

## Operating Results and Financial Position

### 1. The Year in Review

#### (1) Overview of Results of Operations

Staging an overall recovery throughout the year, the Japanese economy reflected a modest increase in consumer spending, encouraged by improved corporate profitability and robust private sector capital investment. However, Lion's mainstay domestic household product business and its over-the-counter (OTC) pharmaceutical business, on which the new growth strategy is centered, were negatively affected by the dual impact of spiraling crude oil prices and declining retail prices with some product exceptions.

Consolidated net sales totaled ¥331,798 million, an increase of 7.2% from the previous fiscal year. Operating income increased 0.7% to ¥6,066 million and ordinary income rose to ¥8,514 million, up by 2.9%. As a result, net income amounted to ¥5,473 million, compared with a net loss of ¥4,723 million in the previous year.

#### <Consolidated>

(Millions of yen)

Net sales	FY 2005	FY 2004	Increase/ decrease	Change
Home Products	237,241	230,398	6,842	3.0%
Pharmaceutical Products	50,315	32,162	18,152	56.4%
Chemicals	33,898	33,108	789	2.4%
Others	10,343	13,844	(3,501)	(25.3%)
<b>Total</b>	<b>331,798</b>	<b>309,514</b>	<b>22,283</b>	<b>7.2%</b>

Note: Previously included in the Pharmaceutical Products segment until the previous fiscal year, dental materials handled by Lion Dental Products Co., Ltd. is classified under the Home Products segment (oral care business field) from FY 2005. The impact of this change on sales was ¥2,919 million in this fiscal year (¥2,835 million in FY 2004).

(Millions of yen)

	FY 2005	Ratio to net sales	FY 2004	Ratio to net sales	Increase/ decrease	Change
Operating income	6,066	1.8%	6,021	2.0%	44	0.7%
Ordinary income	8,514	2.6%	8,271	2.7%	243	2.9%
Net income	5,473	1.7%	(4,723)	(1.5%)	10,196	-

**<Non-consolidated>**

(Millions of yen)

Net sales	FY 2005	FY 2004	Increase/ decrease	Change
Home Products	191,863	205,040	(13,177)	(6.4%)
Pharmaceutical Products	50,291	32,137	18,154	56.5%
Food Products	-	701	(701)	-
Chemicals	26,717	27,551	(833)	(3.0%)
International	2,021	1,951	70	3.6%
Total	270,894	267,382	3,511	1.3%

Note: Previously included in the Pharmaceutical Products segment until the previous fiscal year, dental materials is classified under the Home Products segment from FY 2005. The impact of this change on non-consolidated sales was ¥2,920 million in FY 2005 (¥2,835 million in FY 2004).

(Millions of yen)

	FY 2005	Ratio to net sales	FY 2004	Ratio to net sales	Increase/ decrease	Change
Operating income	2,907	1.1%	1,600	0.6%	1,306	81.6%
Ordinary income	6,453	2.4%	5,295	2.0%	1,157	21.9%
Net income	4,657	1.7%	(5,428)	(2.0%)	10,086	-

**< Geographical Segments >**

(Millions of yen)

Net sales	FY 2005	
	Net sales	Operating income
Japan	295,220	5,720
Asia	39,636	272
Corporate and eliminations	(3,058)	73
Consolidated total	331,798	6,066

**(2) Segment Information****<Home Products>**

(Millions of yen)

	FY 2005	Ratio to net sales	FY 2004	Ratio to net sales	Increase/ decrease	Change
Net sales	237,241		230,398		6,842	3.0%
Operating income	8,434	3.6 %	11,249	4.9 %	(2,814)	(25.0%)

Net sales of Home Products totaled ¥237,241 million, representing an increase of 3.0% year on year.

The Lion Group's mainstay household product market in Japan encountered bleak business conditions amidst price-cutting of laundry detergents and fabric softeners by retailers.

Against this backdrop, Lion strengthened its domestic home products business with the introduction of differentiated products while utilizing strategic marketing investment in principal products to pursue its aim of creating No.1 brands with ¥10 billion in sales. In light of this, Lion is making efforts to reduce sales promotion expenses and increase productivity.

