

## **Management Performance and Financial Status**

### **1. The First Half in Review**

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

During the first half of the current fiscal year, the Japanese economy showed signs of a mild recovery buoyed by increased capital investment in the private sector on the back of improved corporate earnings and moderate expansion of consumer spending. However, in the core area of business for Lion and its Group companies, the home products market in Japan, the operating environment remained difficult due to increased material costs caused by crude oil prices that rose and hovered at high levels, and continuously declining unit prices at retail stores attributable to intensifying competition.

Under these circumstances, Lion undertook aggressive initiatives in its operations. Lion worked to strengthen the Group's growth potential by quickly establishing the Home Products business in South Korea and over-the-counter (OTC) pharmaceutical business, both of which were acquired at the end of fiscal 2004. Lion also brought innovation to its sales structure aiming to raise profitability in its domestic home products business, and reorganized sales and R&D structures in Home Products for developing and fostering new high-value-added products. Furthermore, Lion entered a new field of functional food products. In ASEAN countries, Lion stepped up efforts to exclusively develop the business of its mainstay brands.

On the domestic front, the markets of Home Products, Pharmaceutical Products and Chemicals remained highly competitive, adversely affecting Lion's domestic net sales, which fell below that of the first half of the previous fiscal year. Overseas, sales in ASEAN countries were brisk, resulting in significantly increased overseas net sales compared with the first half of the previous fiscal year.

As a result of the aforementioned, consolidated net sales increased 2.1% to ¥163,295 million compared with the same period of the previous fiscal year. Operating income declined 57.8% to ¥1,343 million, and ordinary income decreased 43.4% to ¥2,508 million. Net income for the interim period under review fell 33.4% to ¥1,770 million, as Lion recorded a loss on shutdown of Tokyo plant, early retirement payments and other restructuring expenses in extraordinary loss, more than offsetting the gain on disposal of property, plant and equipment in extraordinary income.

**<Consolidated>**

(Millions of yen)

Net sales	FY 2006 1st half	FY 2005 1st half	Increase/ decrease	Change
Home Products	114,282	112,191	2,090	1.9%
Pharmaceutical Products	23,636	25,103	(1,467)	(5.8%)
Chemicals	16,074	17,110	(1,035)	(6.1%)
Others	9,301	5,476	3,824	69.8%
Total	163,295	159,882	3,412	2.1%

\* Sales to outside customers

(Millions of yen)

	FY 2006 1st half	Ratio to net sales	FY 2005 1st half	Ratio to net sales	Increase/ decrease	Change
Operating income	1,343	0.8%	3,179	2.0%	(1,835)	(57.8%)
Ordinary income	2,508	1.5%	4,432	2.8%	(1,923)	(43.4%)
Net income	1,770	1.1%	2,659	1.7%	(889)	(33.4%)

**<Non-consolidated>**

(Millions of yen)

Net sales	FY 2006 1st half	FY 2005 1st half	Increase/ decrease	Change
Home Products	89,132	90,318	(1,186)	(1.3%)
Pharmaceutical Products	23,553	25,092	(1,539)	(6.1%)
Chemicals	12,900	13,762	(861)	(6.3%)
International	1,253	1,053	199	18.9%
Total	126,839	130,228	(3,388)	(2.6%)

(Millions of yen)

	FY 2006 1st half	Ratio to net sales	FY 2005 1st half	Ratio to net sales	Increase/ decrease	Change
Operating income	155	0.1%	1,365	1.1%	(1,210)	(88.6%)
Ordinary income	3,339	2.6%	4,418	3.4%	(1,078)	(24.4%)
Net income	2,494	2.0%	3,556	2.7%	(1,062)	(29.9%)

**<Consolidated Geographical Segment>**

(Millions of yen)

Net sales	H1 2006	H1 2005	Increase/ decrease	Change
Japan	141,905	141,811	93	0.1%
Asia	21,390	18,070	3,319	18.4%
Consolidated total	163,295	159,882	3,412	2.1%

\* Sales to outside customers

Operating income	H1 2006	H1 2005	Increase/ decrease	Change
Japan	1,104	2,883	(1,779)	(61.7%)
Asia	95	175	(79)	(45.7%)
Corporate and eliminations	143	120	22	18.9%
Consolidated total	1,343	3,179	(1,835)	57.7%

## (2) Segment Information

### <Home Products>

(Millions of yen)

	FY 2006 1st half	Ratio to net sales	FY 2005 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	114,282		112,191		2,090	1.9%
Operating income	(58)	-	4,216	3.8%	(4,275)	-

\* From the interim period under review, expenses in administrative departments, which were previously recorded as unallocated operating expenses, are allocated to each segment. Operating income under the historic method was ¥3,061 million, declined 27.4% from the same period of the previous fiscal year.

