

Interview with the President



Isao Teshirogi, Ph.D.
President and CEO

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First, would you mind looking back over fiscal 2010, the first year of Shionogi's third five-year medium-term business plan?

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I believe that in fiscal 2010, we made solid progress as a whole in implementing our basic strategies. By focusing resources on the 8 drugs we identified as strategic products, we grew combined sales of these 8 products by 32% year on year. These 8 products accounted for 37% of our sales of prescription drugs in the Japanese market, compared with 29% in the previous fiscal year. With regard to new growth drivers, we achieved progress in domestic and overseas development of several compounds including S-349572 (anti-HIV drug), ospemifene (treatment for vulvar and vaginal atrophy), S-297995 (for alleviating opioid-induced adverse effects), and S-707106 (anti-diabetes drug). In terms of business performance, however, we ended up reporting decreased profits, as a consequence of structural reforms at Shionogi Inc. and booking quake-related extraordinary losses.

Our new medium-term plan, which kicked off in April 2010, is essentially a five-year transition program preparing the Company to surmount the “Cliff” represented by the expiration of Crestor® patents in 2016 and 2017.

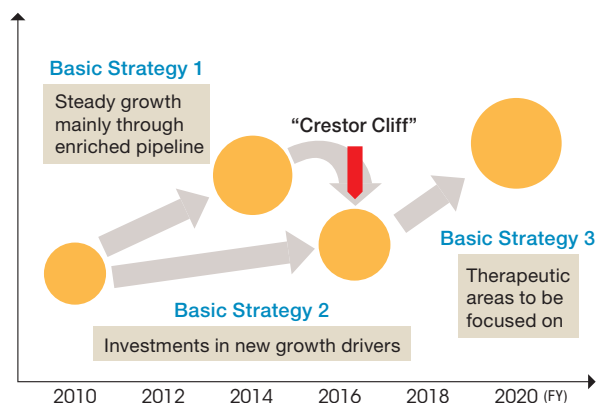
The first of our three basic strategies—that of “steady growth mainly through enriched pipeline”—is geared toward establishing a robust earnings base independent from “legacy products,” including off-patent drugs. To achieve this goal, we are concentrating resources on the eight new drugs we have identified as strategic products, including the hyperlipidemia treatment Crestor® and the antidepressant Cymbalta® (launched in April 2010). Although “selectivity” and “focus” have long been the watchwords for our domestic marketing effort, we have

become dependent on antibiotics such as Flomox®, as a result of which productivity has dwindled alongside market share. In fiscal 2010, however, we consistently reported domestic sales in excess of the market average. As a consequence, combined sales of our 8 strategic products grew 32% year on year, such that these drugs now account for 37% of Shionogi's prescription drug sales in Japan, up from 29% a year earlier.

The goal of our second basic strategy—that of “investments in the new growth drivers” with an eye to surmounting the “Crestor Cliff”—is to develop globally more than five late-stage products. Our anti-HIV drug S-349572 is currently in Phase III clinical trials, with a view to filing for regulatory approval during fiscal 2012. S-297995, for the alleviation of

Shionogi Medium- to Long-Term Vision

Enter a phase of renewed growth after surmounting the "Crestor Cliff"



opioid-induced adverse effects, offers hope that a single drug will prove effective in treating both nausea/vomiting and constipation. This drug is now in Phase IIb trials in Japan and the US. The diabetes treatment S-707106 has entered Phase IIa trials in the US. In January and April of 2011, meanwhile, Shionogi Inc. launched Kapvay™ for the treatment of attention deficit hyperactivity disorder (ADHD) and Cuvposa™ for chronic drooling in children. Following the completion of Phase III trials on our vulvar and vaginal atrophy treatment ospemifene, we have also commenced a bioequivalence study that leaves submission for regulatory approval just around the corner. However, in a combination

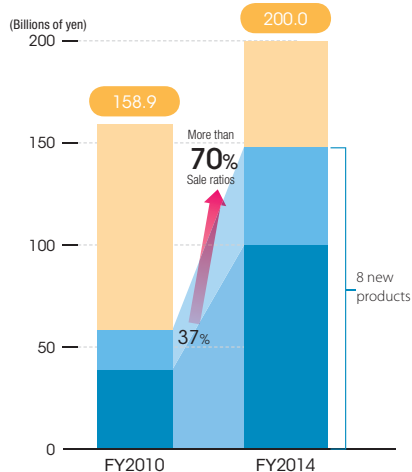
Phase II study with the existing weight-loss pill orlistat, our anti-obesity drug S-2367 fell short of the expected level of efficacy. Based also on the outcome of recent applications to have anti-obesity drugs approved in the US and Europe, we made the difficult decision to halt development in those markets.