Overseas, Lion focused on reinforcing its business foundation by streamlining sales systems and advertising core brands, in preparation for rapidly developing the Home Products business in Korea that was acquired at the end of the previous fiscal year.

Operating income fell 25.0% from the previous fiscal year to ¥8,434 million, impacted by heavy market competition and soaring crude oil prices despite an overall decrease in manufacturing costs and aggressive cutting of domestic sales promotion expenses.

**<Principal divisions>**

(Millions of yen)

	FY 2005	FY 2004	Increase/ decrease	Change
Oral Care Products Division	50,431	45,358	5,072	11.2%
Beauty Care Products Division	35,909	35,109	800	2.3%
Household Products Division	150,900	149,930	969	0.6%

**Oral Care Products**

Dentor Systema is Lion's comprehensive brand for gum disease prevention. To further develop the brand, Lion introduced new mouthwash and interdental products with innovative technology to complement existing toothpaste and toothbrush offerings. A new Clinica Kid's series, which proposed a new cavity prevention lifestyle for parents and children, enjoyed favorable toothpaste, toothbrush and dental rinse sales.

In the toothpaste business, Lion launched an improved Clinica Toothpaste for Caries Risk Control that promotes re-mineralization of teeth and introduced a new flavor of Prime Stain Off that restores teeth to their original whiteness and sparkle, while the Company's mainstay Dentor series showed steady sales. However, overall sales of toothpaste were stagnant due to severe market competition.

Regarding toothbrush sales, the ultra-fine bristles Dentor Systema showed strong performance with its clear, appealing message of gum disease prevention. Lion upgraded the Clinica toothbrush for more effective brushing behind teeth and better access to rear teeth, places where plaque can easily build up. Overall toothbrush sales were, however, on par with the previous period.

Sales of mouthwash remained bolstered from the previous year, owing to new release of Dentor Systema Dental Rinse that penetrates deep inside the "biofilm" (communities of

periodontal-disease producing bacteria) to kill bacteria, along with the release of mild and safe non-alcohol type Clinica Kid's Dental Rinse.

As for dental products, sales increased reflecting the popularity of DENT.EX Systema and the new Brilliant toothpaste for healthy and white shining teeth.

Overseas, demand for the Systema series grew significantly in Thailand. Lion actively updated its selection of toothpastes and toothbrushes for the Chinese market, resulting in remarkable year-on-year sales growth.

As a result, net sales of this segment totaled ¥50,431 million, up by 11.2% from the previous year.

### **Beauty Care Products**

In its Kireikirei series, Lion introduced Kireikirei Gargle that is highly effective in sterilization. Coupled with existing hand soaps and body washes, Lion has actively developed this series as an all-round brand that promotes hygienic lifestyles.

Sales of shampoos and conditioners significantly exceeded sales in the previous period, owing to new Shokubutsu-Monogatari (Plant Story) Herb Blend Shampoo and Shokubutsu-Monogatari (Plant Story) Herb Blend Conditioner, along with the popularity of Soft-in-One moisturizing shampoo with seaweed extract.

Despite strong demand for Kireikirei Medical Foaming Hand Soap, a product that is easily used by children who have trouble making lather with conventional soaps, sales of hand soaps were sluggish due to intensifying market competition.

In the field of body washes, Lion introduced new products Shokubutsu-Monogatari (Plant Story) Herb Blend Body Wash and Kireikirei Medicated Body Wash that contains sanitizing, deodorizing ingredients to prevent body odor and the smell of sweat.

Lion enhanced its lineup of hair-nourishment treatments to meet demand from a wider range of consumers from young to old. In this light, the Company introduced Neo and Scalp Tonic to its Mouhatsuryoku Innovate series. However, sales underran figures from the previous period due to severe competition in the market.

Tough competition in the antiperspirant and deodorant market impeded sales of the mainstay Ban Powder Spray, and weakened overall sales fell below previous period sales despite strong performance in the Men's Ban Zero series.

