

## Management Performance and Financial Status

### 1. The First Half in Review

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

During the first six months of the current fiscal year, the Japanese economy showed signs of a mild recovery as capital investment increased on the back of improved corporate earnings and a rebound in consumer spending. Nevertheless, uncertainties for the future stayed put due to rising crude oil prices and other factors. In the core area of business for Lion and its Group companies, the household products market within Japan, the operating environment remained difficult in some product categories due to ongoing price declines spurred by intensifying competition, even despite signs of a recovery in market scale.

For the first half, consolidated net sales increased 5.9% to ¥159,882 million compared with the same period of the previous fiscal year. Operating income declined 17.9% to ¥3,179 million, and ordinary income decreased 6.9% to ¥4,432 million. Profits declined compared with a year earlier on account of higher crude oil prices and a change in the product mix, despite measures to reduce overall costs centered on lowering production costs.

Net income rose 32.3% to ¥2,659 million.

#### <Consolidated>

(Millions of yen)

Net sales	FY 2005 1st half	FY 2004 1st half	Increase/ decrease	Change
Home Products	112,191	111,307	884	0.8%
Pharmaceutical Products	25,103	14,446	10,657	73.8%
Chemicals	17,110	16,272	837	5.1%
Others	5,476	8,975	(3,498)	(39.0%)
Total	159,882	151,001	8,880	5.9%

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 the six-month period under review. The impact of this change on sales was ¥1,472 million in the first half of the current fiscal year (¥1,411 million in the first half of the previous fiscal year).

(Millions of yen)

	FY 2005 1st half	Ratio to net sales	FY 2004 1st half	Ratio to net sales	Increase/ decrease	Change
Operating income	3,179	2.0%	3,873	2.6%	(694)	(17.9%)
Ordinary income	4,432	2.8%	4,762	3.2%	(330)	(6.9%)
Net income	2,659	1.7%	2,010	1.3%	648	32.3%

**<Non-consolidated>**

(Millions of yen)

Net sales	FY 2005 1st half	FY 2004 1st half	Increase/ decrease	Change
Home Products	90,318	99,705	(9,386)	(9.4%)
Pharmaceutical Products	25,092	14,431	10,661	73.9%
Food Products	-	702	(702)	-
Chemicals	13,762	13,548	213	1.6%
International	1,053	1,001	52	5.3%
Total	130,228	129,389	838	0.6%

Note: Previously included in the Pharmaceutical Products segment until the previous fiscal year, dental materials is classified under the Home Products segment from the six-month period under review. The impact of this change on non-consolidated sales was ¥1,473 million in the first half of the current fiscal year (¥1,411 million in the first half of the previous fiscal year).

(Millions of yen)

	FY 2005 1st half	Ratio to net sales	FY 2004 1st half	Ratio to net sales	Increase/ decrease	Change
Operating income	1,365	1.1%	1,264	1.0%	100	8.0%
Ordinary income	4,418	3.4%	4,387	3.4%	30	0.7%
Net income	3,556	2.7%	2,618	2.0%	938	35.8%

**< Geographical Segments >**

(Millions of yen)

	FY 2005 1st half	
	Net sales	Operating income
Japan	185,435	2,883
Asia	19,147	175
Corporate and eliminations	(44,700)	120
Consolidated total	159,882	3,179

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

(Millions of yen)

	FY 2005 1st half	Ratio to net sales	FY 2004 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	112,191		111,307		884	0.8%
Operating income	4,216	3.8%	5,515	5.0%	(1,298)	(23.5%)

Net sales of Home Products totaled ¥112,191 million, up by 0.8% over the same period of the previous year.

In Lion's mainstay domestic household products market, severe conditions continued amid ongoing price declines at retail stores for laundry detergent and fabric softeners and other products.

Amid these operating conditions, Lion nurtured its core brands by launching novel new products and aggressively investing in marketing.

Overseas in South Korea, Lion launched full-scale operations in household products, a business it acquired toward the end of the previous fiscal year. Lion focused efforts on reducing costs by lowering production costs while aggressively marketing products in line with its growth strategy.

Operating income in Home Products decreased 23.5% to ¥4,216 million, adversely affected by tough sales competition and higher crude oil prices despite efforts to reduce overall costs (by lowering production costs) and increase sales promotion cost efficiency in Japan.

