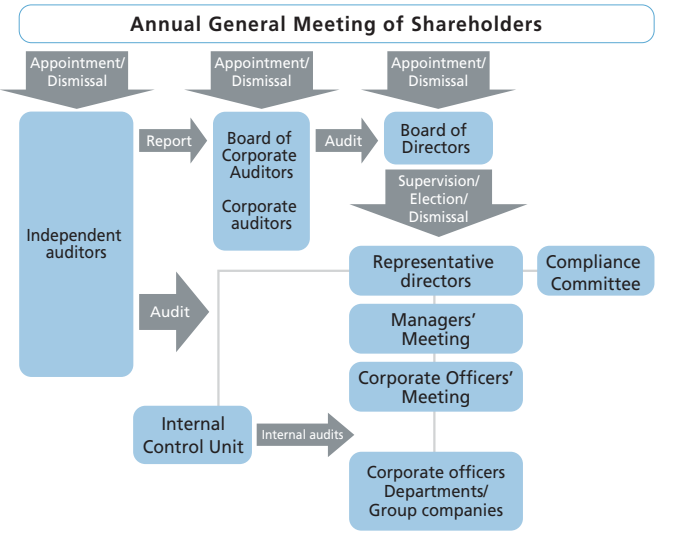
Shionogi has adopted a corporate auditor system, with a Board of Directors, a Board of Auditors and independent auditors. The Company has also introduced a corporate officer system to ensure timely response to changes in the business environment and agile, flexible operations. To deliberate over matters of business execution, Shionogi has established the Managers' Meeting and the Corporate Officers' Meeting, which convene every week as a general rule. The Corporate Officers' Meeting is a forum for discussing and resolving matters of business execution, while the role of the Managers' Meeting is to receive reports from the Corporate Officers' Meeting and provide a higher level of discussion on important matters.

The Board of Directors meets on a monthly basis, in principle, to make decisions on matters affecting management and to supervise business execution. Business is executed in a framework consisting of three major divisions, three executives and two other business divisions, and the responsibilities and authority of the head of each has been set out in the Operational Authority Code. The major divisions are the Pharmaceutical Research & Development Division, which is involved in research and development; the Manufacturing Division, which handles manufacturing; and the Human Health Care Division, which deals with the provision of product information. The executives are the Marketing Executive, which is in charge of product quality assurance and drug safety; the Corporate Strategic Planning Executive, which oversees corporate planning and strategic functions; and the Corporate Business Management Executive, which looks after business management. The other business divisions are the Diagnostics Department and the Consumer Health Care Business Division.

To ensure the legality and propriety of the business practices of directors and the executive organization outlined above, corporate auditors and the Internal Control Unit, which has internal auditing functions, audit the status of business execution on an as needed basis and exchange views with representative directors to develop a framework of necessary measures. The Company has two full-time and two outside corporate auditors. They attend meetings of the Board of Directors, management meetings and other important meetings, offering opinions when necessary. They also check the legality and propriety of directors and corporate officers' activities through work and accounting audits in accordance with corporate auditing standards. In addition, corporate auditors deal with the Company's independent auditors, receiving and discussing accounting audits, and in other ways. Similarly, the Internal Control Unit regularly submits internal audit reports to corporate auditors for review and discussion.

Status of Internal Control System Improvements

Shionogi recognizes that building an internal control system is vital in promoting transparent and honest management. The Company is improving its system with a primary focus on ensuring all internal organizations and employees comply with the law,



conduct proper and efficient business operations and maintain credible financial reporting. Under this improved system, Shionogi will conduct business activities in line with its management strategies and business objectives while disclosing details of its business operations in an appropriate and timely manner.

Compliance

As a company involved in life science, Shionogi places great importance on compliance in all its operations. To improve its internal control system, the Company considers control environment, risk management, control activities, information & communication and supervision to be vital elements. Improvements include the following.

- The Company established the Shionogi Charter of Behavior and Shionogi Behavior Guidelines, and is working to raise awareness among all officers and employees in order to foster corporate culture and implement the Company's unshakeable corporate mission
- As part of its compliance system, the Company established the Compliance Committee under the direct jurisdiction of the representative directors to distribute the Compliance Handbook to all company officers and employees, ingrain awareness of compliance and conduct supervisory activities. As a measure to enhance supervisory activities, Shionogi introduced and is currently operating an internal whistle-blowing system that can be accessed from outside the Company.

Risk Management

- To deal with the various risks connected with business planning and execution, Shionogi has established a framework in which divisions in main organizations respond appropriately and in a coordinated fashion, and regularly report matters to the Managers' Meeting, which is composed of directors, for deliberation. Based on Managers' Meeting discussions and other matters, directors give directions regarding risk management as required.
- The Office of the Compliance Committee (Legal Affairs Department) provides administrative support with regard to compliance risks throughout the company.
- As part of its information management system, Shionogi has established an information security policy and a privacy policy, and is working to ensure the security of company secrets and personal information, and the reliability of information, in accordance with information management and personal information protection rules and regulations.

Compensation of Directors and Corporate Auditors

In fiscal 2005, total compensation paid to directors and corporate auditors was as follows.

Directors	¥182 million
Corporate auditors	¥58 million

Social Contribution and Support

Shionogi, its employees and the employee labor union together have established the Shionogi Social Contribution and Support Association to support activities that contribute to society. In fiscal 2005, the association continued to contribute to the Japan Red Cross Society, UNICEF Japan and other organizations. In addition, in September it provided funds to help with relief work in the aftermath of Hurricane Katrina in the United States, and in October for the Kashmir earthquake in northern Pakistan. Shionogi also contributes to the development of healthcare through monetary donations to many health care associations, and provides medical supplies and funds for numerous medical support activities conducted by various organizations in Japan and elsewhere.

Shionogi's plants and branch offices also interact with their local communities in ways such as conducting neighborhood cleanup campaigns, contributing to local events and actively participating in joint solicitation of donations for various causes. As part of the Company's efforts to create an environment that facilitates individual employee contributions to society, Shionogi has also introduced a system under which employees can take paid leave to participate in volunteer activities.

Environmental Preservation Activities

As stated in its Basic Environmental Policy, the Shionogi Group is keenly aware that "a company is also a member of society. As such, the Group will contribute to building a richer society by placing priority on environmental protection, pollution prevention and human safety in its pharmaceutical and related business activities." Shionogi sets environmental action targets and conducts environmental preservation activities in conformity with this policy. The Group is continuously reducing its impact on the environment in areas such as volume of waste generated and greenhouse gas emissions.

ISO 14001 Acquisition and Environment Audits

All domestic manufacturing and research facilities and subsidiaries in the Shionogi Group acquired ISO 14001 certification of their environmental management systems in fiscal 2001 and continue to undergo independent audits to maintain certification. In addition, Shionogi conducts environmental audits at both domestic and overseas Group companies, with a focus on manufacturing and research sites, to ascertain matters such as compliance with environmental laws and regulations and progress in reducing environmental impact.

For more details on Shionogi's environmental activities, please visit the Shionogi website at http://www.shionogi.co.jp/

Members of the Board, Corporate Auditors and Corporate Officers

(As of June 29, 2006)

Kiyoshi Miyamoto, Chairman of the Board (left), Motozo Shiono, President (right)

Members of the Board

Chairman of the Board and Representative Director

Kiyoshi Miyamoto

President and Representative Director

Motozo Shiono

Directors

Sachio Tokaji*
Corporate Officer, Corporate Business Management Executive and General Manager, Accounting & Financial Department

Isao Teshirogi, Ph.D.*
Senior Executive Officer, Executive General Manager, Pharmaceutical Research & Development Division

Yasuhiro Mino*
Corporate Officer, Corporate Strategic Planning Executive and General Manager, Corporate Planning Department

*Serves concurrently as a corporate officer

Corporate Officers

Executive Officers

Takuo Fukuda
Executive General Manager, Human Health Care Division

Ryuichi Kume, Ph.D
Executive General Manager, Manufacturing Division

Corporate Officers

Hirosato Kondo, Ph.D
General Manager, Discovery Research Laboratories

Kazuyoshi Fujii
Vice General Manager, Human Health Care Division & General Manager, Sales and Distribution Department

Norio Yamada
Marketing Executive

Satoshi Komatsu
General Manager , General Affairs & Personnel Department and Legal Affairs Department

Hitoshi Maeda
General Manager, Consumer Health Care Business Division

Keiichiro Nouda
General Manager, Diagnostics Department

Nobuzo Takeda
Shionogi General Service Co., Ltd.

Corporate Auditors

Standing Corporate Auditors

Teruo Sasaki

Mitsuaki Ohtani, Ph.D

Corporate Auditors

Toshiomi Uragami

Takeharu Nagata

Prescription Drugs

For fiscal 2005, the year ended March 31, 2006, consolidated sales of prescription drugs decreased 0.3 percent compared with the previous year to ¥167,549 million (US$1,426 million). A shrinking market for antibiotics, together with ongoing government measures to contain medical costs and intensifying competition among both local and foreign companies, has increased the difficulty of sales growth in the pharmaceutical industry in Japan over the past few years. However, royalty income from licensing fees increased substantially compared with the previous fiscal year.

The market for antibiotics, the core sector of Shionogi's prescription drug business, continued to contract during fiscal 2005. In response, the Company worked to strengthen the position of its core products in this field as first-line treatments for both inpatients and outpatients. As a result, sales of Flomox, an oral cephem antibiotic for microbial infections created in-house, increased 2.7 percent year-on-year, as the brand further expanded its dominant share of its market category. However, sales of Flumarin, an injectable oxacephem antibiotic, decreased 3.5 percent compared with the previous fiscal year, and sales of Vancomycin, an injectable glycopeptide antibiotic that is effective in treating methicillin-resistant *Staphylococcus aureus* (MRSA) infections, remained unchanged year-on-year. Sales of Claritin, an anti-allergic, decreased 10.1 percent year-on-year due to the lower prevalence of pollen allergies compared with the previous year.

New products in the field of antibiotics included Finibax, which Shionogi launched in September 2005. This next-generation, broad-spectrum novel carbapenem antibiotic was developed in-house. Shionogi extended the Finibax lineup in June 2006 with the launch of Finibax 0.25g IV Solution Kit. Avelox, a new quinolone antibiotic licensed from Bayer Yakuhin, Ltd., was launched in December 2005. In order to facilitate the rapid penetration of Avelox into the Japanese market, Shionogi worked closely together with Bayer Yakuhin in the areas of marketing and post-marketing surveillance, supporting strong performance.