Overseas, Lion enhanced Thailand's favorite Shokubutsu-Monogatari (Plant Story) series and launched hand soap in South Korea. As a result, overseas sales surged, doubling those of the previous fiscal year.

Net sales in this segment amounted to ¥35,909 million, with an increase of 2.3%.

## **Household Products**

In the Household Products business, Lion placed the highest priority on reducing sales promotion expenses for laundry detergents and fabric softeners. Sales of laundry detergents decreased amid heavy market competition, however, Lion made steady progress in restructuring its sales network for greater profitability.

Lion improved its mainstay laundry detergents, including Top that breaks down sebaceous stains from body oils and Heyaboshi (Hang-to-Dry Indoors) Top that controls unpleasant smells generated by laundry hung inside to dry. Lion also enhanced the effectiveness of Acron, a delicate fabric wash that prevents clothes from losing their style and fit. Furthermore, the Company introduced new Liquid Heyaboshi (Hang-to-Dry Indoors) Top. Despite the Company's efforts, overall sales of laundry detergents declined from the previous fiscal year against the backdrop of intensifying competition.

Overall sales of bleaches increased, owing to the steady performance of Temanashi Bright and the further development of Super Temanashi Bright that contains powerful stain-removing additives.

Lion introduced the new fabric softeners Kaori to Deodorant no Soflan ("Soflan with Fragrance and Deodorant") with superlative odor protection advantages and Heyaboshi (Hang-to-Dry Indoors) Soflan that controls the cause of musty smells associated with indoor drying. As a result, sales of fabric softeners saw strong year-on-year growth.

Against the backdrop of intensifying market competition, sales declined in dishwashing detergents despite the improvement of Charmy Liv with strong cleaning power and the introduction of new Charmy Liv Mild to the market.

Overall sales of household cleaners were weak compared with the previous fiscal year, and reflected sluggish sales of Kabitori (Mold-Removing) Look Powerful Gel that masked robust sales of high-detergency Ofuro no Look (bath cleaner).

Among cooking-aid products, sales of Lion's mainstay Reed Cooking Paper were affected by market consolidation. As a result, overall sales fell year on year.

Overseas sales expanded overall to levels twice those of the previous fiscal year. This result can be attributed to the strong performance of laundry detergent Top in Singapore, soaring demand for the new hang-to-dry indoor type laundry detergent Pao in Thailand, and quality enhancement of Beat, a laundry detergent sold in South Korea.

As a result, net sales of the segment totaled ¥150,900 million, representing an increase of 0.6%.

### Principal new products

Clinica Toothpaste for Caries Risk Control (Brisk cool mint flavors type)

Clinica Toothbrush

Shokubutsu-Monotari (Plant story) Herb Blend Shampoo

Shokubutsu-Monogatari (Plant story) Herb Blend Conditioner

Shokubutsu-monogatari (Plant story) Herb Blend Body Wash

Liquid Hheyaboshi (Hang-to-Dry Indoors) Top / Laundry detergent

Kaori to Deodorant no Soflan ("Soflan with Fragrance and Deodorant") / Fabric softener

Heyaboshi (Hang-to-Dry Indoors) Soflan / Fabric softener

Charmy Liv Mild / Dishwashing detergents

### <Pharmaceutical Products>

(Millions of yen)

	FY 2005	Ratio to net sales	FY 2004	Ratio to net sales	Increase/decrease	Change
Net sales	50,315		32,162		18,152	56.4%
Operating income	3,619	7.2%	2,231	6.9%	1,387	62.2%

In the Pharmaceutical Products business, net sales increased 56.4% compared with the corresponding period of the previous fiscal year to ¥50,315 million.

With prompt introduction of new products to core brands in the over-the-counter (OTC) drugs business that was acquired at the end of the previous fiscal year, Lion placed priority on establishing a firm foundation in this market by advertising aggressively. Operating income increased 62.2% year on year to ¥3,619 million due to early contribution of new products in the OTC drugs business, despite the cost of market competition to nurture new products and brands.

