CHUGAI PHARMACEUTICAL CO., LTD.

A member of the Roche group

CONSOLIDATED FINANCIAL STATEMENTS (IFRS) (Non-Audited)

(for the fiscal year 2016)

Name of Company: Chugai Pharmaceutical Co., Ltd. February 1, 2017

Stock Listing: Tokyo Stock Exchange

Security Code No.: 4519 (URL https://www.chugai-pharm.co.jp/english)

Representative: Osamu Nagayama, Representative Director, Chairman and CEO

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Date of General Meeting of Shareholders: March 23, 2017

Date of Submission of Marketable Securities Filings: March 23, 2017

Date on which Dividend Payments to Commence: March 24, 2017

Supplementary Materials Prepared for the Financial Statements: Yes

Presentation Held to Explain the Financial Statements: Yes (for institutional investors, securities analysts and the media)

(Note: Amounts of less than one million yen are rounded.)

1. Consolidated results for FY 2016 (January 1, 2016–December 31, 2016)

(1) Consolidated operating results

	Revenues	% change	Operating profit	% change	Profit before taxes	% change
FY ended Dec. 2016	¥491,780 million	(1.4)	¥76,884 million	(11.4)	¥74,448 million	(14.7)
FY ended Dec. 2015	¥498,839 million	8.2	¥86,784 million	14.4	¥87,276 million	14.6

	Net income	% change	Net income attributable to Chugai shareholders	% change	Total comprehensive income	% change
FY ended Dec. 2016	¥54,372 million	(12.8)	¥53,592 million	(12.3)	¥51,073 million	(11.1)
FY ended Dec. 2015	¥62,353 million	19.7	¥61,125 million	19.9	¥57,476 million	18.5

	Earnings per share (Basic)	Earnings per share (Diluted)
FY ended Dec. 2016	¥98.12	¥97.97
FY ended Dec. 2015	¥112.00	¥111.79

	Ratio of net income to equity attributable to Chugai shareholders	Ratio of profit before taxes to total assets	Ratio of operating profit to revenues
FY ended Dec. 2016	8.4%	9.3%	15.6%
FY ended Dec. 2015	10.0%	11.4%	17.4%

Notes: 1. Equity-method earnings for the year ended December 31, 2016: ¥— million, December 31, 2015: ¥— million

2. Percentages represent changes compared with the same period of the previous fiscal year.

3. The item "Attributable to Chugai shareholders" excludes the portion attributable to non-controlling interests.

(2) Consolidated results (balance sheet)

	Total assets	Total equity	Equity attributable to Chugai shareholders	Ratio of equity attributable to Chugai shareholders	Equity per share attributable to Chugai shareholders
As of Dec. 31, 2016	¥806,285 million	¥646,497 million	¥645,508 million	80.1%	¥1,181.67
As of Dec. 31, 2015	¥787,401 million	¥627,271 million	¥625,857 million	79.5%	¥1,146.17

Note: The item "Attributable to Chugai shareholders" excludes the portion attributable to non-controlling interests.

(3) Consolidated results (cash flow)

	Cash flows from operating activities	Cash flows from investing activities	Cash flows from financing activities	Balance of cash and cash equivalents
FY ended Dec. 2016	¥38,787 million	¥(10,107) million	¥(33,415) million	¥95,368 million
FY ended Dec. 2015	¥62,918 million	¥(45,269) million	¥(28,467) million	¥101,707 million

2. Dividends

	Annual dividends per share				
	End of first quarter	End of second quarter	End of third quarter	End of fiscal year	Total
FY ended Dec. 2015	—	¥26.00	—	¥32.00	¥58.00
FY ended Dec. 2016	—	¥26.00	—	¥26.00	¥52.00
FY ending Dec. 2017 (Forecast)	—	¥29.00	—	¥29.00	¥58.00

	Total dividends (annual)	Dividend payout ratio (consolidated)	Ratio of dividends to equity attributable to Chugai shareholders (consolidated)
FY ended Dec. 2015	¥31,664 million	51.8%	5.2%
FY ended Dec. 2016	¥28,404 million	53.0%	4.5%
FY ending Dec. 2017 (Forecast)		—%	

Note: Year-end dividends per share for the fiscal year ended December 31, 2015 include a special dividend of ¥6 per share.