In the cancer and related chronic pain therapy market, sales of Imunace, an interleukin-2 product, increased 6.7 percent. Sales of OxyContin, a controlled-release analgesic for cancer pain licensed from Mundipharma AG that Shionogi launched in July 2003, rose 48.3 percent during fiscal 2005 as the number of hospitals that officially decided to use OxyContin continued to increase. However, sales of MS Contin, another Shionogi product in the same category, decreased 37.5 percent due to the growing popularity of OxyContin tablets.

In the market for cardiovascular and metabolic therapies, sales of Longes declined 10.2 percent in a contracting market for ACE inhibitors. Sales of Landel, a calcium channel receptor antagonist for treating hypertension, decreased 5.0 percent year-on-year. Shionogi launched Crestor, an antihyperlipidemia treatment, in April 2005 in Japan. In order to build Crestor into a core product in the near future, Shionogi is conducting intensive post-marketing surveillance with AstraZeneca to collect comprehensive safety and efficacy data on Japanese patients.

Reviewing overall sales of prescription drugs in fiscal 2005, Shionogi launched three new products (Crestor, Finibax and Avelox) in the increasingly challenging Japanese pharmaceutical market. However, efforts for Crestor concentrated on the post-marketing study discussed above, and due to the timing of the launches of Finibax and Avelox, the main promotional activities were limited to product introductions and promotion of use. As a result, sales of new prescription

Net Sales of Principal Prescription Drugs

(Non-consolidated; Years ended March 31; Billions of yen)

Product name	Category	**2006**	2005	2004
Flomox	Oral cephem antibiotic	**¥34.1**	¥33.2	¥34.5
Flumarin	Injectable oxacephem antibiotic	**16.4**	17.0	19.3
Vancomycin	Injectable antibiotic effective in treating methicillin-resistant *Staphylococcus aureus* (MRSA)	**16.1**	16.1	18.2
Imunace	Anticancer agent	**11.1**	10.4	9.5
Rinderon	Synthetic adrenal cortical hormone agent	**10.2**	10.3	10.1
Claritin	Anti-allergic	**8.0**	8.9	5.5
Longes	Antihypertensive (ACE inhibitor)	**4.4**	4.9	5.7
OxyContin	Oral oxycodone hydrochloride analgesic	**4.3**	2.9	0.9
MS Contin Tablets	Oral morphine sulfate analgesic	**3.5**	5.6	7.7
Finibax	Carbapenem antibiotic	**0.8**	—	—
Avelox	Antibiotic	**1.8**	—	—

drugs were unable to cover decreased sales of existing products resulting from measures to contain healthcare costs.

In addition to the three products launched in fiscal 2005, Shionogi will launch new products that are expected to contribute to overall sales growth in fiscal 2006. In June 2006, Shionogi launched Finibax 0.25g IV Solution Kit, and plans to launch Cetrotide (cetrorelix acetate), a gonadotropin-releasing hormone antagonist for prevention of premature ovulation during a controlled ovarian stimulation followed by assisted reproductive technology, in September 2006. Other products tentatively scheduled for launch in fiscal 2006 include S-8116, an immediate-release formulation of OxyContin, and a dry syrup formulation of Claritin for pediatric use. Products currently in Phase III clinical trials include LY248686, an antidepressant, and S-7701 (pirfenidone) for anti-fibrosis. In addition, for SR47436 (irbesartan), an angiotensin II receptor antagonist for treatment of hypertension, Shionogi has completed additional Phase III studies and is scheduled to file an NDA during 2006.

Shionogi's licensing strategy has begun to produce results. Total royalty income increased 61.3 percent year-on-year in fiscal 2005 due to expanding sales of Crestor by AstraZeneca plc. Crestor is a hyperlipidemia treatment Shionogi created and licensed to AstraZeneca plc in 1998. Beginning with the Netherlands in November 2002, the product has been approved in more than 70 countries as of March 31, 2006. Other outlicensed items include S-4661 (doripenem), a broad spectrum carbapenem antibiotic developed in-house and licensed to Peninsula Pharmaceuticals, Inc. of the United States. In June 2005, Johnson & Johnson acquired Peninsula Pharmaceuticals to include doripenem in its pipeline. The compound is now in Phase III clinical trials.

Over-the-Counter (OTC) Products

Despite an intensely competitive marketplace, consolidated sales of OTC products increased 1.5 percent year-on-year to ¥6,447 million (US$55 million). Sales of core product Sedes, an analgesic and antipyretic, decreased during the fiscal year, but sales of Popon-S multivitamins with minerals increased.

Shionogi continues to use its Sedes and Popon-S brands, which are widely known among consumers, as the basis for efforts to increase sales, expand the product pipeline and build a stronger direct presence among consumers in the OTC market. In July 2006, Shionogi expanded the Sedes brand lineup to four by launching Sedes V, a non-pyrazolone antipyretic analgesic with vitamin B1. Shionogi plans to expand sales and strengthen market presence by differentiating the use of each of these four products according to the type of pain.

Diagnostics

Sales of diagnostics decreased 5.3 percent year-on-year to ¥3,392 million (US$29 million). Shionogi's leading products are MI02 Shionogi BNP and Shionoria BNP, which are specific biological markers for heart failure. Users range from cardiologists to general internists, and usage is expanding from treatment of severe cardiovascular disease to include mild heart failure. Because BNP predicts heart failure and stroke, it has gained attention in the field of preventive medicine, where its use is becoming more substantial. Moreover, the number of tests performed by licensees rose by 176.0 percent during fiscal 2005. As part of its efforts to expand the market for BNP, Shionogi plans to increase marketing synergies with prescription drugs for metabolic syndrome.

In allergy-related diagnostics, HRT Shionogi can be used to determine both the causes of food allergies and atopic dermatitis and the effectiveness of allergy immunotherapies. It was listed as a test for diagnosing allergens in the 2005 edition of Treatment Guidelines for Food Allergies published by the Japan Society of Pediatric Allergy and Clinical Immunology and was noted in the 2005 Allergy Care Guidebook of the Research Section of the Ministry of Health, Labour and Welfare as useful in determining when a food should be eliminated from the diet. Shionogi expects solid expansion in sales once HRT Shionogi is covered by National Health Insurance as a food intolerance test.

Other Businesses

The Shionogi Qualicaps Group was a subsidiary engaged in the capsule business. In October 2005, Shionogi sold all of the shares of this subsidiary to the Carlyle Group with the expectation of increasing the value of the business. As a result, the Shionogi Group made further progress in concentrating on its core prescription drug business. The other businesses segment consists primarily of real estate leasing, conducted by the parent company, and a distribution business that mainly handles Shionogi products. Combined sales of these businesses decreased 8.9 percent compared with the previous fiscal year to ¥3,093 million (US$26 million).

Six-Year Summary of Selected Financial Data

Shionogi & Co., Ltd. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen						Thousands of U.S. dollars
	2006	2005	2004	2003	2002	2001	2006
For the year ended March 31:							
Net sales	**¥196,389**	¥199,365	¥200,485	¥285,232	¥420,188	¥412,664	**$1,671,680**
Cost of sales	**68,708**	74,069	79,856	153,402	273,692	263,629	**584,848**
Selling, general and administrative expenses	**98,455**	96,567	100,337	112,564	130,312	125,126	**838,058**
Operating income	**29,226**	28,729	20,292	19,266	16,184	23,909	**248,774**
Income before income taxes and minority interests	**38,798**	31,655	5,178	9,139	18,755	24,556	**330,252**
Net income	**22,735**	18,942	2,204	5,904	8,456	12,614	**193,522**
Research and development expenses	**32,257**	29,409	29,808	31,284	30,602	29,255	**274,574**
Capital investments	**5,386**	5,424	4,404	9,012	8,810	8,331	**45,846**
As of March 31:							
Property, plant and equipment, net	**¥ 64,251**	¥ 68,191	¥ 71,993	¥ 75,585	¥ 86,387	¥ 87,971	**$ 546,910**
Total assets	**427,683**	396,999	376,161	371,704	480,668	496,591	**3,640,475**
Total long-term liabilities	**38,371**	27,783	49,005	49,145	58,971	67,592	**326,617**
Total shareholders' equity	**337,186**	299,847	292,187	274,824	280,675	286,728	**2,870,157**
Working capital	**156,449**	152,914	179,382	162,926	155,239	197,686	**1,331,708**
Number of shares of common stock issued (in thousands)	**351,136**	351,136	351,136	351,136	351,136	351,136	
Per share amounts (in yen and U.S. dollars):							
Net income	**¥ 66.55**	¥ 54.64	¥ 6.06	¥ 16.66	¥ 24.28	¥ 36.29	**$0.57**
Net assets	**989.76**	879.79	844.53	789.91	806.02	823.27	**8.42**
Cash dividends applicable to the year	**16.00**	12.00	8.50	8.50	8.50	8.50	**0.14**

Note: U.S. dollar figures have been calculated, for convenience only, at the rate of ¥117.48 = US$1.00, the approximate rate of exchange on March 31, 2006.

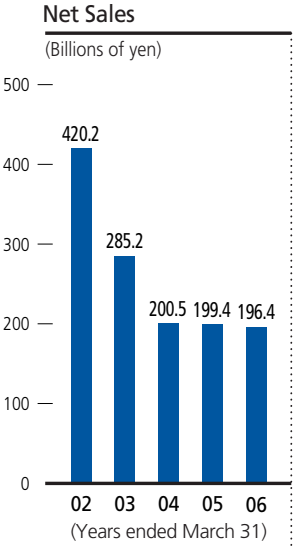
Financial Strategy

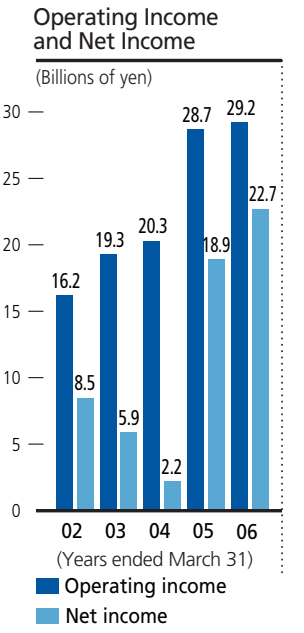
The Shionogi Group emphasizes profitability and cash flow in managing its businesses in order to generate the capital resources required to fund research and development and expand internationally. Shionogi & Co., Ltd. and other Shionogi Group companies make capital investments according to clearly defined guidelines and objectives. Shionogi will constantly work to increase its corporate value by developing, manufacturing and selling superior medicines that serve people's health needs and provide an even higher level of satisfaction to patients, their families and healthcare providers.

We are committed to maintaining steady dividends to our shareholders over the long term, taking into account performance trends in each fiscal year.