### Principal divisions

In the area of analgesics, mainstay Bufferin A enjoyed robust sales as sales promotion activities were strengthened by the product's own features of being both fast-acting and mild on the stomach.

Sales of eye care products significantly increased, owing to strong performance of Smile 40 EX. In this fiscal year, Lion launched new eye drops Smile PIT Dry Eye, which effectively relieve dry eye distress, and Smile Contact Fine Fit Plus, a medical eye drop that makes insertion of contact lenses easier.

In the gum-disease treatment business, Lion enhanced effectiveness of new Dent-health, an ointment to ease symptoms of gum disease, which contributed to the strong sales increase.

Sales of Stoppa Anti-Diarrhea Medicine, which can be taken anywhere without water, were robust, contributing to overall sales of anti-diarrheic drugs along with Stoppa L with herbal medicine introduced in this fiscal year.

In addition, Lion released Tomerumin, an easy-to-carry remedy for sleepiness and fatigue that can be taken without water, which also contributed to sales.

At the end of the previous fiscal year, Lion took over the nonprescription products (OTC) business of Chugai Pharmaceutical Co., Ltd., including its tonic and insecticide businesses.

To that end, the Company endeavored to develop new products while nurturing its core brands by releasing Guronsan Red, a health tonic drink that is effective at relieving fatigue. In parallel, Lion vigorously facilitated sales promotion activities for the Varsan series, calling attention to the need to protect family members from allergenic substances. These activities largely contributed to sales expansion within this segment.

### Principal new products

Smile PIT Dry Eye / Eyedrops  
 Dent-health Brushing Care / Gum-disease treatments  
 Stoppa L Anti-Diarrhea Medicine  
 Tomerumin / Medicine for prevention of drowsiness  
 Guronsan Red / Health tonic drink  
 Chugai Ichoyaku S / Gastrointestinal medicine

### <Chemicals>

(Millions of yen)

	FY 2005	Ratio to net sales	FY 2004	Ratio to net sales	Increase/decrease	Change
Net sales	33,898		33,108		789	2.4%
Operating income	1,020	3.0%	1,623	4.9%	(602)	(37.1%)

In this segment, net sales rose by 2.4% to ¥33,898 million compared with the corresponding period of the previous fiscal year.

Despite the severe business environment, marked by surging crude oil prices and inventory adjustments associated with the ongoing IT recession, Lion engaged in the development of new products that meet customer demands, along with other high-value added products

Operating income decreased by 37.1% to ¥1,020 million, impacted by soaring crude oil prices and related factors, overshadowing improvements in profitability through rationalization.

### Principal divisions

Demand for surfactants and fatty-acid nitrogen derivatives for fabric softeners showed steady increase in the domestic market. However, overall sales of surfactants and fatty-acid nitrogen derivatives declined year on year due to intensifying export competition to China.

On the contrary, sales of fatty-acid methyl ester were buoyed both at home and overseas, owing to the high-purity features of its palm oil ingredient, with strong demand for use in metalworking processes and in alcohol.

Exports of electro-conductive carbon increased markedly, reflecting high appreciation by overseas users of its excellent conductivity for use in electronic components. In the domestic market, however, sales decreased compared with the previous fiscal year due to increased competition, leading to an overall sales decrease.

Overseas, the South Korean acquisition of the chemicals division of CJ Corporation at the end of the previous fiscal year contributed to the increase of segment sales.

### <Others>

(Millions of yen)

	FY 2005	Ratio to net sales	FY 2004	Ratio to net sales	Increase/decrease	Change
Net sales	10,343		13,844		(3,501)	(25.3%)
Operating income	(97)	-	258	1.9%	(356)	-

The decrease in the number of works completions in the construction contracting business was a factor that caused net sales in this segment to down by 25.3%, to ¥10,343 million, and operating loss was ¥97 million (Operating income of FY 2004 was ¥258 million).