Among initiatives supporting our third basic strategy of "therapeutic areas to be focused on," and the discovery of development candidates capable of underpinning an era of renewed growth ten years from now, we inked a joint research agreement concerning Gram-negative cepheims with GlaxoSmithKline, launched a collaboration with Purdue Pharma L.P. in the field of pain management, and undertook research into treating Alzheimer's disease.

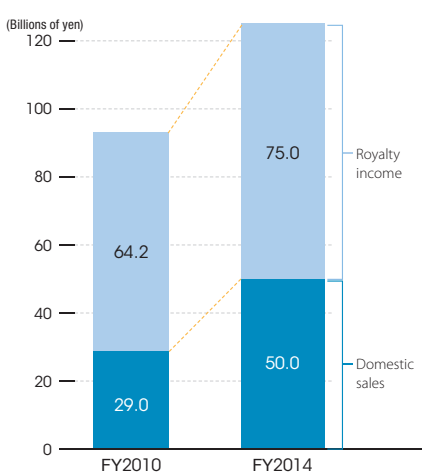
In terms of our business performance in fiscal 2010, domestic prescription drug sales increased year on year despite the adverse impact of NHI drug price revisions, in addition to which AstraZeneca achieved solid growth in global sales of Crestor®, resulting in higher royalty revenues. As a consequence, net sales rose 1.4% year on year in fiscal 2010, to ¥282.4 billion. However, operating income decreased 10.6% year on year to ¥46.9 billion. One reason was an increase in selling, general and administrative (SG&A) expenses. Furthermore, the cost of sales ratio worsened in line with a decrease in sales at Shionogi Inc. and a shortfall versus plan in companywide activities to reduce the cost of sales. Ordinary income decreased 10.6% to ¥45.2 billion. Net income decreased 48.2% to ¥20.0 billion as a result of extraordinary losses, including losses relating to the Great East Japan Earthquake, business structure reform expenses and impairment losses at Shionogi Inc.

Shionogi Growth Indicators in the Third Medium-Term Business Plan

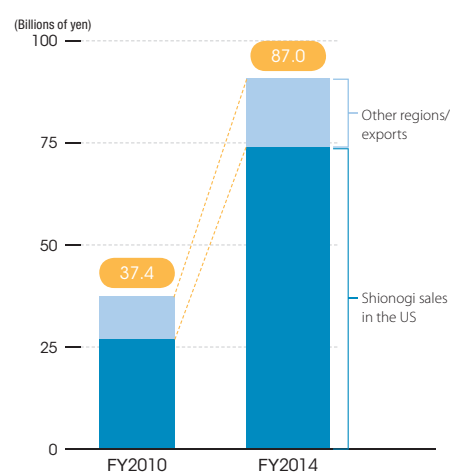
Domestic Sales Forecast



Global Growth of Crestor®



Overseas Sales Forecast



Q What issues came to light in this first year that stand in the way of achieving the objectives of the new medium-term plan?

A While I think the first year proved that we are heading in the right direction with the various initiatives undertaken as part of the new medium-term plan, it became clear that further action is needed to support global growth.

One thing we need to do is to control costs. Second, we need to enhance our R&D pipeline. In these regards, we must enhance the Group's drug discovery capabilities, as well as improve and accelerate strategic decision-making about global products under development.

Although results from the first year of the new medium-term plan appear to validate the initiatives undertaken to support the first basic strategy, "steady growth mainly through enriched pipeline," we think there is still room for improvement in productivity per Medical Representative (MR) and in detailing* to hospitals. Also, we cannot claim that our goals have been met if sales are on target but profits fall short. As has already been announced, for fiscal 2014 we are targeting net sales of ¥375 billion and operating income of ¥110 billion. If we are to meet those objectives, we must continue making a concerted effort to enforce cost controls across the Shionogi Group, including domestic marketing.

With regard to our second basic strategy, "investments in the new growth drivers," development of our anti-HIV drug is proceeding apace. Unfortunately, though, we were obliged to halt development in the US and Europe of S-2367, an anti-obesity drug that we had hoped would play a role in us surmounting the "Crestor Cliff." We have no choice now but to quicken the pace of pipeline development to fill the hole left by this discontinuation, all the more so because we envisioned S-2367 fitting the bill of an internally developed drug with global market potential, and had acquired the former Sciele Pharma, Inc. with the specific goal of building a US marketing network. It was for this reason, too, that we established the Global Development in April 2011, in order to create a

unified global development strategy.

On the subject of our third basic strategy, "therapeutic areas to be focused on," we are taking steps to flesh out our drug discovery portfolio through joint research with other pharmaceutical companies and bioventures to create new development candidates. With a view to securing new drug seeds, we believe it is important to continue our collaboration with Hokkaido University and Osaka University, along with the FLASH* drug discovery initiatives. In a move to enhance research productivity by consolidating research functions, we also undertook to build a new research building on the grounds of the Shionogi Pharmaceutical Research Center in Toyonaka City, Osaka Prefecture, which was completed in July 2011.