Sales, Operating Expenses and Operating Income

For fiscal 2005, the year ended March 31, 2006, consolidated net sales decreased 1.5 percent year-on-year to ¥196,389 million (US$1,672 million). While royalty revenue from licensing fees increased substantially, sales of prescription drugs decreased due to continued contraction in the market for antibiotics, a core Shionogi product. Net sales also decreased because Shionogi sold its capsule business and excluded it from the scope of consolidation in the second half of the fiscal year. Cost of sales represented 35.0 percent of net sales, compared to 37.2 percent in the previous fiscal year. This improvement reflects ongoing efforts to control manufacturing costs and the exclusion of the capsule business from the scope of consolidation, in addition to the contribution from an increase in royalty income. Gross profit increased 1.9 percent to ¥127,681 million (US$1,087 million), and increased as a percentage of net sales to 65.0 percent from 62.8 percent for the previous fiscal year.





Costs, Expenses and Income as Percentages of Net Sales

(Years ended March 31)	2006	2005	2004
Cost of sales	35.0%	37.2%	39.8%
Gross profit	65.0	62.8	60.2
SG&A expenses	50.1	48.4	50.0
R&D expenses	16.4	14.8	14.9
Operating income	14.9	14.4	10.1
Income before income taxes and minority interests	19.8	15.9	2.6
Net income	11.6	9.5	1.1

Selling, general and administrative (SG&A) expenses increased 2.0 percent to ¥98,455 million (US$838 million), and represented 50.1 percent of net sales, compared to 48.4 percent for the previous fiscal year. The increase was due largely to increased marketing expenses associated with the launch of three drugs during the past fiscal year. Research and development expenses, which are included in SG&A expenses, increased 9.7 percent to ¥32,257 million (US$275 million), and accounted for 16.4 percent of net sales, compared to 14.8 percent for the previous fiscal year.

Operating income increased 1.7 percent year-on-year to ¥29,226 million (US$249 million) because of reduced production costs, improved profitability resulting from Shionogi's focus on prescription drugs and increased royalty income. The ratio of operating income to net sales was 14.9 percent, compared to 14.4 percent for the previous fiscal year.

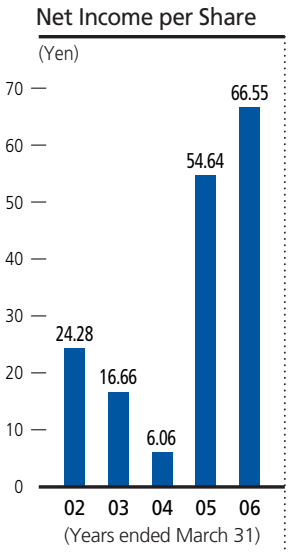
Other Income (Expenses)

Net other income totaled ¥9,572 million (US$81 million), compared to net other income of ¥2,926 million for the previous fiscal year. The primary factor in the year-on-year increase was gain on sale of capsule business totaling ¥7,452 million (US$63 million). In addition, gain on sales of investments in securities totaling ¥3,054 million (US$26 million)

offset the absence of the one-time gain on conversion to defined contribution pension plans totaling ¥3,667 million in the previous fiscal year.

Income before Income Taxes and Minority Interests and Net Income

Due to higher operating income and the year-on-year increase in net other income discussed above, income before income taxes and minority interests increased 22.6 percent year-on-year to ¥38,798 million (US$330 million). Income taxes net of deferrals increased 26.3 percent to ¥16,029 million (US$136 million), and the effective tax rate increased to 41.3 percent from 40.1 percent for the previous fiscal year. As a result, net income increased 20.0 percent year-on-year to ¥22,735 million (US$194 million), and represented 11.6 percent of net sales, compared to 9.5 percent for the previous fiscal year. Net income per share was ¥66.55 (US$0.57), compared to ¥54.64 for the previous fiscal year. Cash dividends per share of common stock totaled ¥16.00 (US$0.14) for the fiscal year, an increase of ¥4.00 per share from the previous fiscal year, and the payout ratio was 24.0 percent, compared to 22.0 percent for the previous fiscal year.



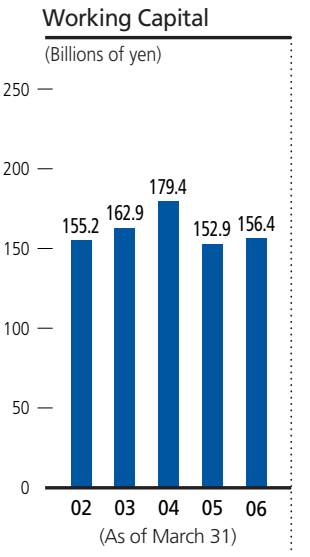
Liquidity and Cash Flows

Statements of Cash Flows Highlights

(Millions of yen)

(Years ended March 31)	2006	2005	2004
Net cash provided by operating activities	**¥ 16,885**	¥ 28,549	¥ 15,060
Net cash (used in) provided by investing activities	**(12,048)**	9,786	(8,045)
Net cash used in financing activities	**(24,796)**	(11,209)	(10,340)
Cash and cash equivalents at end of year	**76,142**	95,719	68,624

Net cash provided by operating activities decreased 40.9 percent to ¥16,885 million (US$144 million). A net reduction in cash flow from changes in operating assets and liabilities was a primary factor offsetting the increase in income before income taxes and minority interests. Moreover, income tax payments on a cash basis increased substantially compared to the previous fiscal year, primarily due to the timing of tax payments. Depreciation and amortization decreased 8.1 percent to ¥8,653 million (US$74 million), and net cash flow, defined as the sum of net income and depreciation and amortization, was ¥31,388 million (US$267 million), compared to ¥28,354 million for the previous fiscal year. Working capital increased 2.3 percent to ¥156,449 million (US$1,332 million). The current ratio increased to 4.0 to 1 from 3.2 to 1 a year earlier, primarily reflecting the decrease in current liabilities resulting from the redemption of ¥20,000 million in 2.0 percent unsecured bonds during the past fiscal year.



Net cash used in investing activities totaled ¥12,048 million (US$103 million). In the previous fiscal year, investing activities provided net cash totaling ¥9,786 million. The year-on-year change was primarily due to a net increase in short-term investments and an increase in investments in securities, reflecting Shionogi's program for managing cash prior to deployment. Purchases of property, plant and equipment were essentially unchanged at ¥5,386 million (US$46 million). Free cash flow, calculated as the total of net cash provided by operating activities and net cash used in investing activities, totaled ¥4,837 million (US$41 million), compared to ¥38,335 million for the previous fiscal year.

Net cash used in financing activities totaled ¥24,796 million (US$211 million), compared to ¥11,209 million for the previous fiscal year. Shionogi deployed cash totaling ¥20,000 million (US$170 million) for redemption of bonds. Cash dividends paid increased to ¥4,675 million (US$40 million) from ¥2,935 million for the previous fiscal year.

Reflecting the use of internal capital resources to redeem bonds, cash and cash equivalents at the end of the year decreased 20.5 percent to ¥76,142 million (US$648 million).

Assets and Capital Structure

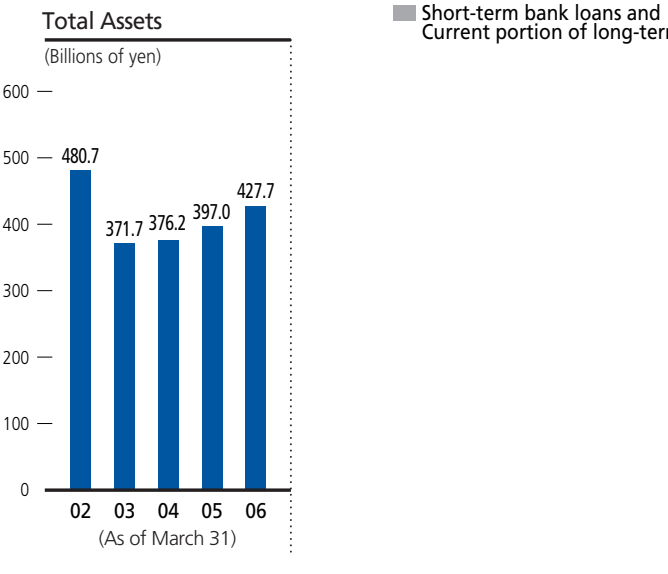
Total assets increased 7.7 percent, or ¥30,684 million, to ¥427,683 million (US$3,640 million). Current assets decreased as the use of internal capital resources to redeem bonds reduced cash and cash equivalents. Shionogi also reduced receivables and inventories, mainly because of the exclusion of the capsule business from the scope of consolidation. Investments and other assets increased primarily because of an increase in the market value of investments in securities during the fiscal year. Total liabilities decreased 6.9 percent, or ¥6,685 million, to ¥90,249 million (US$768 million), with repayment of debt more than offsetting an increase in deferred income taxes.

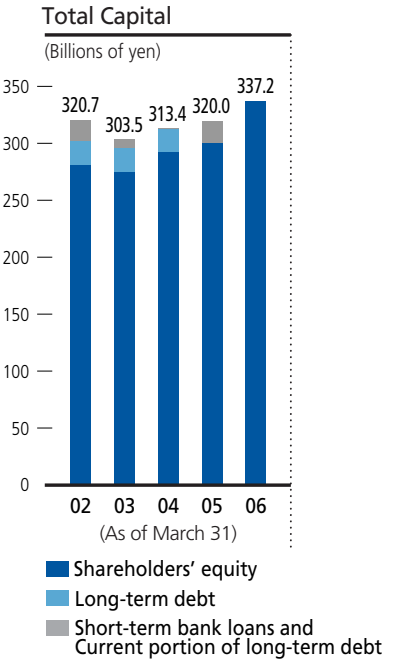
Balance Sheet Highlights

(Millions of yen)

(As of March 31)	2006	2005	% change 2006/2005
Current assets	**¥208,327**	¥222,065	(6.2)
Property, plant and equipment	**64,251**	68,191	(5.8)
Investments and other assets	**155,105**	106,743	45.3
Current liabilities	**51,878**	69,151	(25.0)
Long-term liabilities	**38,371**	27,783	38.1
Minority interests	**248**	218	13.8
Shareholders' equity	**337,186**	299,847	12.5

Shareholders' equity increased 12.5 percent, or ¥37,339 million, to ¥337,186 million (US$2,870 million), due to additions to net assets as represented by retained earnings resulting from the increase in net income. Net unrealized holding gain on securities also increased substantially. Total capital, the sum of short-term bank loans, the current portion of long-term debt, long-term debt and shareholders' equity, increased 5.4 percent to ¥337,186 million (US$2,870 million). Higher shareholders' equity accounted for this increase. Shareholders' equity accounted for 100.0 percent of total capital, compared to 93.7 percent a year earlier, underscoring the soundness of Shionogi's capital structure and its low level of fixed interest expenses. The ratio of debt to equity, calculated as the total of current liabilities and long-term debt divided by shareholders' equity, was 0.15 to 1, compared to 0.23 to 1 a year earlier. Shareholders' equity represented 78.8 percent of total assets, compared to 75.5 percent a year earlier. The return on average total shareholders' equity was 7.1 percent, compared to 6.4 percent for the previous fiscal year.