## Financial Status

	FY 2005	FY 2004	Change
Total assets (million yen)	249,303	235,405	13,898
Total shareholders' equity (million yen)	109,103	101,021	8,081
Shareholders' equity ratio (%)	43.8	42.9	0.9p
Shareholders' equity per share (yen)	384.60	356.90	27.70

(Millions of yen)

	FY 2005	FY 2004	Change
Cash flows from operating activities	1,865	4,270	(2,405)
Cash flows from investing activities	(9,262)	(10,059)	796
Cash flows from financing activities	(1,514)	(1,553)	38
Translation gain related to cash and cash equivalents	130	104	25
Increase (decrease) in cash and cash equivalents	(8,781)	(7,237)	(1,544)
Cash and cash equivalents at end of the fiscal year	15,788	24,480	(8,691)

Total assets at the end of fiscal 2005 amounted to ¥249,303 million, an increase of ¥13,898 million compared with the corresponding period of the previous fiscal year. Shareholders' equity totaled ¥109,103 owing to a shift to net income from net loss in the previous fiscal year, an increase in retained earnings and unrealized holding gains on other securities. The shareholders' equity ratio stood at 43.8%.

### <Consolidated Cash Flows>

Net cash provided by operating activities totaled ¥1,865 million, compared with ¥4,270 million during the previous fiscal year. While net income before income taxes amounted to ¥8,737 million (compared with a net loss of ¥5,017 million in the previous fiscal year), major factors behind the decrease included decreases in depreciation and amortization charges, as well as in accrued expenses and other payables, coupled with increases in trade notes and accounts receivable, and in inventories.

Net cash used in investing was ¥9,262 million, compared with ¥10,059 million in the previous fiscal year, owing to purchases of property, plant and equipment of ¥8,943 million and investment securities of ¥4,562 million.

Net cash used in financing activities was ¥1,514 million, compared with ¥1,553 million at the end of the previous fiscal year. Cash dividends totaled ¥2,260 million.

### <Changes in major indicators for financial status>

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Shareholders' equity ratio (%)	44.6	43.1	45.0	42.9	43.8
Shareholders' equity ratio on a market value basis (%)	58.3	56.5	66.6	71.9	85.8
Debt redemption (years)	1.2	0.5	0.7	3.9	9.8
Interest coverage ratio	40.8	119.8	86.7	25.6	7.1

(Notes)

Shareholders' equity ratio: Total shareholders' equity / Total assets

Shareholders' equity ratio on a market value basis: Value of shares / Total assets

Debt redemption (years): Interest bearing liabilities / Cash flows from operating activities

Interest coverage ratio: Cash flows from operating activities / Interest payment

\* All the indicators are based on consolidated financial data.

\* "Value of shares" is calculated on the basis of "closing stock price as of the end of the term" multiplied by "the number of outstanding stocks as of the end of the term" (after the deduction of treasury stocks).

\* "Cash flows from operating activities" are those in the consolidated cash flow data.

"Interest bearing liabilities" mean all liabilities that are bearing interests among the liabilities in the consolidated balance sheet.

For the amount of interest paid, figures in the consolidated cash flow data are used.

### (4) Appropriation of Earnings

#### <Dividends>

The dividend for the second half of fiscal 2005 will be ¥5 per share, up from the first half of fiscal 2005, and a total dividend will be ¥9 per share for the full year.

#### <Repurchase of Treasury Stock>

In January 2005, Lion repurchased one million shares of treasury stock with an aggregate value of ¥605 million.

## 2. Outlook for FY 2006

### (1) Forecasts

#### <Consolidated>

(Millions of yen)

	FY 2006 forecast	FY 2005	Increase/decrease	Change
Net sales	350,000	331,798	18,201	5.5%
Ordinary income	9,000	8,514	485	5.7%
Net income	5,000	5,473	(473)	(8.6%)

#### <Non-Consolidated>

(Millions of yen)

	FY 2006 forecast	FY 2005	Increase/decrease	Change
Net sales	280,000	270,894	9,105	3.4%
Ordinary income	7,000	6,453	546	8.5%
Net income	5,000	4,657	342	7.4%

In 2006, gradual recovery is expected in the Japanese economy. However, a continuing severe business environment is predicted to prevail in the household product market, reflecting intensifying sales competition among manufacturers as well as hovering raw material costs.