It may go without saying, but if we are to market original products in the US market and in other countries worldwide, we must further strengthen our in-house R&D capacity. We see this as critical to our capacity for survival in this industry, and our ability to realize global growth.

Glossary

- * **Detailing**
Providing doctors or other healthcare professionals with detailed information about drugs in a timely fashion.
- * **FLASH** (Pharma-Link between Academia and SHionogi)



The new pharmaceutical research building was completed in July 2011

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What are the key points for realizing the goals set in the new medium-term plan?

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We believe a change of approach is necessary if these goals are to be met. We must change our approach and our employees must better control costs. We are therefore taking steps to achieve the plan's goals from the dual perspectives of operational reform and corporate culture.

We recognize that holding on to past practices and attitudes would make it difficult to meet the objectives of our new medium-term plan. When kicking off our new medium-term plan, we also instigated Project SING (Shionogi Innovative New-DNA Generator), a two-pronged companywide initiative comprising an "operational reform project" aimed at changing business practices and optimizing resource allocation, and a "corporate culture reform project" geared toward upending a corporate culture that has consistently seen Shionogi fall short of its goals.

In particular, we hope that actions such as these will instill greater cost awareness among our employees. Sales are often at the mercy of external factors, but cost control is something that can be pursued internally. We plan to be unflinching in our cost-control efforts, devolving management objectives into targets for individual divisions and working toward those targets by clarifying the order of priorities, enabling optimal allocation of limited resources.

Under continual pressure from daily business operations, it is conceivable that employees may lose sight of their goal. For that reason, I



have taken to marking the first day of each quarter with a message to employees. I also endeavor to address our employees directly when something significant has taken place. It is my hope that conveying my thoughts in this manner will promote unity within the "Shionogi family," thereby aiding in the realization of our plan's goals.

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What lessons have you learned from halting development of the anti-obesity drug S-2367 in the US and Europe?

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In drug development, the Go/No Go decision is critical. Halting development of S-2367 reaffirmed for me that you must always be prepared so as to respond flexibly in the event a drug candidate is dropped.

While halting development is a matter for great regret, in pharmaceutical development it is imperative that compounds be assigned priority according to their perceived potential and marketability. Dropping a drug candidate must be regarded as one of the options available. At Shionogi, we will be evaluating all development candidates every six months, reviewing our investment allocation and order of priority, as part of our approach to ensuring we are always prepared to respond flexibly in the event a development candidate is dropped. We believe that pharmaceutical companies derive a competitive advantage from being ever-ready to respond flexibly in the event a drug candidate is dropped. Based on this

belief, we create back-up compounds and focus on priority projects.

With the anti-obesity drug S-2367, while continuing with Phase II trials in Japan, our Pharmaceutical Research Division is accelerating development of backup compounds. S-2367 had been garnering attention as a global development compound originated internally, but we made the decision to discontinue development in the US and Europe in light of recent decisions on other obesity drugs by regulatory authorities; in addition, S-2367 fell short of its 6% weight loss goal. We think the right decision was made, based on the massive cost involved in continuing development, and the risks likely to be encountered on the road to seeking approval.

Q**What expectations do you have for the Global Development?****A****We expect it to result in faster and more efficient development due to the unification of strategic functions for global development compounds.**

We established the Global Development in April 2011. The Global Development was created as one initiative under our new medium-term plan and is charged with speeding up global development through timely and flexible decision-making. It will oversee the unification of development strategies aimed at creating highly marketable new drugs

across Europe, the US and Asia (including Japan). The establishment of the Global Development should maximize the value of development compounds. And with a framework for global development and an integrated strategy, we expect development to be faster and more efficient.

Q**Please comment on US operations (Shionogi Inc.) and the outlook.****A****In fiscal 2010, we revamped Shionogi Inc.'s business model and implemented operational structure reforms in response to changes in the business environment. As a result, Shionogi Inc. experienced a marked drop in sales, which was caused by terminating marketing agreements for some primary care products. Going forward, management in Japan and the US will work as a committed team to steer the company's operations.**

In the US, we acquired Sciele Pharma, Inc. (now Shionogi Inc.) in 2008 as a bridgehead toward globalization. Initially, our plan was to continue selling Sciele Pharma products while we instilled the "Shionogi spirit" and later market Shionogi-developed products in the US, the largest pharmaceutical market, through Sciele Pharma marketing channels. However, we brought forward transformation into a business model based on new drugs similar to Shionogi; Sciele Pharma's previous business model was that of a specialty pharma licensing in late-stage products and adding value to them before launching. We took this action because of changes in the business environment such as the rapid emergence of generics and price negotiations with insurers. A reshuffling of the product lineup and cuts in the work force resulting from this move gave rise to extraordinary losses, while in the process some shipments were affected by quality assurance issues.