Net sales of Home Products totaled ¥114,282 million, up by 1.9% over the same period of the previous year.

Lion continued efforts to enhance its core brands through introducing new, differentiated and superior products and focusing on aggressive advertising campaigns as well as pioneering new product categories. However, domestic net sales in the Home Products segment stagnated amid intensifying competition and other severe conditions.

On the other hand, Lion aggressively promoted its core brands in Thailand while introducing new products in South Korea, resulting in a steady sales growth overseas.

In this segment, Lion recorded an operating loss of ¥58 million, compared with the operating income of ¥4,216 million in the same period of the previous fiscal year. Lion's performance was adversely affected by rising material costs caused by high crude oil prices and the decrease in domestic net sales, despite Lion's all-out efforts to reduce production and logistics costs.

### <Net Sales of Principal divisions>

(Millions of yen)

	FY 2006 1st half	FY 2005 1st half	Increase/ decrease	Change
Oral Care Products Division	25,301	23,134	2,166	9.4%
Beauty Care Products Division	17,290	19,793	(2,503)	(12.6%)
Household Products Division	71,690	69,263	2,427	3.5%

### Oral Care Products

In the Oral Care Products business, which has seen 110 years of operations for toothpaste sales, Lion has aggressively proposed new daily oral care practices that contribute to the overall health of consumers, and consequently, to the better quality of their lives. In an effort to further strengthen Lion's standing as Japan's No. 1 oral care company, expand the sale of core brands to a ¥10 billion level and/or establish these brands as No. 1 in the category, Lion vigorously introduced new products and accelerated advertising campaigns for the new Clinica, Dentor Systema and Between product lines.

In toothpaste products, sales were brisk for PC Clinica Toothpaste, which suppresses plaque buildup and is offered in a new fresh mint flavor, in addition to the existing mild mint flavor. In addition, sales promotion activities for Clinica Toothpaste for Caries Risk Control were enhanced, positively affecting overall sales of toothpastes to exceed that of the first half of the previous fiscal year.

Lion's newly designed Between toothbrush and Clinica toothbrush, which effectively removes dental plaque, were well received by consumers. As a result, sales of toothbrushes experienced steady growth.

In mouthwash, Clinica Dental Rinse-Quick Care, a new product that prevents caries and bad breath odor with just a simple rinse, won acclaim on the market. Overall sales of mouthwash products significantly exceeded that of the same period of the previous fiscal year.

Among dental materials, sales were steady for DENT. EX Systema, an ultrafine bristle toothbrush. With the addition of the new DENT. EX Kodomo Disney toothbrush, featuring Disney character designs for kids, overall sales of dental materials were solid.

In the overseas segment, Systema toothpaste and toothbrushes maintained brisk sales in Thailand, while in South Korea a new line of Dentralla toothbrushes and toothpaste were launched, contributing to a significant increase in sales from the corresponding interim period of the previous fiscal year.

As a result, sales of Oral Care Products increased 9.4% to ¥25,301 million.

## **Beauty Care Products**

Lion focused on strengthening operations for hand soaps, antiperspirants and deodorants and hair-nourishment treatments for which Lion expects growth in the future.

In hand soaps, the KireiKirei Medicated Liquid Hand Soap was upgraded and released. The sales of hand soaps grew significantly, exceeding the results of the same period of the previous fiscal year.

Sales of antiperspirants and deodorants stagnated on the back of intensifying competition, despite the introduction of the new Ban Powder Spray, with a powder that effectively absorbs moisture created by the skin's oil and sweat.

In hair-nourishment treatments, Lion released the Mouhatsuryoku Innovate EX with deep-reaching active ingredients. Sales in this product category rose greatly compared with the same period of the previous fiscal year.