**<Principal divisions>**

(Millions of yen)

	FY 2005 1st half	FY 2004 1st half	Increase/ decrease	Change
Oral Care Products Division	23,134	21,519	1,615	7.5%
Beauty Care Products Division	19,793	19,046	747	3.9%
Household Products Division	69,263	70,742	(1,478)	(2.1%)

**Oral Care Products**

In Oral Care Products, Lion positioned Dentor Systema as a comprehensive brand for products that prevent gum disease, and aimed to expand the product lineup by releasing new mouthwash and dental care products while actively promoting toothpastes and toothbrushes.

We added a new flavor of Prime Stain Off toothpaste, which helps restore bright white teeth, and proactively fostered Dentor Systema toothpaste that prevents gum disease, which were introduced in autumn 2004. However, sales declined year on year due to tough market competition.

Sales of toothbrushes stagnated on account of intense market competition, despite the popularity of Dentor Systema toothbrushes with ultra-fine bristles and a strong message for preventing gum disease.

In mouthwash, we launched Dentor Systema Dental Rinse, which thoroughly penetrates “biofilm,” a community of periodontal-disease producing bacteria, to kill bacteria. As a result, sales increased considerably from the previous fiscal year.

In dental materials, sales were steady for DENT EX Systema, an ultra-fine bristle toothbrush. We also released Systema Dental Paste, a toothpaste that prevents gum disease, and Systema Medicated Gel,

which is used with interdental brushes. Accordingly, sales of dental materials increased from the same period a year ago.

Overseas in Thailand, sales of Systema toothpaste and toothbrushes for preventing gum disease increased steadily.

As a result, sales of Oral Care Products increased 7.5% to ¥23,134 million.

## **Beauty Care Products**

In shampoos and conditioners, sales grew considerably year on year with the new release of Shokubutsu-Monogatari (Plant Story) Herb Blend Shampoo and Conditioner, which has “natural mother herbs” that leave the hair moist and manageable.

In hand soap, sales decreased year on year, as new products were released during the previous fiscal year, despite the popularity of Kireikirei Medical Foaming Hand Soap.

In body washes, sales increased substantially with the launch of Shokubutsu-Monogatari Herb Blend Body Wash and Kireikirei Medicated Body Wash.

In hair-styling products, hair-nourishment treatments, antiperspirants, and deodorants, sales declined compared with the same period of the previous fiscal year amid fierce market competition, despite aggressively promoting sales.

Overseas, in Taiwan and Singapore, we launched the hair damage repair Free & Free Damage Aid series of products, which are popular in Thailand and Hong Kong, to expand the area coverage of the brand.

As a result, sales of Beauty Care Products increased 3.9% to ¥19,793 million.

## **Household Products**

Laundry detergents showed a decline in sales due to lower product sales prices and efforts to streamline sales promotion costs amid a severely competitive operating environment. This decline was in spite of the release of an improved version of Top, which is able to remove stains that have set in over time with the new additive Stainzyme (amylase), and Liquid Heyaboshi (Hang-to-Dry Indoors) Top, which avoids the smell of air-dried clothes.

In fabric softeners, sales struggled due to harsh market competition, despite the release of Kaori to Deodorant no Soflan ("Soflan with Fragrance and Deodorant"), which provides superlative protection against odors on clothing and leaves a pleasant, long-lasting fragrance.

In after-care products, sales expanded significantly year on year, supported by firm sales of Kafunguard, a spray for clothes and fabric that enhances the indoor environment for pollen allergy sufferers by inhibiting the effects of pollen that was launched at the end of the previous fiscal year.

In dishwashing detergents, sales declined year on year on account of tough competition, despite the launch of Powerful Charmy (for dishwashers), a detergent specifically for use with dishwashers that lifts off hard-to-remove, dried-on food and dirt.

In household cleaners, sales were favorable for Ofuro no Look, a high-powered bathroom cleaner, and Toire no Look, a toilet bowl cleaner that completely removes even the most stubborn dirt from under the lip of the toilet bowl. As a result, sales of household cleaners increased compared with a year ago.

Overseas, we launched a laundry detergent in Thailand, emphasizing indoor air-drying qualities, and a laundry detergent brand in Malaysia, promoting its ability to remove odors. Sales of laundry detergent in both countries increased considerably as a result. Moreover, in South Korea, sales were favorable for Beat laundry detergent for drum-style washer/dryers as a result of an aggressive advertising campaign.