Consolidated Statements of Income

Shionogi & Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2006	2005	**2006**
Net sales (Note 19)	**¥196,389**	¥199,365	**$1,671,680**
Cost of sales	**68,708**	74,069	**584,848**
Gross profit	**127,681**	125,296	**1,086,832**
Selling, general and administrative expenses (Note 14)	**98,455**	96,567	**838,058**
Operating income (Note 19)	**29,226**	28,729	**248,774**
Other income (expenses):			
Interest and dividend income	**1,255**	1,073	**10,683**
Interest expense	**(128)**	(443)	**(1,090)**
Loss on disposal of property, plant and equipment	**(956)**	(326)	**(8,138)**
Loss on disposal of inventories	**(536)**	(564)	**(4,562)**
Gain on sale of capsule business	**7,452**	—	**63,432**
Gain on sales of investments in securities	**3,054**	—	**25,996**
Loss on impairment of fixed assets	**(937)**	—	**(7,976)**
Gain on conversion to defined contribution pension plans (Note 13)	**—**	3,667	**—**
Other, net	**368**	(481)	**3,133**
	9,572	2,926	**81,478**
Income before income taxes and minority interests	**38,798**	31,655	**330,252**
Income taxes (Note 11)**:**			
Current	**16,890**	10,066	**143,769**
Deferred	**(861)**	2,629	**(7,329)**
	16,029	12,695	**136,440**
Income before minority interests	**22,769**	18,960	**193,812**
Minority interests	**(34)**	(18)	**(290)**
Net income (Note 18)	**¥ 22,735**	¥ 18,942	**$ 193,522**

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

Shionogi & Co., Ltd. and Consolidated Subsidiaries
March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
ASSETS	**2006**	2005	**2006**
Current assets:			
Cash and cash equivalents (Note 9)	**¥ 76,142**	¥ 95,719	**$ 648,127**
Short-term investments (Note 5)	**18,541**	11,708	**157,823**
Notes and accounts receivable:			
Unconsolidated subsidiaries and affiliates	**3,316**	5,555	**28,226**
Trade	**69,534**	69,097	**591,880**
Allowance for doubtful accounts	**(13)**	(63)	**(111)**
	72,837	74,589	**619,995**
Inventories (Note 6)	**27,184**	29,696	**231,393**
Deferred income taxes (Note 11)	**6,321**	5,239	**53,805**
Other current assets	**7,302**	5,114	**62,155**
Total current assets	**208,327**	222,065	**1,773,298**
Property, plant and equipment:			
Land	**14,806**	17,052	**126,030**
Buildings and structures	**95,700**	98,304	**814,607**
Machinery and equipment	**78,901**	90,594	**671,612**
Furniture and fixtures	**29,757**	30,621	**253,294**
Construction in progress	**3,601**	1,408	**30,652**
Accumulated depreciation	**(158,514)**	(169,788)	**(1,349,285)**
Property, plant and equipment, net	**64,251**	68,191	**546,910**
Investments and other assets:			
Investments in securities (Note 5)	**126,553**	79,199	**1,077,230**
Investments in and advances to unconsolidated subsidiaries and affiliates	**2,778**	2,868	**23,647**
Prepaid pension costs (Note 13)	**15,361**	13,088	**130,754**
Intangible assets	**7,132**	7,147	**60,708**
Long-term prepaid expenses	**2,451**	3,385	**20,863**
Deferred income taxes (Note 11)	**50**	247	**426**
Other assets	**780**	809	**6,639**
Total investments and other assets	**155,105**	106,743	**1,320,267**
Total assets	**¥ 427,683**	¥396,999	**$3,640,475**

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen 2006	2005	Thousands of U.S. dollars (Note 3) 2006
Current liabilities:			
Short-term bank loans (Note 7)	**¥ —**	¥ 157	**$ —**
Current portion of long-term debt (Note 7)	**—**	20,000	**—**
Notes and accounts payable:			
Trade	**10,227**	8,660	**87,053**
Construction	**2,277**	1,226	**19,382**
Accrued expenses	**12,796**	13,677	**108,921**
Accrued income taxes (Note 11)	**11,735**	9,267	**99,889**
Other current liabilities (Notes 8 and 13)	**14,843**	16,164	**126,345**
Total current liabilities	**51,878**	69,151	**441,590**
Long-term liabilities:			
Long-term debt (Note 7)	**—**	2	**—**
Accrued retirement benefits for employees (Note 13)	**8,319**	8,321	**70,812**
Accrued retirement benefits for directors and statutory auditors	**241**	255	**2,051**
Deferred income taxes (Note 11)	**23,276**	11,603	**198,128**
Long-term accounts payable — other (Notes 8 and 13)	**5,569**	6,601	**47,404**
Other long-term liabilities	**966**	1,001	**8,222**
Total long-term liabilities	**38,371**	27,783	**326,617**
Minority interests	**248**	218	**2,111**
Contingent liabilities (Note 16)			
Shareholders' equity (Note 20)**:**			
Common stock:			
Authorized: 1,000,000,000 shares			
Issued: 351,136,165 shares in 2006 and 2005	**21,280**	21,280	**181,137**
Additional paid-in capital	**20,227**	20,227	**172,174**
Retained earnings (Note 20)	**266,470**	248,486	**2,268,216**
Net unrealized holding gain on securities	**38,116**	19,964	**324,447**
Translation adjustments	**(156)**	(1,536)	**(1,328)**
Less treasury stock, at cost	**(8,751)**	(8,574)	**(74,489)**
Total shareholders' equity	**337,186**	299,847	**2,870,157**
Total liabilities and shareholders' equity	**¥427,683**	¥396,999	**$3,640,475**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Shionogi & Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2006	2005	**2006**
Common stock:			
Balance at beginning and end of year	**¥ 21,280**	¥ 21,280	**$ 181,137**
Additional paid-in capital:			
Balance at beginning and end of year	**¥ 20,227**	¥ 20,227	**$ 172,174**
Retained earnings:			
Balance at beginning of year	**¥248,486**	¥232,589	**$2,115,134**
Add:			
Net income	**22,735**	18,942	**193,522**
Net increase arising from merger of an unconsolidated subsidiary with a consolidated subsidiary	**16**	—	**136**
Deduct:			
Cash dividends	**(4,685)**	(2,940)	**(39,879)**
Bonuses to directors and statutory auditors	**(82)**	(105)	**(697)**
Balance at end of year	**¥266,470**	¥248,486	**$2,268,216**
Net unrealized holding gain on securities:			
Balance at beginning of year	**¥ 19,964**	¥ 21,023	**$ 169,935**
Net change during the year	**18,152**	(1,059)	**154,512**
Balance at end of year	**¥ 38,116**	¥ 19,964	**$ 324,447**
Translation adjustments:			
Balance at beginning of year	**¥ (1,536)**	¥ (1,588)	**$ (13,075)**
Net change during the year	**1,380**	52	**11,747**
Balance at end of year	**¥ (156)**	¥ (1,536)	**$ (1,328)**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Shionogi & Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2006	2005	**2006**
Operating activities:			
Income before income taxes and minority interests	**¥ 38,798**	¥ 31,655	**$ 330,252**
Adjustments for:			
Depreciation and amortization	**8,653**	9,412	**73,655**
Loss on impairment of fixed assets	**937**	—	**7,976**
Gain on sale of capsule business	**(7,452)**	—	**(63,432)**
Gain on sales of investments in securities	**(3,054)**	—	**(25,996)**
Gain on conversion to defined contribution pension plans	**—**	(3,667)	**—**
Pension assets transferred to defined contribution pension plans	**—**	(17,414)	**—**
Reversal of retirement benefits, net of payments	**(1,720)**	(66)	**(14,641)**
Bonuses to directors and statutory auditors	**(83)**	(106)	**(707)**
Interest and dividend income	**(1,255)**	(1,073)	**(10,683)**
Interest expense	**128**	443	**1,090**
Other	**4,510**	534	**38,390**
Changes in operating assets and liabilities:			
Notes and accounts receivable	**(90)**	(133)	**(766)**
Inventories	**(167)**	4,315	**(1,422)**
Other current assets	**(7,642)**	(5,459)	**(65,049)**
Notes and accounts payable	**2,657**	(1,686)	**22,617**
Accrued expenses	**(32)**	(111)	**(272)**
Other current liabilities	**(4,836)**	13,320	**(41,165)**
Subtotal	**29,352**	29,964	**249,847**
Interest and dividends received	**1,471**	1,279	**12,521**
Interest paid	**(234)**	(417)	**(1,992)**
Income taxes paid	**(13,704)**	(2,277)	**(116,649)**
Net cash provided by operating activities	**16,885**	28,549	**143,727**
Investing activities:			
Increase in short-term investments	**(24,562)**	(14,777)	**(209,074)**
Proceeds from sales of short-term investments	**19,911**	34,518	**169,484**
Increase in investments in securities	**(21,182)**	(3,753)	**(180,303)**
Purchases of property, plant and equipment	**(5,386)**	(5,424)	**(45,846)**
Proceeds from sales of investments in securities	**3,562**	—	**30,320**
Increase in investments in affiliates	**—**	(384)	**—**
Proceeds from sales of investments in a subsidiary and an affiliate	**1,016**	177	**8,648**
Payment for acquisition of business	**—**	(774)	**—**
Proceeds from sales of subsidiaries' stock resulting in change in scope of consolidation (Note 17)	**18,723**	—	**159,372**
Other	**(4,130)**	203	**(35,155)**
Net cash (used in) provided by investing activities	**(12,048)**	9,786	**(102,554)**
Financing activities:			
Increase (decrease) in short-term bank loans, net	**276**	(125)	**2,349**
Repayment of long-term debt	**(0)**	(918)	**(0)**
Purchases of treasury stock	**(176)**	(7,231)	**(1,498)**
Redemption of bonds	**(20,000)**	—	**(170,242)**
Repayment of installment accounts payable	**(218)**	—	**(1,856)**
Cash dividends paid	**(4,675)**	(2,935)	**(39,794)**
Other	**(3)**	—	**(25)**
Net cash used in financing activities	**(24,796)**	(11,209)	**(211,066)**
Effect of exchange rate changes on cash and cash equivalents	**359**	(41)	**3,056**
Net (decrease) increase in cash and cash equivalents	**(19,600)**	27,085	**(166,837)**
Cash and cash equivalents at beginning of year	**95,719**	68,624	**814,768**
Increase in cash and cash equivalents resulting from merger of an unconsolidated subsidiary with a consolidated subsidiary	**23**	—	**196**
Increase in cash and cash equivalents resulting from initial consolidation of a subsidiary	**—**	10	**—**
Cash and cash equivalents at end of year	**¥ 76,142**	¥ 95,719	**$ 648,127**

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Shionogi & Co., Ltd. and Consolidated Subsidiaries
March 31, 2006

1. BASIS OF PREPARATION

The accompanying consolidated financial statements of Shionogi & Co., Ltd. (the "Company") and consolidated subsidiaries are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan.

