

Basis of Preparation of Consolidated Financial Statements

1. Scope of Consolidation

Lion Corporation has 25 subsidiaries, of which 21 are consolidated subsidiaries.

Principal companies: Lion Engineering Co., Ltd., Lion Logistics Service Company, Ltd., Lion Trading Co., Ltd., Lion Packaging Co., Ltd., Lion Chemical Co., Ltd., CJ Lion Corporation, and Lion Corporation (Thailand) Ltd.

Inclusion: Lion Eco Chemicals Sdn. Bhd. which was established in FY 2007 was included as consolidated subsidiary.

Exclusion: McCormick-Lion Limited was excluded from consolidation because its liquidation was completed.

2. Application of Equity-Method Accounting

Equity-method accounting is applied to two out of 4 non-consolidated subsidiaries and to nine out of 16 affiliated companies.

Principal companies: Lion Akzo Co., Ltd., Calp Corporation and Southern Lion Sdn. Bhd.

Inclusion: Pacific Soap Mfg. Sdn. Bhd. and Lion Service Company Limited which is a subsidiary company of Lion Corporation (Thailand) Ltd. were included as equity-method companies due to increased importance of these companies.

Exclusion: Kanagata (Thailand) Co., Ltd. which was a subsidiary company of Lion Corporation (Thailand) Ltd. was excluded from equity-method companies because whole subsidiary shares were transferred.

Bristol-Myers Lion Ltd. was excluded from equity-method companies because its liquidation was completed.

3. Balance Sheet Date of Consolidated Subsidiaries

December 31 is the balance sheet date of 21 consolidated subsidiaries (consolidated balance sheet date).

4. Accounting Policies

a) *Valuation of Assets*

1) Marketable securities

(a) Held-to-maturity debt securities

Valuation is by the amortized cost method (straight-line method).

(b) Other marketable securities

Securities with market value

Carried at market value prevailing on the balance sheet date (changes in valuation are recorded in full as a separate component of net assets, and sales cost is determined by the moving-average method).

Securities without market value

Stated primarily at cost based on the moving-average method.

2) Derivatives

Stated at market value.

3) Valuation of inventories

Merchandise and finished products are stated at cost determined primarily by the first-in, first-out method.

Raw materials, work-in-progress, and supplies are stated at cost determined primarily by the moving-average method.

b) *Depreciation*

1) Property, plant and equipment

Depreciation is primarily by the declining balance method, with some consolidated subsidiaries using the straight-line method.

2) Intangible assets

Amortization is by the straight-line method. Software for in-house use is amortized primarily by the straight-line method, assuming a useful life of five years.

c) Recognition of Allowances

1) Allowance for doubtful accounts

To provide for potential losses on loans, an allowance is made by the parent company and by domestic consolidated companies for general claims using the default rate for such claims, and an allowance is also made for doubtful claims in accordance with individually estimated uncollectible amounts. In the case of foreign consolidated companies, an allowance is made for the estimated uncollectible amounts of certain claims.

2) Allowance for returns

To provide for the return of merchandise and finished products after the balance sheet date, the estimated loss on returns is recorded.

3) Allowance for sales promotion expenses

The estimated payment of rebates and other sales promotion expenses related to consolidated sales are recorded.

4) Allowance for bonuses to internal directors

To provide for the payment of bonuses to internal directors, an allowance is made based on projected amount.

5) Allowance for retirement benefits

To provide for the payment of retirement benefits to employees, an allowance is made based on projected benefit obligations and fair value of pension plan assets at the end of the consolidated fiscal year.

Past benefit liabilities are amortized from the time they accrue by the straight-line method for a given number of years (five years) within employees' average remaining years of service.

Actuarial gain or loss is amortized from the consolidated fiscal year following the year in which the gain or loss is recognized by the straight-line method for employees' average remaining years of service.

6) Allowance for director retirement benefits

To provide for the payment of director retirement benefits, an allowance is made for the estimated amount accruing as of the balance sheet date in accordance with Lion's director retirement allowance regulations.

In accordance with the adoption of stock options under a stock-based compensation plan at the parent company, no additional allowances have been made after March 30, 2006.

d) Foreign Currency Translation

All current and long-term monetary assets and liabilities denominated in foreign currencies are translated into Japanese yen at current rates prevailing on the consolidated balance sheet date, and the resulting translation gains or losses are taken into income. All asset and liability accounts of foreign subsidiaries and affiliates are translated into Japanese yen at current rates prevailing on the consolidated balance sheet date, and all income and expense accounts are translated at average rates for the fiscal year. The resulting translation adjustments are accumulated as minority interest in consolidated subsidiaries and valuation and translation adjustments under net assets.

e) Leases

Finance leases are accounted as operating leases excluding leases where ownership is transferred to the lessee.

f) Significant Matters in Hedge Accounting

1) Hedge accounting

Deferred hedge accounting is used. Translation at the contract rate is applied in accounting for forward currency contracts and currency swaps when appropriate conditions are met. Hedges meeting conditions for the special treatment of interest-rate swaps are accounted for separately.