As a result, sales of Household Products decreased 2.1% to ¥69,263 million.

### **Principal new products**

Dentor Systema Dental Rinse

Prime Stain-Off (Natural herbal mint fragrance) / Toothpaste

Shokubutsu-Monotari (Plant Story) Herb Blend Shampoo & Conditioner

Kireikirei Medicated Body Wash

Ban Powder Spray (Sweet Muscat fragrance)

Ban Zero Medicated Deodorant Spray

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

Soflan with Fragrance and Deodorant / Fabric softener

Powerful Charmy /Dishwashing detergents for dishwashers

**<Pharmaceutical Products>**

(Millions of yen)

	FY 2005 1st half	Ratio to net sales	FY 2004 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	25,103		14,446		10,657	73.8%
Operating income	1,263	5.0%	947	6.6%	316	33.4%

Sales of Pharmaceutical Products increased 73.8% to ¥25,103 million.

Amid firm demand for products that treat sickness from influenza and pollen, Lion quickly moved to introduce new products in its new OTC business, which was newly acquired at the end of the previous fiscal year. At the same time, we made concerted efforts to nurture these products through an aggressive advertising campaign.

Operating income grew 33.4% to ¥1,263 million due to contributions from the new OTC business, despite higher expenditures to nurture new products and key brands.

**Principal divisions**

Sales increased year on year due to strong demand for Bufferin A analgesics and Kids Bufferin cold medicine owing to the spread of influenza during the period under review.

Sales of eye drops increased significantly, reflecting the popularity of Smile 40EX, an eye drop containing three vitamins.

In anti-diarrheic drugs, sales increased noticeably year on year due to firm demand for Stoppa Anti-Diarrhea Medicine, which can be taken anywhere without water.

In tonics and nutrients, Lion launched three new Guronsan health tonic drinks with glucuronolactone, which strongly fortifies nutrition, and concentrated efforts on an advertising campaign to promote these products.

In insecticides, the new concept of protecting families from allergens increased support for sales of Varsan.

**Principal new products**

Guronsan Red, Guronsan Gold, and Guronsan Real / Health tonic drinks

**<Chemicals>**

(Millions of yen)

	FY 2005 1st half	Ratio to net sales	FY 2004 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	17,110		16,272		837	5.1%
Operating income	786	4.6%	1,060	6.5%	(273)	(25.8%)

In Chemicals, business, business conditions were challenging due to rising material prices in reflection of higher crude oil prices, and weaker sales of products related to IT on account of inventory adjustments. Amid this operating environment, sales increased 5.1% to ¥17,110 million, owing to the aggressive development of markets in Japan and abroad for products that use our innovative technologies.

Operating income decreased 25.8% to ¥786 million, adversely affected by higher crude oil prices and other factors.

**<Principal divisions>**

In fatty-acid methyl ester, which is used as a raw material for long-chain alcohol, sales increased significantly year on year with strong user support in Japan and abroad for its plant origins and high quality.

In surfactants, demand expanded in Japan for cationic surfactants for various applications including softeners. Due to the streamlining of our product lineup, overall sales decreased compared with the same period of the previous fiscal year.

In electro-conductive carbon, exports of Ketjenblack were robust based on a high appraisal of its excellent electrical conductivity, but inventory adjustments from the IT downturn slowed sales of electrically conductive compounds, leading to a decline in sales overall.

**<Others>**

(Millions of yen)

	FY 2005 1st half	Ratio to net sales	FY 2004 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	5,476		8,975		(3,498)	(39.0%)
Operating income	143	2.6%	784	8.7%	(641)	(81.7%)

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 39.0%, to ¥5,476 million, and operating income to decline by 81.7%, to ¥143 million.