In preparing the accompanying consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a format which is more familiar to readers outside Japan.

In addition, the notes to the consolidated financial statements include information which is not required under accounting principles generally accepted in Japan but is presented herein as additional information.

Certain reclassifications of previously reported amounts have been made to conform the consolidated financial statements for the year ended March 31, 2005 to the 2006 presentation. Such reclassifications had no effect on consolidated net income or shareholders' equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of consolidation and accounting for investments in unconsolidated subsidiaries and affiliates

The accompanying consolidated financial statements include the accounts of the Company and of all significant companies controlled directly or indirectly by the Company. Companies over which the Company exercises significant influence in terms of their operating and financial policies have been included in the consolidated financial statements on an equity basis. The Company has applied the equity method to its investment in an affiliate for the years ended March 31, 2006 and 2005.

Investments in unconsolidated subsidiaries and affiliates not accounted for by the equity method are carried at cost.

All significant intercompany accounts and transactions have been eliminated in consolidation.

The difference, not significant in amount, between the cost of investments in subsidiaries and the equity in their net assets at the dates of acquisition is amortized by the straight-line method over a period of five years.

The overseas consolidated subsidiaries have a December 31 year end which differs from that of the Company. As a result, adjustments have been made for any significant intercompany transactions which took place during the period between the year end of these subsidiaries and the year end of the Company.

(b) Foreign currency translation

All monetary assets and liabilities denominated in foreign currencies are translated into yen at the rates of exchange in effect at the balance sheet date and the gain or loss on each translation is credited or charged to income.

Revenue and expense items arising from transactions denominated in foreign currencies are generally translated into Japanese yen at the rates in effect at the respective transaction dates. Gain or loss on foreign exchange is credited or charged to income in the period in which such gain or loss is recognized for financial reporting purposes.

The financial statements of the overseas subsidiaries are translated into yen at the rates of exchange in effect at the balance sheet date except that the components of shareholders' equity are translated at their historical exchange rates. Adjustments resulting from translating the foreign currency financial statements are not included in the determination of net income and have been reported as "Translation adjustments" in shareholders' equity in the consolidated balance sheets.

(c) Cash and cash equivalents

Cash and cash equivalents include cash on hand and in banks and other highly liquid investments with maturities of three months or less when purchased.

(d) Short-term investments and investments in securities

Securities have been classified into three categories: trading securities, held-to-maturity debt securities or other securities. Trading securities, consisting of debt and marketable equity securities, are stated at fair value. Gain and loss, both realized and unrealized, are charged to income. Held-to-maturity debt securities are stated at their amortized cost. Marketable securities classified as other securities are carried at fair value with any changes in unrealized holding gain or loss, net of the applicable income taxes, reported as a separate component of shareholders' equity. Non-marketable securities classified as other securities are carried at cost determined by the moving-average method.

(e) Inventories

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

(f) Property, plant and equipment

Property, plant and equipment are stated at cost.

Depreciation of buildings (except for structures attached to the buildings) acquired subsequent to April 1, 1998 is calculated principally by the straight-line method over the estimated useful lives of the respective assets. Depreciation of other property, plant and equipment is computed by the declining-balance method over the useful lives of the respective assets.

The useful lives of property, plant and equipment are summarized as follows:

Buildings and structures	2 to 60 years
Machinery and equipment	2 to 17 years

Significant renewals and additions are capitalized at cost. Maintenance and repairs are charged to income as incurred.

(g) Leases

Non-cancelable leases related to the Company and the domestic consolidated subsidiaries are accounted for as operating leases (whether such leases are classified as operating or finance leases) except that leases which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases.

(h) Research and development costs and computer software

Research and development costs are charged to income when incurred. Expenditures relating to computer software developed

for internal use are charged to income as incurred unless these are deemed to contribute to the generation of future income or cost savings. Such expenditures are capitalized as assets and amortized by the straight-line method over their useful lives, generally a period of 5 years.

(i) Income taxes

Income taxes are calculated based on taxable income and charged to income on an accrual basis. Certain temporary differences exist between taxable income and income reported for financial statement purposes which enter into the determination of taxable income in a different period. The Company has recognized the tax effect of such temporary differences in the accompanying consolidated financial statements.

(j) Retirement benefits

The Company has adopted a defined benefit pension plan known as a "cash balance plan," which allows pension benefits to fluctuate in accordance with market interest rates, and also has a lump-sum payment plan and a defined contribution pension plan. Certain domestic consolidated subsidiaries have adopted lump-sum payment plans and defined contribution pension plans. In addition, certain consolidated subsidiaries have adopted defined contribution pension plans.

Accrued retirement benefits are provided based on the amount of the projected benefit obligation reduced by the pension plan assets at fair value at the year end.

Prior service cost is amortized by the straight-line method over 10 years, which is within the estimated average remaining years of service of the eligible employees.

Actuarial gain or loss is proportionally amortized each year following the year in which the gain or loss is recognized, principally by the straight-line method over 10 years, which falls within the estimated average remaining years of service of the eligible employees.

In addition, directors and statutory auditors of the Company who held in their positions as of June 29, 2004 are customarily entitled to lump-sum payments under an unfunded retirement benefit plan, because the retirement benefits system for directors and statutory auditors was abolished in June 2004. The provision for retirement allowances for these officers has been made at estimated amounts based on the Company's internal rules.

Change in accounting policy

The Company and consolidated subsidiaries have adopted "Partial Revision of Accounting Standard for Retirement Benefits (Corporate Accounting Standard No. 3)" and "Implementation Guidance for Partial Revision of Accounting Standard for Retirement Benefits (Implementation Guidance No. 7 for Applying Corporate Accounting Standards)," both issued by the Accounting Standards Board of Japan on March 16, 2005, in their consolidated financial statements for the year ended March 31, 2006. There was no impact on consolidated net income for the year ended March 31, 2006 as a result of this adoption.

(k) Derivatives

Derivative financial instruments are utilized by the Company principally to reduce the risk of fluctuation in foreign exchange rates. The Company has established a control environment which includes policies and procedures for risk assessment and for the approval, reporting and monitoring of derivatives transactions. The Company does not hold or issue derivative financial instruments for speculative trading purposes.

The Company is exposed to certain market risk arising from its forward foreign exchange contracts. The Company is also exposed to the risk of credit loss in the event of nonperformance by the counterparties to the currency contracts; however, the Company does not anticipate nonperformance by any of these counterparties all of whom are financial institutions with high credit ratings.

(l) Appropriation of retained earnings

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by resolution of the shareholders at a general meeting held subsequent to the close of the financial period. The accounts for that period do not, therefore, reflect such appropriations. See Note 20.

3. U.S. DOLLAR AMOUNTS

The translation of yen amounts into U.S. dollar amounts is included solely for convenience, as a matter of arithmetic computation only, at ¥117.48= U.S.$1.00, the approximate rate of exchange in effect on March 31, 2006. This translation should not be construed as a representation that yen have been, could have been, or could in the future be, converted into U.S. dollars at the above or any other rate.

4. CHANGE IN ACCOUNTING POLICY

Effective the year ended March 31, 2006, the Company and consolidated subsidiaries have adopted a new accounting standard for the impairment of fixed assets which requires that tangible and intangible fixed assets be carried at cost less depreciation and be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company and consolidated subsidiaries would be required to recognize a loss on impairment of fixed assets in their statement of income if certain indicators of asset impairment exist and if the book value of an asset exceeds the undiscounted sum of its future cash flows. The standard states that loss on impairment of fixed assets should be measured as the excess of the book value over the higher of (1) the fair market value of the asset, net of its disposition costs, and (2) the present value of future cash flows arising from the ongoing utilization of the asset and from its disposal after use. The standard covers land, buildings, other forms of property, plant and equipment as well as intangible assets.

As a result of the adoption of this new accounting standard, a loss on impairment of fixed assets in the amount of ¥937 million ($7,976 thousand) was recognized in the consolidated statement of income for the year ended March 31, 2006, and income before income taxes and minority interests decreased by the same amount from the corresponding amount which would have been recorded under the previous method. The impact on the consolidated segment information is outlined herein in the notes to the consolidated financial statements. See Note 15.

5. SHORT-TERM INVESTMENTS AND INVESTMENTS IN SECURITIES

Held-to-maturity debt securities and other securities at March 31, 2006 and 2005 were as follows:

(1) Held-to-maturity debt securities

	Millions of yen 2006			
	Book value	Gross unrealized gain	Gross unrealized loss	Estimated fair value
Market value determinable:				
Bond and debentures	**¥40,193**	**¥22**	**¥(499)**	**¥39,716**

	Millions of yen 2005			
	Book value	Gross unrealized gain	Gross unrealized loss	Estimated fair value
Market value determinable:				
Bond and debentures	¥20,192	¥349	¥(37)	¥20,504

	Thousands of U.S. dollars 2006			
	Book value	Gross unrealized gain	Gross unrealized loss	Estimated fair value
Market value determinable:				
Bond and debentures	**$342,126**	**$187**	**$(4,247)**	**$338,066**

(2) Other securities

	Millions of yen 2006			
	Cost	Gross unrealized gain	Gross unrealized loss	Book value (estimated fair value)
Market value determinable:				
Equity securities	**¥15,745**	**¥62,603**	**¥—**	**¥78,348**
Bonds and debentures	**1,847**	**885**	**—**	**2,732**
Other securities	**5,005**	**78**	**(0)**	**5,083**
	¥22,597	**¥63,566**	**¥ (0)**	**¥86,163**

	Millions of yen 2005			
	Cost	Gross unrealized gain	Gross unrealized loss	Book value (estimated fair value)
Market value determinable:				
Equity securities	¥14,685	¥32,734	¥—	¥47,419
Bonds and debentures	1,879	751	—	2,630
Other securities	5,005	101	(0)	5,106
	¥21,569	¥33,586	¥ (0)	¥55,155