Amid intensifying competition in the shampoo and conditioner market, slumping sales of Lion's core brands, including Shokubutsu-Monogatari (Plant Story) Herb Blend Shampoo and Conditioner and Soft-in-One Shampoo and Conditioner, resulted in decreased sales in the category compared with the same period of the previous fiscal year.

Sales of body washes were sluggish for the Shokubutsu-Monogatari (Plant Story) Herb Blend Body Wash, due to intensifying competition. As a result, sales declined year on year.

Looking at overseas, the Shokubutsu-Monogatari Series of products recorded steady sales in Thailand and Taiwan, although operations in South Korea faced an increasingly competitive operating environment, constraining overseas sales to the same level as the same period of the previous fiscal year.

As a result, sales of Beauty Care Products decreased 12.6% to ¥17,290 million.

## **Household Products**

Lion stepped up efforts to strengthen the growth potential of its Household Products business, including fostering the laundry detergent brand Top, which has been on the market for 50 years, and aggressively developing the liquid detergent business for which large-scale market expansion is expected, as well as creating a new market for new-concept household cleaners. As an ongoing effort, Lion streamlined sales promotion costs in laundry detergents and fabric softeners, with the aim of further reinforcing the business foundation.

In laundry detergents, Lion released an improved version of plant-based Top, which boasts superior detergency, and Liquid Top, which is able to remove mud and grime. Lion enhanced the Top brand through such initiatives as early distribution of the products to retail stores, point-of-sales promotion and an aggressive advertising campaign. As a result of these endeavors, overall sales in laundry detergents increased compared with the same period of the previous fiscal year.

Lion worked to nurture Kaori to Deodorant no Soflan ('Soflan with Fragrance and Deodorant'), a core fabric softener brand. Adversely affected by the severe market condition of declining unit prices, sales of fabric softeners decreased year on year.

Amid market expansion for detergents specifically for use with dishwashers, Lion released Charmy Crysta Gel for Dishwashers, which is able to remove the dimness of glass and dish surfaces. Lion also upgraded Charmy V Quick dishwashing detergent. Nevertheless, the severe competitive operating environment affected result in this area, with sales remaining flat year on year.

In household cleaners, the Look Kirei no Mist Series' new concept of "preventing slimy surfaces and odors in kitchens, bathrooms and toilets" was welcomed by consumers. Consequently, sales of this product category increased considerably compared with the same period of the previous fiscal year.

Sales in the overseas Household Products business showed a marked increase year on year, buoyed by steady sales growth of Pao laundry detergent and Essence fabric softener in Thailand.

As a result, sales of Household Products increased 3.5% to ¥71,690 million.

## Principal new products

PC Clinica (Fresh mint flavor) / Toothpaste  
Clinica Dental Rinse - Quick Care / Mouthwash  
Mouhatsuryoku Innovate Ex / Hair-nourishment treatment  
Ban Powder Spray / Antiperspirants and deodorants  
Liquid Top / Laundry detergent  
Top / Laundry detergent  
Charmy Crysta Gel for dishwashers  
Look Kirei no Mist for Kitchen, Bathrooms and Toilets / Disinfectants

## <Pharmaceutical Products>

(Millions of yen)

	FY 2006 1st half	Ratio to net sales	FY 2005 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	23,636		25,103		(1,467)	(5.8%)
Operating income	1,553	6.6%	1,263	5.0%	289	22.9%

\* Operating income under the historic method was ¥2,294 million in this interim period, increased 81.6% from the same period of the previous fiscal year.

Sales of Pharmaceutical Products decreased 5.8% to ¥23,636 million.

Lion is working to strengthen its R&D capabilities with the aim of becoming a general OTC drug manufacturer, while pursuing synergistic effects between pharmaceutical and home products in the area of distribution.

The OTC drug market suffered under harsh conditions, reflecting the shrinking markets of analgesics, pollen allergy-related products, health tonic drinks and insecticides.

Under these circumstances, Lion strongly advanced its growth strategies such as entering the functional food product field and expanding the lineup of its insecticide products, as well as utilizing the sales channels for home products. Despite these efforts, sales in the pharmaceutical products business were stagnant.