### (3) Financial Status

	FY 2005 1st half	FY 2004	Change
Total assets (millions of yen)	234,692	235,405	(712)
Total shareholders' equity (millions of yen)	103,077	101,021	2,055
Shareholders' equity ratio (%)	43.9	42.9	1.0*
Shareholders' equity per share (yen)	365.40	356.90	8.50

\*In percentage points

(Millions of yen)

	FY 2005 1st half	FY 2004 1st half	Change
Cash flows from operating activities	(9,584)	(2,710)	(6,873)
Cash flows from investing activities	(1,908)	5,911	(7,820)
Cash flows from financing activities	6,064	(2,708)	8,772
Translation gain related to cash and cash equivalents	31	(50)	81
Increase (decrease) in cash and cash equivalents	(5,397)	442	(5,839)
Cash and cash equivalents at end of period	19,173	32,160	(12,986)

As of June 30, 2005, total assets were ¥234,692 million, a decrease of ¥712 million from December 31, 2004. Shareholders' equity was ¥103,077 million, reflecting the acquisition of treasury stock, growth in net income, and gains on valuation differences of other securities. The shareholders' equity ratio was 43.9%.

#### <Consolidated Cash Flows>

Cash flows from operating activities decreased ¥6,873 million compared with the same period of the previous fiscal year, owing to increases in accounts receivable and inventories, and a decrease in other payables and accrued expenses, despite growth in income before income taxes.

Cash flows from investing activities decreased ¥7,820 million compared with the same period of the previous fiscal year, reflecting purchases of property, plant and equipment and the absence of proceeds from sale of investment securities, which was recorded in the previous fiscal year.

Cash flows from financing activities increased ¥8,772 million compared with the same period of the previous fiscal year, owing to proceeds from the issuance of commercial paper and a decline in purchases of treasury stock.

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

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005 1st half
Shareholders' equity ratio (%)	44.6	43.1	45.0	42.9	43.9
Shareholders' equity ratio on a market value basis (%)	58.3	56.5	66.6	71.9	70.7
Debt redemption (years)	1.2	0.5	0.7	3.9	—
Interest coverage ratio	40.8	119.8	86.7	25.6	—

(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.

\* Debt redemption (years) and interest coverage ratio are not described for FY 2005 1st half, because cash flows from operating activities was a minus figure.

**(4) Appropriation of Earnings****<Dividends>**

The interim dividend for the first half of fiscal 2005 will be ¥4 per share, the same as that for the first half of fiscal 2004.

**<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 Fiscal 2005

### (1) Forecasts

#### <Consolidated>

(Millions of yen)

	FY 2005 forecast	FY 2004	Increase/decrease	Change
Net sales	335,000	309,514	25,485	8.2%
Ordinary income	9,500	8,271	1,228	14.8%
Net income	5,500	(4,723)	10,223	-

#### <Non-Consolidated>

(Millions of yen)

	FY 2005 forecast	FY 2004	Increase/decrease	Change
Net sales	280,000	267,382	12,617	4.7%
Ordinary income	6,000	5,295	704	13.3%
Net income	4,000	(5,428)	9,248	-

In the second half of the fiscal year ending December 31, 2005, the Japanese economy is expected to continue a moderate recovery. In the household products market, challenging conditions are expected to continue with intensifying competition among manufacturers and rising material prices.

Under these business conditions, Lion aims to nurture key brands by increasing cost efficiency and developing and introducing advanced high-value-added products in the Home Products business. Overseas, we expect sales to expand year on year in all businesses as we aggressively develop operations in South Korea and ASEAN countries.

In Pharmaceutical Products business, we estimate a significant increase in sales compared with the previous fiscal year, and plan to aggressively nurture key brands in new and existing fields through marketing and store-boosting activities.

In the Chemicals division, we aim to expand sales of high-value-added, environmentally friendly and proprietary products and natural oils and fats, and expect sales to grow.

In the Other business segment, we expect sales to decline on account of a decrease in project completions in the construction contracting business.

As a net result of the above, Lion projects full-term consolidated net sales of ¥335 billion, an increase of 8.2% compared with the previous fiscal year.

Lion also projects ordinary income to expand 14.8% to ¥9.5 billion and net income of ¥5.5 billion.

Lion plans to maintain dividends of ¥8 per share, including interim and year-end dividends of ¥4 per share each.

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

In cash flows from operating activities, Lion projects income before income taxes of approximately ¥7.0 billion. Lion estimates depreciation and amortization charges of about ¥9.0 billion.

In cash flows from investing activities, Lion plans capital expenditure of ¥12.0 billion.

Lion estimates net cash used in financing activities to amount to ¥3.0 billion, owing in part to dividend payments.

Based on these projections, Lion estimates cash and cash equivalents at the end of the year to total ¥25.0 billion, roughly the same level as the balance at the end of fiscal 2004.

## **2. 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 interim 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 the six-month period 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.