	Thousands of U.S. dollars 2006			
	Cost	Gross unrealized gain	Gross unrealized loss	Book value (estimated fair value)
Market value determinable:				
Equity securities	**$134,023**	**$532,882**	**$ —**	**$666,905**
Bonds and debentures	**15,722**	**7,533**	**—**	**23,255**
Other securities	**42,603**	**664**	**(0)**	**43,267**
	$192,348	**$541,079**	**$ (0)**	**$733,427**

(3) The proceeds from sales of, and gross realized gain on, other securities for the years ended March 31, 2006 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Proceeds from sales	**¥4,242**	¥175	**$36,108**
Gross realized gain	**2,590**	154	**22,046**

(4) The carrying value of investments in non-marketable securities at March 31, 2006 and 2005 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Other securities:			
Unlisted equity securities	**¥4,189**	¥5,884	**$35,657**

(5) The carrying value of held-to-maturity debt securities and debt securities classified as other securities at March 31, 2006 and 2005 is summarized as follows:

	Millions of yen 2006	
	Bonds and debentures	Other
Due within one year	**¥ 4,005**	**¥ 20**
Due after one year through five years	**16,112**	**723**
Due after five years through ten years	**20,056**	**637**
Due after ten years	**—**	**1,372**

	Millions of yen 2005	
	Bonds and debentures	Other
Due within one year	¥2,006	¥ 20
Due after one year through five years	8,198	716
Due after five years through ten years	9,968	621
Due after ten years	—	1,292

	Thousands of U.S. dollars 2006	
	Bonds and debentures	Other
Due within one year	**$ 34,091**	**$ 170**
Due after one year through five years	**137,147**	**6,154**
Due after five years through ten years	**170,718**	**5,422**
Due after ten years	**—**	**11,679**

6. INVENTORIES

Inventories at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Merchandise	**¥ 3,601**	¥ 3,370	**$ 30,652**
Finished goods	**8,603**	8,603	**73,229**
Semifinished goods and work in process	**9,968**	12,735	**84,849**
Raw materials and supplies	**5,012**	4,988	**42,663**
	¥27,184	¥29,696	**$231,393**

7. SHORT-TERM BANK LOANS AND LONG-TERM DEBT

The annual average interest rates applicable to short-term bank loans at March 31, 2005 was 3.1%.

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

	Millions of yen 2005
Loans from banks, financial institutions at 2.0%: Unsecured	¥ 2
2.0% unsecured bonds, payable in yen, due 2005	20,000
	20,002
Less current portion	(20,000)
	¥ 2

At March 31, 2006, the Company had unused line-of-credit commitments for short-term financing arrangements totaling ¥24,000 million ($204,290 thousand). These lines of credit have commitment fee requirements.

8. INSTALLMENT ACCOUNTS PAYABLE

Installment accounts payable included in 'other current liabilities' and 'long-term accounts payable – other' at March 31, 2006 were as follows:

	Millions of yen	Thousands of U.S. dollars
	2006	**2006**
Current portion	**¥ 711**	**$ 6,052**
Long-term portion	**2,700**	**22,983**
	¥3,411	**$29,035**

The annual maturities of installment accounts payable subsequent to March 31, 2006 are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2007	**¥ 711**	**$ 6,052**
2008	**741**	**6,307**
2009	**710**	**6,044**
2010	**712**	**6,061**
2011	**537**	**4,571**
	¥3,411	**$29,035**

9. ASSETS PLEDGED

At March 31, 2006 and 2005, the assets pledged as collateral for deposits received from employees which have been included in other current liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Cash and cash equivalents	**¥5**	¥5	**$43**

10. SHAREHOLDERS' EQUITY

The Commercial Code of Japan (the "Code") provides that an amount equal to at least 10% of the amounts to be disbursed as distributions of earnings be appropriated to the legal reserve until the sum of the legal reserve and additional paid-in capital equals 25% of the common stock account. The Code also stipulates that, to the extent that the sum of the additional paid-in capital account and the legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for appropriation by resolution of the shareholders.

Retained earnings include the legal reserve provided in accordance with the provisions of the Code. The legal reserve of the Company and its consolidated subsidiaries included in retained earnings at March 31, 2006 and 2005 amounted to ¥6,468 million ($55,056 thousand) and ¥6,362 million, respectively.

11. INCOME TAXES

Income taxes applicable to the Company and its domestic consolidated subsidiaries comprise corporation tax, inhabitants' taxes and enterprise tax which, in the aggregate, resulted in a statutory tax rate of approximately 40.6% for the years ended March 31, 2006 and 2005.

The overseas subsidiaries are subject to the income taxes of the countries in which they operate.

The effective tax rates for the years ended March 31, 2006 and 2005 differ from the statutory tax rate above for the following reasons:

	2006	2005
Statutory tax rate	**40.6%**	40.6%
Expenses not deductible for income tax purposes	**2.9**	3.6
Dividends not taxable for income tax purposes	**(0.1)**	(0.1)
Amortization of excess of cost over net assets acquired	**0.2**	0.1
Inhabitants' per capita taxes	**0.3**	0.5
Tax credits	**(6.5)**	(4.5)
Tax loss carryforward of a consolidated subsidiary	**1.1**	—
Difference in statutory tax rates of overseas subsidiaries	**(0.1)**	—
Adjustment to surplus resulting from sale of capsule business	**3.4**	—
Other	**(0.5)**	(0.1)
Effective tax rates	**41.3%**	40.1%

The tax effects of temporary differences at March 31, 2006 and 2005 which gave rise to significant deferred tax assets and liabilities are presented below:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Accrued expenses	**¥ 3,037**	¥ 3,169	**$ 25,851**
Retirement benefits	**145**	1,208	**1,235**
Accrued enterprise tax	**1,082**	849	**9,210**
Research and development expenses	**2,029**	1,390	**17,271**
Reserve for sales rebates	**385**	274	**3,277**
Loss on revaluation of investments in securities	**443**	549	**3,771**
Tax loss carryforward of a consolidated subsidiary	**412**	—	**3,507**
Other	**2,170**	1,562	**18,471**
Valuation allowance	**(412)**	—	**(3,507)**
Total deferred tax assets	**9,291**	9,001	**79,086**
Deferred tax liabilities:			
Unrealized gain on other securities	**(25,388)**	(13,559)	**(216,105)**
Unrealized gain on consolidated subsidiaries	**—**	(533)	**—**
Depreciation	**(576)**	(420)	**(4,903)**
Other	**(232)**	(606)	**(1,975)**
Total deferred tax liabilities	**(26,196)**	(15,118)	**(222,983)**
Net deferred tax liabilities	**¥(16,905)**	¥ (6,117)	**$(143,897)**

12. LEASES

The following *pro forma* amounts represent the acquisition costs, accumulated depreciation and net book value of the property leased to the Company and its consolidated subsidiaries at March 31, 2006 and 2005, which would have been reflected in the balance sheets if finance leases other than those which transfer the ownership of the leased property to the Company and its consolidated subsidiaries (which are currently accounted for as operating leases) had been capitalized:

	Millions of yen		
	2006		
	Acquisition costs	Accumulated depreciation	Net book value
Machinery, equipment and other	**¥842**	**¥316**	**¥526**

	Millions of yen		
	2005		
	Acquisition costs	Accumulated depreciation	Net book value
Machinery, equipment and other	¥1,056	¥366	¥690

	Thousands of U.S. dollars		
	2006		
	Acquisition costs	Accumulated depreciation	Net book value
Machinery, equipment and other	**$7,167**	**$2,690**	**$4,477**

Finance lease payments of the Company and its consolidated subsidiaries for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Lease payments	**¥184**	¥171	**$1,566**

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2006 under finance leases other than those which transfer the ownership of the leased property to the Company and its consolidated subsidiaries are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Due within one year	¥163	$1,387
Due after one year	363	3,090
Total	¥526	$4,477

13. RETIREMENT BENEFITS

The following table sets forth the changes in the retirement benefit obligation, plan assets and the funded status of the Company and the consolidated subsidiaries at March 31, 2006 and 2005:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Retirement benefit obligation at end of year	**¥(93,509)**	¥(94,856)	**$(795,957)**
Fair value of plan assets at end of year	**122,604**	96,949	**1,043,616**
Plan assets in excess of retirement benefit obligation	**29,095**	2,093	**247,659**
Unrecognized prior service cost	**(18,978)**	(21,652)	**(161,542)**
Unrecognized actuarial (gain) loss	**(3,075)**	24,326	**(26,175)**
Net retirement benefit obligation	**7,042**	4,767	**59,942**
Prepaid pension costs	**(15,361)**	(13,088)	**(130,754)**
Accrued retirement benefits for employees	**¥ (8,319)**	¥ (8,321)	**$ (70,812)**

The Company and a certain domestic consolidated subsidiary transferred a portion of their retirement benefit plans to defined contribution pension plans in April 2004 and March 2005, respectively.

The pension assets are scheduled to be transferred over 4 years to defined contribution pension plans. The amounts to be transferred for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year (presented as 'other current liabilities')	**¥3,522**	¥ 3,869	**$29,980**
Due after one year (presented as 'long-term accounts payable – other')	**2,869**	6,491	**24,421**
	¥6,391	¥10,360	**$54,401**

The components of retirement benefit expenses for the years ended March 31, 2006 and 2005 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Service cost	**¥ 1,980**	¥ 2,047	**$ 16,854**
Interest cost	**1,874**	1,842	**15,952**
Expected return on plan assets	**(2,265)**	(2,183)	**(19,280)**
Amortization of actuarial loss	**3,717**	3,089	**31,639**
Amortization of prior service cost	**(2,674)**	(2,674)	**(22,761)**
Other	**878**	769	**7,473**
Retirement benefit expenses	**¥ 3,510**	¥ 2,890	**$ 29,877**

"Other" represents contributions to the defined contribution retirement benefit plans.

Effective April 1, 2004, the Company adopted a new type of defined benefit pension plan known as a "cash balance plan," which allows pension benefits to fluctuate in accordance with market interest rates. The Company and a certain domestic consolidated subsidiary also converted a portion of their non-contributory defined benefit pension plans and retirement benefit plans into defined contribution pension plans. With respect to this transfer, the Company adopted "Accounting for Transfers Among Retirement Benefit Plans" ("Financial Accounting Standard Implementation Guidance No. 1."). As a result of the adoption of this accounting standard, gain on conversion to defined contribution pension plans of ¥3,667 million was recorded in the consolidated statement of income for the year ended March 31, 2005.