Operating income, on the other hand, rose 22.9% to ¥1,553 million, due to contributions from reducing production costs, reorganizing distribution bases and streamlining sales promotion costs.

## Principal divisions

In analgesics, Lion boosted sales promotion activities for Bufferin A by increasing investment in its advertising campaign. Nevertheless, sales declined year on year, impacted by the shrinking market.

Sales of eyedrops grew significantly, buoyed by robust sales of Smile 40EX.

In health tonic drinks, Lion upgraded the Guronsan Strong Oral Liquid while accelerating point-of-sales promotion for the New Guromont. The shrinking market affected Lion's performance, however, and overall sales of health tonic drinks decreased compared with the same period of the previous fiscal year.

Lion upgraded Varsan SX Jet, a mainstay fumigation product in the Varsan Series that get rid of mites, and added seven new insecticide products to its lineup, including Varsan Insect-Repellent Cube. These products contributed to a considerable sales increase year on year.

In medicinal skin-care products, Lion released Pairacne W, a cream for treating acne at the root, which positively affected sales in this product division to grow significantly compared with the same period of the previous fiscal year.

In a new field of health drinks, Gussumin, a drink that combines tomato vinegar and GABA and supports a comfortable life, and Kyupurun, a beauty-support drink that combines collagen and flavangenol, both recorded sales exceeding projected targets. As a result, overall sales in this field were strong.

### Principal new products

Varsan Insect-Repellent Cube

Varsan Mite Elimination Pack

Gussumin / Health drink

Kyupurun / Health drink

Tomato no Akazu Drink / Health drink

Pairacne W / Acne medicine

### <Chemicals>

(Millions of yen)

	FY 2006 1st half	Ratio to net sales	FY 2005 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	16,074		17,110		(1,035)	(6.1%)
Operating income	(123)	-	786	4.6%	(910)	-

\* Operating income under the historic method was ¥101 million in this interim period, decreased 87.2% from the same period of the previous fiscal year.

Sales of Chemicals decreased 6.1% to ¥16,074 million.

Amid recovering demand for IT-related products, Lion strove to foster high-value-added products, focusing primarily on electro-conductive compounds and industrial detergents. However, slow sales of fatty-acid methyl ester and other products impacted overall sales of chemical products, declining from the level in the same period of the previous fiscal year.

Despite efforts in cost-reduction measures, including transferring production functions overseas and streamlining the manufacturing process, Lion recorded an operating loss of ¥123 million, compared with the operating income of ¥786 million in the same period of the previous fiscal year, mainly due to rising

material costs attributed to surging crude oil prices that hovered at high levels.

### <Principal divisions>

In surfactants, domestic sales of nonionic surfactants were sluggish because of the severely competitive environment in Japan. On the other hand, overseas sales were strong, buoyed by robust demand of surfactants for use in household cleaners. As a result, overall sales of surfactants experienced solid growth.

On the back of recovering domestic demand for detergents used in the manufacture of liquid crystal displays (LCDs), sales of industrial detergents improved significantly compared with the same period of the previous fiscal year.

Fatty-acid methyl ester maintained a high level of recognition thanks to its exceptional purity. However, sales decreased year on year, impacted by inventory adjustments in domestic and overseas markets.

Electro-conductive compounds showed brisk sales overseas, reflecting Lion's creation of new markets. Overall, sales remained flat, however, due to continued severe competition in domestic markets.

### <Others>

(Millions of yen)

	FY 2006 1st half	Ratio to net sales	FY 2005 1st half	Ratio to net sales	Increase/ decrease	Change
Net sales	9,301		5,476		3,824	69.8%
Operating income	(83)	-	143	2.6%	(227)	-

\* Operating loss under the historic method was ¥37 million in this interim period, while operating income in the same period of the previous fiscal year was ¥143 million.

In the Others segment, net sales amounted to ¥9,301 million, a 69.8% increase year on year, owing to the increase in the number of works completions in the construction contracting business. However, Lion recorded an operating loss of ¥83 million, a drop from operating income of ¥143 million during the same period of the previous fiscal year, due to an increasingly competitive operating environment.