We are keenly aware of the disappointment and dissatisfaction our shareholders experienced in regard to the US business, and I personally became acutely aware of how difficult it is to get an overseas operation on the right track. We took a number of steps to enhance communication throughout the company (including at the operational level), such as moving up the schedule for consolidating our US operations on one site, conducting a management reshuffle, and also newly establishing the

Overseas Business Unit to enable those in Japan to at all times have a solid grasp of conditions at the US operation. Looking ahead, we aim to ensure stable business operations by marketing ospemifene (treatment for vulvar and vaginal atrophy), S-297995 (for alleviating opioid-induced adverse effects) and then other in-house developed drugs through Shionogi Inc.

As regards our future plans for business overseas, I am sometimes asked whether we should maintain a focus on out-licensing drugs. It is my belief, though, that if we are to achieve true globalization we must construct our own sales channels. Crestor® sales grew more than 20% year on year in fiscal 2010, but this was an exceptional result attributable in large part to AstraZeneca's marketing efforts, which reflect its appreciation for the drug's clinical advantages. As far as globalization is concerned, we believe that organic growth is not possible unless we have our own sale channels and are able to harness our own strengths and ideas in marketing internally developed products. While development of our anti-obesity drug has been discontinued in the US and Europe, if all goes well we expect to be ready in fiscal 2012 to seek approval for our anti-HIV drug S-349572 as a monotherapy and in combination regimens. This compound is being developed by joint venture Shionogi-ViiV Healthcare LLC, but as Shionogi now has its own sales channels overseas, we can approach negotiations over a sales scheme on an equal footing.

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Please describe the impact of the Great East Japan Earthquake.

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Although our Kanegasaki Plant in Iwate Prefecture sustained damage in the earthquake, we continue to regard this plant as having a key role to play in ensuring a stable supply of pharmaceuticals.

Shionogi's Kanegasaki Plant in Iwate Prefecture as well as sales bases and a Distribution Center in eastern Japan were damaged in the earthquake. The Kanegasaki Plant was forced to halt operations, while operations were disrupted at the sales bases and the Distribution Center. While I am sure that the key plant's location in Iwate Prefecture has caused our shareholders to worry, fortunately there was no loss of life or injury. Employees at the Kanegasaki Plant and related departments made a concerted effort to restore operations, and as a result sales activities and distribution center operations quickly resumed, and the Kanegasaki Plant recommenced production approximately one month after the disaster. In terms of ensuring a stable supply of pharmaceuticals, we were helped by having appropriate inventory levels prior to the earthquake. Thanks

also to our wholesalers' efforts and the calm response of medical professionals, fears of product shortages proved unfounded. Whereas some Japanese companies have moved to transfer production since the earthquake, at Shionogi we plan to continue using the Kanegasaki Plant as a key production facility.

Across the Company we will also work to save power. We are extending the annual Cool Biz period, cutting the use of lighting, and controlling overtime, among other measures. While our top priority as a pharmaceutical manufacturer is to ensure a stable supply of drugs, we will be doing our utmost to achieve the goal set by The Federation of Pharmaceutical Manufacturers' Associations of Japan, namely to reduce electricity consumption by at least 15% year on year.

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Finally, what is your thinking on shareholder returns?

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Shionogi seeks to strike the correct balance between strengthening business fundamentals and returning profits to shareholders in order to meet shareholders' expectations and maximize corporate value.

Our new medium-term plan identifies three key priorities: investment for the future, shareholder returns, and strategic balance sheet improvement. By simultaneously implementing these three priorities, we will balance the strengthening of operational fundamentals and returning profits to shareholders. We believe that we can drive growth at Shionogi as a result and meet the expectations of our shareholders. Steep yen appreciation and a protracted economic slump have kept the Nikkei Average pinned below 10,000 yen, while the earthquake is also likely to leave lingering effects. Against this backdrop, we plan to actively make necessary business investments in such forms as R&D spending on in-house developed drugs, as we believe we must increase and enhance our drug pipeline in order to achieve medium- to long-term growth. In regard to dividends, our new medium-term plan calls for the Company to maintain a dividend payout ratio of 35% and to return to shareholders any income from business activities that is incremental to our initial expectations. In

addition, we will repay debt and take other actions with a view to further improving the health of our balance sheet.

We must stay true to Shionogi's basic corporate policies on a global



basis if we are to continue growing. This new medium-term plan contains a practical course of action for globalizing our business. I hope that all of our shareholders will continue to lend us their support in this endeavor, such that together we can experience the tangible benefits of growth.