The assumptions used in accounting for the defined benefit plans for the years ended March 31, 2006 and 2005 were as follows:

	2006	2005
Discount rate	**2.0%**	2.0%
Expected rates of return on plan assets	**2.3%**	2.2%

14. RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses included in selling, general and administrative expenses for the years ended March 31, 2006 and 2005 amounted to ¥32,257 million ($274,574 thousand) and ¥29,409 million, respectively.

15. IMPAIRMENT OF FIXED ASSETS

The Company and its consolidated subsidiaries group their fixed assets for business purposes by management control units (by product groups), and idle assets and leased assets are grouped individually.

For the year ended March 31, 2006, the carrying value of leased assets whose market value had decreased significantly from their carrying value were reduced to their respective recoverable amounts and a loss on impairment was recognized in the accompanying consolidated financial statements. The net recoverable amounts of the leased assets are measured based on the estimated selling value which is principally equivalent to the official published prices.

The carrying amount of excess of cost over the amount of the underlying equity in the net assets of a certain domestic subsidiary in the amount of ¥163 million ($1,388 thousand) has been reduced since its carrying amount is deemed not to be recoverable. In addition, an overseas consolidated subsidiary performed impairment tests for goodwill and other assets in accordance with "Statement of Financial Accounting Standards No. 144" (Accounting for the Impairment or Disposal of Long-Lived Assets). As a result, the Company recognized a loss on impairment based on the amount determined by third-party appraisers.

Loss on impairment of fixed assets is summarized as follows:

Place	Classification	Millions of yen	Thousands of U.S. dollars
Wakabayashi-ku, Sendai and Other	Land (leased assets)	**¥278**	**$2,366**
U.S.A.	Goodwill and other assets	**496**	**4,222**
—	Excess of cost over the amount of the underlying equity in the net assets	**163**	**1,388**

16. CONTINGENT LIABILITIES

The Company had the following contingent liabilities at March 31, 2006:

	Millions of yen	Thousands of U.S. dollars
Guarantees of housing loans to employees	**¥117**	**$996**

17. SUPPLEMENTARY CASH FLOW INFORMATION

In October 2005, the assets and liabilities of Shionogi Qualicaps Co., Ltd., Shionogi Europe B.V., Shionogi Qualicaps Inc. and Shionogi Qualicaps S.A. were excluded from consolidation following the sale of the capsule business. The following summarizes the assets and liabilities excluded from consolidation for the year ended March 31, 2006:

	Millions of yen	Thousands of U.S. dollars
	2006	**2006**
Current assets	**¥11,496**	**$ 97,855**
Non-current assets	**6,366**	**54,188**
Total assets	**¥17,862**	**$152,043**
Current liabilities	**¥ 5,335**	**$ 45,412**
Non-current liabilities	**603**	**5,133**
Total liabilities	**¥ 5,938**	**$ 50,545**

18. AMOUNTS PER SHARE

Amounts per share for the years ended March 31, 2006 and 2005 were as follows:

	Yen		U.S. dollars
	2006	2005	**2006**
Net income	**¥ 66.55**	¥ 54.64	**$0.57**
Net assets	**989.76**	879.79	**8.42**
Cash dividends applicable to the year	**16.00**	12.00	**0.14**

Diluted net income per share is not presented since no potentially dilutive securities have been issued.

Net income per share has been computed based on the net income attributable to shareholders of common stock and the weighted-average number of shares of common stock outstanding during the year. The amounts per share of net assets have been computed based on the net assets available for distribution to the shareholders of common stock and the number of shares of common stock outstanding at the year end.

Cash dividends per share represent the cash dividends proposed by the Board of Directors as applicable to the respective years together with the interim cash dividends paid.

The financial data for the computation of basic consolidated net income per share for the years ended March 31, 2006 and 2005 based on the above are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Information on basic net income per share:			
Net income	**¥22,735**	¥18,942	**$193,522**
Deduction from net income:			
Bonuses to directors and statutory auditors	**(63)**	(82)	**(536)**
Adjusted net income allocated to common stock	**¥22,672**	¥18,860	**$192,986**

	Thousands of shares	
	2006	2005
Weighted-average number of shares of common stock outstanding	**340,667**	345,175

19. SEGMENT INFORMATION

The Company and its consolidated subsidiaries are engaged primarily in the manufacture and sales of pharmaceutical products and in related marketing activities in Japan and overseas, principally in North America and Europe, in two major segments.

The business of the pharmaceuticals segment is conducted principally by the Company and that of the capsules segment was conducted principally by consolidated subsidiaries. The Company sold the capsule business in October 2005; consequently, information on the capsule business subsequent to October 2005 has been excluded from the business segment presented below for the year ended March 31, 2006.

The business segment information for the Company and its consolidated subsidiaries for the years ended March 31, 2006 and 2005 is outlined as follows:

	Millions of yen					
	Year ended March 31, 2006					
	Pharmaceuticals	Capsules	Other	Total	Eliminations and general corporate assets	Consolidated
I. Sales and operating income						
Sales to third parties	**¥187,235**	**¥6,061**	**¥ 3,093**	**¥196,389**	**¥ —**	**¥196,389**
Intergroup sales and transfers	**—**	**116**	**8,571**	**8,687**	**(8,687)**	**—**
Total sales	**187,235**	**6,177**	**11,664**	**205,076**	**(8,687)**	**196,389**
Operating expenses	**160,476**	**5,490**	**9,934**	**175,900**	**(8,737)**	**167,163**
Operating income	**¥ 26,759**	**¥ 687**	**¥ 1,730**	**¥ 29,176**	**¥ 50**	**¥ 29,226**
II. Assets, depreciation and capital expenditures						
Total assets	**¥240,914**	**¥ —**	**¥10,677**	**¥251,591**	**¥176,092**	**¥427,683**
Depreciation	**9,001**	**414**	**16**	**9,431**	**—**	**9,431**
Capital expenditures	**12,228**	**979**	**33**	**13,240**	**—**	**13,240**

	Millions of yen					
	Year ended March 31, 2005					
	Pharmaceuticals	Capsules	Other	Total	Eliminations and general corporate assets	Consolidated
I. Sales and operating income						
Sales to third parties	¥184,075	¥11,896	¥ 3,394	¥199,365	¥ —	¥199,365
Intergroup sales and transfers	—	237	4,727	4,964	(4,964)	—
Total sales	184,075	12,133	8,121	204,329	(4,964)	199,365
Operating expenses	158,188	10,672	6,760	175,620	(4,984)	170,636
Operating income	¥ 25,887	¥ 1,461	¥ 1,361	¥ 28,709	¥ 20	¥ 28,729
II. Assets, depreciation and capital expenditures						
Total assets	¥221,289	¥21,237	¥13,879	¥256,405	¥140,594	¥396,999
Depreciation	8,330	998	560	9,888	—	9,888
Capital expenditures	10,602	406	90	11,098	—	11,097

	Thousands of U.S. dollars					
	Year ended March 31, 2006					
	Pharmaceuticals	Capsules	Other	Total	Eliminations and general corporate assets	Consolidated
I. Sales and operating income						
Sales to third parties	**$1,593,761**	**$51,591**	**$ 26,328**	**$1,671,680**	**$ —**	**$1,671,680**
Intergroup sales and transfers	**—**	**988**	**72,957**	**73,945**	**(73,945)**	**—**
Total sales	**1,593,761**	**52,579**	**99,285**	**1,745,625**	**(73,945)**	**1,671,680**
Operating expenses	**1,365,986**	**46,731**	**84,559**	**1,497,276**	**(74,370)**	**1,422,906**
Operating income	**$ 227,775**	**$ 5,848**	**$ 14,726**	**$ 248,349**	**$ 425**	**$ 248,774**
II. Assets, depreciation and capital expenditures						
Total assets	**$2,050,681**	**$ —**	**$ 90,884**	**$2,141,565**	**$1,498,910**	**$3,640,475**
Depreciation	**76,617**	**3,524**	**136**	**80,277**	**—**	**80,277**
Capital expenditures	**104,086**	**8,333**	**281**	**112,700**	**—**	**112,700**

As more than 90% of the consolidated net sales for the years ended March 31, 2006 and 2005 were made in Japan, the disclosure of geographical segment information has been omitted.

20. SUBSEQUENT EVENT

The following appropriations of retained earnings of the Company, which have not been reflected in the accompanying consolidated financial statements for the year ended March 31, 2006, were approved at a shareholders' meeting held on June 29, 2006:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥10.00 = U.S.$0.09 per share)	**¥3,406**	**$28,992**
Bonuses to directors and statutory auditors	**55**	**468**

Report of Independent Auditors

ERNST & YOUNG SHINNIHON

The Board of Directors
Shionogi & Co., Ltd.

We have audited the accompanying consolidated balance sheets of Shionogi & Co., Ltd. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Shionogi & Co., Ltd. and consolidated subsidiaries at March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

Supplemental Information

As described in Note 4, effective the year ended March 31, 2006, Shionogi & Co., Ltd. and consolidated subsidiaries have adopted a new accounting standard for the impairment of fixed assets.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 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.

Ernst & Young Shin Nihon

June 29, 2006

Subsidiaries and Affiliates

(As of March 31, 2006)

Company	Location	Main Business	Ownership (%)
OVERSEAS—4 COMPANIES			
Taiwan Shionogi & Co., Ltd.	Taipei, Taiwan, R.O.C.	Manufacture and sale of pharmaceuticals	100.0
Shionogi USA, Inc.	New Jersey, U.S.A.	Pharmaceutical development/Conducting clinical trials/Sale of pharmaceuticals	100.0
SG Holding, Inc.	Delaware, U.S.A.	Holding company	100.0
Shionogi-GlaxoSmithKline Holding LP**	Cayman Islands	Holding company	50.0*
DOMESTIC—8 COMPANIES			
Bushu Pharmaceuticals Ltd.	Saitama, Japan	Contract manufacture of pharmaceuticals	100.0
Nichia Pharmaceutical Industries Ltd.	Tokushima, Japan	Manufacture of pharmaceutical raw materials	75.0
Ohmori Group Honsha Co., Ltd.***	Osaka, Japan	Asset management	100.0
Saishin Igaku Co., Ltd.	Osaka, Japan	Publication of medical literature	100.0
Shionogi Engineering Service Co., Ltd.	Hyogo, Japan	Inspection and maintenance of pharmaceutical manufacturing equipment	100.0
Shionogi Buturyuu Service & Co., Ltd.	Osaka, Japan	Warehousing and logistic services	100.0
Shionogi General Service Co., Ltd.	Osaka, Japan	Travel and insurance agency	100.0
Aburahi AgroResearch Co., Ltd.	Shiga, Japan	Contract laboratories for agrochemicals	100.0*