### (3) Financial Status

	FY 2006 1st half	FY 2005	Change
Total assets (millions of yen)	249,418	249,303	114
Net assets (millions of yen)	112,955	109,103	3,851
Shareholders' equity to total assets (%)	44.2	43.8	0.4 <sup>*2</sup>
Net assets per share <sup>*1</sup> (yen)	388.05	384.60	3.45

\*1 Minority interest was excluded from calculation of net assets per share

\*2 In percentage points

(Millions of yen)			
	FY 2006 1st half	FY 2005 1st half	Change
Cash flows from operating activities	(4,976)	(9,584)	4,608
Cash flows from investing activities	(1,135)	(1,908)	772
Cash flows from financing activities	6,843	6,064	779
Translation gain related to cash and cash equivalents	0	31	(31)
Increase (decrease) in cash and cash equivalents	731	(5,397)	6,128
Cash and cash equivalents at end of period	16,520	19,173	(2,652)

As of June 30, 2006, total assets were ¥249,418 million, an increase of ¥114 million from December 31, 2005. Net assets were ¥112,955 million, reflecting the gains on unrealized holding gain on other securities. The shareholders' equity to total assets was 44.2%.

#### <Consolidated Cash Flows>

Net cash used in operating activities totaled ¥4,976 million, compared with ¥9,584 million during the same period of the previous fiscal year. Decrease in trade notes and accounts payable offset income before income taxes of ¥5,136 million.

Net cash used in investing activities was ¥1,135 million, compared with ¥1,908 million during the same period of the previous fiscal year, owing mainly to purchases of property, plant and equipment and purchases of investment securities.

Net cash provided by financing activities was ¥6,843 million, compared with ¥6,064 million during the same period of the previous fiscal year, owing primarily to proceeds from commercial paper.

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

	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006 1st half
Shareholders' equity to total assets (%)	43.1	45.0	42.9	43.8	44.2
Shareholders' equity to total assets on a market value basis (%)	56.5	66.6	71.9	85.8	84.5
Debt redemption (years)	0.5	0.7	3.9	9.8	—
Interest coverage ratio	119.8	86.7	25.6	7.1	—

(Notes)

Shareholders' equity to total assets: Net assets / Total assets

(Total shareholders' equity / Total assets until FY 2005)

Shareholders' equity to total assets 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 2006 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 2006 will be ¥5 per share, up ¥1 from the first half of fiscal 2005.

## 2. Outlook for Fiscal 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	275,000	270,894	4,105	1.5%
Ordinary income	7,000	6,453	546	8.5%
Net income	5,000	4,657	342	7.4%

In the second half of the fiscal year ending December 31, 2006, the Japanese economy is expected to continue a moderate recovery. In the home products market, challenging conditions are expected to persist with intensifying competition among manufacturers and rising material prices caused by higher crude oil prices.

Amid such an operating environment, Lion aims to nurture key brands in the Home Products business by streamlining investment and improving cost efficiency in marketing activities, and by introducing advanced high-value-added products. Overseas, we will aggressively develop operations in Thailand and South Korea. Buoyed by these initiatives, overall sales of the home products business are expected to expand year on year.

In the Pharmaceutical Products business, we estimate an increase in sales compared with the previous fiscal year as we release new products of our key and existing brands and boost investment in marketing activities.

In the Chemicals business, Lion aims to foster environmentally friendly products such as natural oils and fats and other high-value-added products. Nevertheless, sales are expected to remain flat compared with the previous fiscal year, due to the effects of Lion's activities to withdraw from unprofitable products.

In the Other business segment, we expect sales to increase on account of an increase in project completions in the construction contracting business.

As a net result of the above, Lion projects full-term consolidated net sales of ¥350 billion, an increase of 5.5% compared with the previous fiscal year.

Lion also projects ordinary income to expand 5.7% to ¥9.0 billion and net income of ¥5.0 billion.

Lion plans to declare annual dividends for fiscal 2006 of ¥ 10 per share (¥5 per share both for interim and year end dividends).

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

In cash flows from operating activities, Lion projects income before income taxes of approximately ¥8.0 billion. Lion estimates depreciation and amortization charges of about ¥10.0 billion.

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

Based on these projections, Lion estimates cash and cash equivalents at the end of the year to total ¥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.

## **3. 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

In a future lawsuit, 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.