Against this backdrop, the Home Products business will facilitate the development and launch of new value-added products in advance of our competitors, as well as nourish core brands by focusing on marketing investment and strengthening in-store management activities.

Overseas, active business development is expected to produce an upswing in sales throughout South Korea and ASEAN countries.

In the pharmaceutical products business, greater sales within the new OTC drugs business are anticipated through the addition of new products to mainstay brands, while sales are also expected to increase with Lion's entry into the functional food products business utilizing proprietary technology.

Despite the Company's endeavors to expand sales in eco-friendly high-value-added products, sales in the chemicals business are expected to be on par with the fiscal 2005 due to continuing severity in the business environment.

In the other business segment, possible sales growth is seen in the construction contracting business.

As a result, consolidated net sales are estimated to increase by 5.5% to ¥350,000 million. Estimated ordinary income is expected to reach ¥9,000 million, up 5.7%, with estimated net

income of ¥5,000 million, a decrease of 8.6% year on year.

Cash dividends for fiscal 2006 are forecast at ¥5 per share both for interim and year-end dividends, up ¥1 from fiscal 2005.

## **(2) Consolidated Cash Flows**

In cash flows from operating activities, income before income taxes is projected at approximately ¥8.0 billion. Depreciation and amortization charges are projected to total around ¥10.0 billion.

In cash flows from investing activities, capital expenditures are projected to total ¥11.5 billion.

The cash flows from financing activities are expected to decline by about ¥3.0 billion from the fiscal 2005 level because of the payment of dividends.

Consequently, cash and cash equivalents at the end of fiscal 2006 are projected at ¥19.0 billion.

The forecasts and projected operating results contained in this report are based on information available at the time of preparation, and thus involve inherent risks and uncertainties. Accordingly, readers are cautioned that actual results may differ materially from those projected as a result of a variety of factors.

## **1. Business Risks**

The Lion Group's management performance and financial status may be adversely affected by various risks as business activities are pursued in the future. Of these risks, the following items in particular may have a material impact on the decisions of investors.

Forward-looking statements are based on decisions made by the Lion Group as of the date of release of this business report. Business risks are not limited to the items listed below.

### **(1) Product quality and value**

The Lion Group plans, develops, produces, and sells products under management based on international quality standards while strictly following related laws and regulations, such as the Pharmaceutical Affairs Law, to provide worry-free, safe, convenient, and environmentally conscious products to customers. In addition, we use customer opinions received through our Consumer Service Office to improve our products, packaging text and displays.

In the event of an unforeseen and serious problem with product quality, however, the affected product and all products made by the Lion Group may lose their perceived value. This may adversely affect the Lion Group's management performance and financial status.

(2) Changes in raw material prices

The Lion Group's products use minerals and vegetable oils and fats as basic materials. Since these materials are easily affected by international market prices, we have measures in place to reduce costs and diversify the range of materials used. However, an increase in raw material prices may adversely affect the Lion Group's management performance and financial status.

(3) Exchange rate fluctuations

The Lion Group translates into yen the financial statements of overseas subsidiaries when preparing consolidated financial statements. For items denominated in foreign currency, their yen values may be affected by prevailing foreign exchange rates when translated into yen. The Lion Group has taken steps to minimize the risk of an increase in raw material costs by hedging against exchange rate fluctuations. However, short-, medium-, and long-term changes in foreign exchange rates may adversely affect the Lion Group's management performance and financial status.

(4) Major lawsuits

During this fiscal year under review, the Lion Group was not subject to any lawsuits that would materially affect its operations. In a future lawsuit, however, if the Lion Group is successfully sued for significant damages, it may adversely affect the Lion Group's management performance and financial status.

(5) Earthquakes and other natural disasters

In the product manufacturing process, the Lion Group has put in place safety measures against earthquakes and other natural disasters. In the event of a major disaster, however, our production equipment may be damaged or business activities may cease, adversely affecting the Lion Group's management performance and financial status.