* Includes indirect ownership
** Affiliated company accounted for by the equity method
*** Merged and absorbed into Shionogi & Co., Ltd. on April 1, 2006

Corporate Directory

(As of March 31, 2006)

Head Office
1-8, Doshomachi 3-chome,
Chuo-ku, Osaka 541-0045, Japan
Tel: 81-6-6202-2161
Fax: 81-6-6229-9596

Tokyo Branch Office
Shionogi Shibuya Bldg., 17-5, Shibuya 2-chome,
Shibuya-ku, Tokyo 150-0002, Japan
Tel: 81-3-3406-8111

Nagoya Branch Office
SKY OASIS SAKAE., 9, Shinsakaemachi 2-chome,
Naka-ku, Nagoya 460-0004, Japan
Tel: 81-52-957-8271

Fukuoka Branch Office
Shin KBC Bldg.,
1-35, Nagahama 1-chome, Chuo-ku,
Fukuoka 810-0072, Japan
Tel: 81-92-737-7750

Sapporo Branch Office
Daisan Kouan Bldg.,
13, Minami Nanajo Nishi 1-chome,
Chuo-ku, Sapporo 064-0807, Japan
Tel: 81-11-530-0360

Shionogi Research Laboratories
12-4, Sagisu 5-chome,
Fukushima-ku, Osaka 553-0002, Japan
Tel: 81-6-6458-5861

Developmental Research Laboratories
1-1, Futaba-cho 3-chome,
Toyonaka, Osaka 561-0825, Japan
Tel: 81-6-6331-8081

Shionogi Institute for Medical Science
5-1, Mishima 2-chome,
Settsu, Osaka 566-0022, Japan
Tel: 81-6-6382-2612

Aburahi Laboratories
1405, Gotanda, Koka-cho,
Koka, Shiga 520-3423, Japan
Tel: 81-748-88-3281

Settsu Plant
5-1, Mishima 2-chome, Settsu,
Osaka 566-0022, Japan
Tel: 81-6-6381-7341

Kanegasaki Plant
7, Moriyama, Nishine, Kanegasaki-cho,
Isawa-gun, Iwate 029-4503, Japan
Tel: 81-197-44-5121

Kuise Plant
1-3, Kuise Terajima 2-chome,
Amagasaki, Hyogo 660-0813, Japan
Tel: 81-6-6401-1221

Shionogi Distribution Center
5-1, Mishima 2-chome,
Settsu, Osaka 566-0022, Japan
Tel: 81-6-6381-7342

Shionogi Tokyo Distribution Center
1513, Funagata-Azaueharaichi,
Noda, Chiba 270-0233, Japan
Tel: 81-471-27-3000

Bushu Pharmaceuticals Ltd.
1, Ooaza-Takeno, Kawagoe,
Saitama 350-0801, Japan
Tel: 81-49-233-4651

Nichia Pharmaceutical Industries Ltd.
224-20, Ebisuno Hiraishi Kawauchi-cho,
Tokushima 771-0132, Japan
Tel: 81-88-665-2312

Saishin Igaku Co., Ltd.
Shionogi Doshomachi Bldg., 7-6,
Doshomachi 4-chome,
Chuo-ku, Osaka 541-0045, Japan
Tel: 81-6-6222-2876

Shionogi Engineering Service Co., Ltd.
1-3, Kuise Terajima 2-chome,
Amagasaki, Hyogo 660-0813, Japan
Tel: 81-6-6401-1227

Shionogi & Co., Ltd. Taipei Office
Taiwan Shionogi & Co., Ltd.
Transworld Commercial Center 4F,
No. 2, Sec. 2, Nanking E. Road 10408,
Taipei, Taiwan, R.O.C.
Tel: 886-2-2551-6336

Shionogi USA, Inc.
100 Campus Drive, Florham Park,
NJ 07932, U.S.A.
Tel: 1-973-966-6900

SG Holding, Inc.
1209 Orange Street,
Wilmington, New Castle, DE, U.S.A.

Corporate Data

(As of March 31, 2006)

Company Name
Shionogi & Co., Ltd.

Web Page
http://www.shionogi.co.jp/

Head Office
1-8, Doshomachi 3-chome, Chuo-ku, Osaka 541-0045, Japan
Tel: +81-6-6202-2161
Fax: +81-6-6229-9596

Established
March 17, 1878

Incorporated
June 5, 1919

Paid-in Capital
¥21,280 million

Number of Employees
Consolidated: 4,997
Non-consolidated: 4,246

Dividends
March 31—Date for confirming the shareholders receiving year-end dividends
September 30—Date for confirming the shareholders receiving interim dividends

Stock (Securities) Listings
Osaka, Tokyo (#4507)

Common Stock
Authorized: 1,000,000,000 shares
Issued: 351,136,165 shares
Number of Shareholders: 24,561

Transfer Agent
The Sumitomo Trust & Banking Co., Ltd.
Stock Transfer Agency Department,
5-33, Kitahama 4-chome,
Chuo-ku, Osaka 541-0041, Japan

Major Shareholders

	Number of Shares (thousands)	Percentage of Total Shares
Sumitomo Life Insurance Company	18,604	5.30%
The Master Trust Bank of Japan, Ltd. (trust account)	16,811	4.79
Japan Trustee Services Bank, Ltd. (trust account)	15,272	4.35
Nippon Life Insurance Company	13,138	3.74
The Chase Manhattan Bank, NA London	12,413	3.54
The Chase Manhattan Bank NA, London SL Omnibus Account	12,131	3.45
State Street Trust and Banking Company, Limited	12,124	3.45
Shionogi & Co., Ltd.	10,526	3.00
Japan Trustee Services Bank, Ltd. (Trust Account Re-entrusted by The Sumitomo Trust & Banking Co., Ltd., The Sumitomo Mitsui Banking Corporation Retirement Trust Account)	9,485	2.70
NIPPON KOA Insurance Company, Limited	9,422	2.68
Total	129,928	37.00%

Note: International investment fund management business companies Wellington Management Company, LLP of the United States and Wellington Management International Ltd. of the United Kingdom have filed reports of large holdings of shares with the Company, but cannot be verified on the shareholders' register as of March 31, 2006 or elsewhere, and are therefore not included in the above list of major shareholders. The relevant information in the report of large holding of shares is as follows.

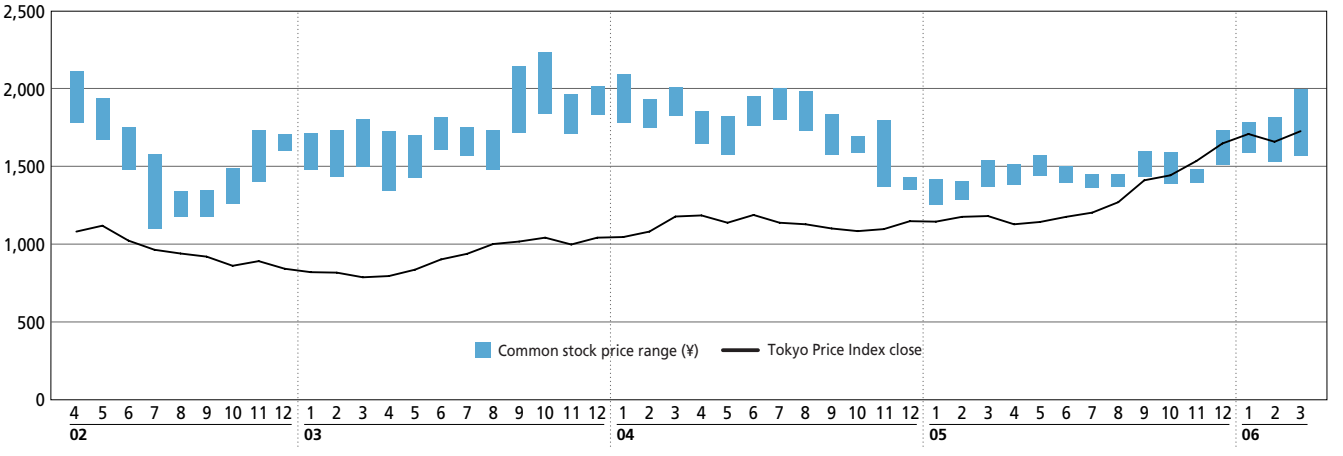
Name: Wellington Management Company, LLP

Address: 75 State Street, Boston, Massachusetts 02109, U.S.A.

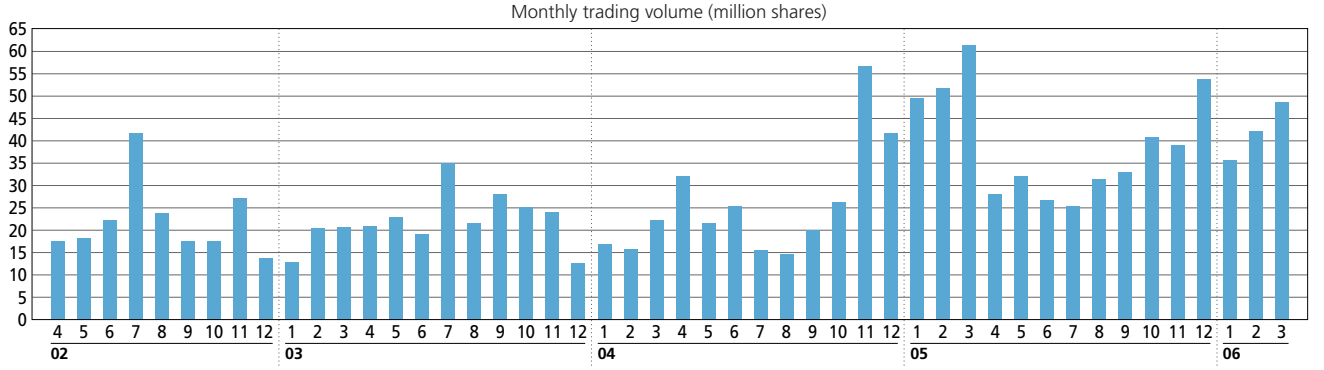
Number of Shares Held: 39,016,050 (11.11% of total shares as of December 22, 2005)

Holding Objective: Management of customers' assets under contract

Stock Price Range and Trading Volume (Tokyo Stock Exchange)



Monthly trading volume (million shares)



SHIONOGI & CO., LTD.

The *fundo* mark was registered as a trademark in 1909, and continues to be used as our corporate emblem today. *Fundo* were used as weights for scales during the Edo period (1600-1868), and they appropriately symbolize Shionogi's relentless pursuit of precision and accuracy.

http://www.shionogi.co.jp/

Printed in Japan with soy ink on recycled paper.

J-500-035