2) Hedging instruments and hedged items

Hedging instruments	Hedged items
Forward currency contracts	Transactions to be denominated in a foreign currency
Interest rate swap	Interest rate

3) Hedging policy

Currency risk and interest-rate risk are hedged by the Finance Department of the parent company and by the management units of subsidiaries primarily in accordance with internal regulations.

g) Other Significant Matters in the Presentation of Consolidated Financial Statements

The tax-excluded method is used in consumption tax accounting.

5. Valuation of assets and liabilities of consolidated subsidiaries

Valuation of assets and liabilities of consolidated subsidiaries is made by market value method.

6. Amortization of goodwill

Goodwill is amortized equally over the estimated number of years (10) with respect to items for which rational estimates can be made, and is amortized at the time at which they arise with respect to immaterial items.

7. Scope of Cash and Cash Equivalents in Consolidated Statements of Cash Flows

For the purpose of consolidated statements of cash flows, cash and cash equivalents consist of cash on hand, demand deposits, and short-term liquid investments that mature within three months from the purchase date and can be converted easily into cash with little risk of change in value.

Notes to Consolidated Financial Statements

[Notes to Consolidated Balance Sheets]

	(Millions of yen)	
	<u>Fiscal 2006</u>	<u>Fiscal 2007</u>
1. Cumulative depreciation of property, plant and equipment	144,961	148,214
2. Assets pledged as collateral		
Cash and time deposits	—	688
Land	327	315
Buildings and structures	1,626	1,592
Machinery and equipment	549	632
Total	<u>2,503</u>	<u>3,228</u>
Secured debt		
Short-term loans payable	328	140
Account payable	272	335
Total	<u>600</u>	<u>476</u>
3. Endorsed notes receivable	43	—
4. Balance Outstanding of Export Bills	121	18
Negotiated		
5. Guarantees of debt	3,591	2,757
6. Treasury stock held at the fiscal year end	28,974 (Thousands of shares)	28,556 (Thousands of shares)
7. Notes with their maturity date as of the fiscal year-end are settled for accounting purposes as of their clearing date.		

[Notes to Consolidated Statements of Income]

Breakdown of significant selling, general and administrative expenses:
(Millions of yen)

	FY 2006	FY 2007
Sales incentive expenses	14,660	15,719
Sales promotion expenses	63,753	67,488
Freight and storage expenses	16,549	16,818
Advertising expenses	22,393	21,934
Salaries	14,729	14,603
R&D expenses	7,922	8,745

*No R&D expenses have been included in production expenses for FY 2007

[Notes to Consolidated Statement of Changes in Shareholders' Equity]

1. Outstanding Shares

Class of shares	Number of shares held at December 31, 2006	Increase	Decrease	Number of shares held at December 31, 2007
Common shares (shares)	299,115,346	—	—	299,115,346

2. Treasury stock

Class of shares	Number of shares held at December 31, 2006	Increase	Decrease	Number of shares held at December 31, 2007
Common shares (shares)	28,974,638	235,834	654,182	28,556,290

Reasons for the Changes

* Increase: Purchase of odd lot shares of common stock – 235,834 shares

* Decrease: Release of treasury stock to allow shareholders with less than a full lot to complete their holdings – 130,938 shares; Release in response to execution of stock compensation rights – 523,244 shares

3. Dividends

a) Amount of dividend payments

Resolution	Class of shares	Annual dividend paid (million Yen)	Dividend par share (Yen)	Record date	Effective date
Board of Directors meeting held on February 9, 2007	Common shares	1,350	5.00	December 31, 2006	March 5, 2007
Board of Directors meeting held on July 31, 2007	Common shares	1,352	5.00	June 30, 2007	September 5, 2007

b) Dividends with a record date that falls within FY 2007 and an effective date in the following fiscal period

Resolution	Class of shares	Dividend Resource	Annual dividend paid (million Yen)	Dividend par share (Yen)	Record date	Effective date
Board of Directors meeting held on February 7, 2008	Common shares	Retained earnings	1,352	5.00	December 31, 2007	March 5, 2008

[Notes to Consolidated Statements of Cash Flows]

Balance of cash and cash equivalents at the end of the fiscal year and relationship with consolidated balance sheet:

	FY 2006 (December 31, 2006)	(Millions of yen) FY 2007 (December 31, 2007)
Cash and deposits	26,995	32,647
Marketable securities	—	923
Time deposits with maturities greater than three months	(212)	(350)
Total	<u>26,782</u>	<u>33,219</u>