3. Consolidated forecasts for FY 2017 (January 1, 2017–December 31, 2017)

	Revenues	% change	Core operating profit	% change	Core earnings per share		Core dividend payout ratio %
FY ending Dec. 2017 (Forecast)	¥520,500 million	+5.8	¥92,000 million	+14.2	¥124.11	+21.1	46.7
FY ended Dec. 2016 (Results)	¥491,780 million	(1.4)	¥80,573 million	(11.2)	¥102.50	(12.0)	50.7

Notes: 1. Percentages shown for revenues, Core operating profit and Core EPS represent changes from the same period of the previous fiscal year.

2. The figures for the consolidated forecasts and actuals are calculated based on Core basis indicators established by Chugai Pharmaceutical Co., Ltd. ("Chugai") and used on a consistent basis. Core EPS is diluted earnings per share attributable to Chugai shareholders on a Core basis.

4. Others

(1) Changes in the state of material subsidiaries during the period (Changes in the state of specific subsidiaries with change in scope of consolidation): None

(2) Changes in accounting policies and changes in accounting estimates

(a) Changes in accounting policies required by IFRS: None

(b) Changes in accounting policies other than those in (a) above: None

(c) Changes in accounting estimates: None

(3) Number of shares issued (common stock):

(a) Number of shares issued at the end of the period (including treasury stock)	As of Dec. 31, 2016	559,685,889	As of Dec. 31, 2015	559,685,889
(b) Number of treasury stock at the end of the period	As of Dec. 31, 2016	13,417,953	As of Dec. 31, 2015	13,641,743
(c) Average number of shares issued during the period	FY ended Dec. 31, 2016	546,179,634	FY ended Dec. 31, 2015	545,773,462

Note: For an explanation of the number of shares used for computing earnings per share (consolidated), please refer to "Earnings per share" on page 23 of the attached document.

Notes:

Items related to the status of the implementation of auditing procedures

At the time of disclosure of these consolidated financial statements, auditing procedures were in progress for the financial statements based on the Financial Instruments and Exchange Act.

Explanation of the appropriate use of performance forecasts and other related items

(1) Portions of this report that refer to performance forecasts or any other future events are believed to be reasonable under information available at the time of the forecasts. Actual results may differ from these forecasts due to potential risks and uncertainties.
(2) The forecast which is published for shareholders and investors is based on the internal management indicator Core basis under International Financial Reporting Standards ("IFRS"). The difference between IFRS results and Core results will be explained at each event and presentation.
(3) For the specifics of the forecasts, please refer to "Analysis concerning business performance" on pages 2-5, "Basic profit distribution principles and dividends for the fiscal year under review and the following fiscal year" on page 8, and "Management Principles and Goals" on pages 12-14 of the attached document.
(4) Chugai is scheduled to hold a presentation of the financial statements as noted below. The materials, video, Q&A, and other related documents for the presentation for institutional investors and securities analysts will be posted on the Chugai's website following the conclusion of the presentation.
Presentation for the media (Japanese only): February 1, 2017, Wednesday (Japan time).
Presentation for institutional investors and securities analysts (Japanese only): February 2, 2017, Thursday (Japan time).

Index of the Attachment

1. Business Performance

(1) Analysis concerning business performance

1) Summary of business activities in billions of yen

	Year ended December 31		
	2016	2015	% change
Core results			
Revenues	**491.8**	**498.8**	**(1.4)**
Sales (excluding Tamiflu)	459.2	460.2	(0.2)
Tamiflu sales	13.5	8.2	+64.6
Royalties and other operating income	19.1	30.4	(37.2)
Cost of sales	(246.7)	(238.9)	+3.3
Gross profit	**245.0**	**260.0**	**(5.8)**
Marketing and distribution	(69.8)	(74.7)	(6.6)
Research and development	(82.6)	(81.9)	+0.9
General and administration	(12.1)	(12.8)	(5.5)
Operating profit	**80.6**	**90.7**	**(11.1)**
Net income	**56.8**	**64.9**	**(12.5)**
IFRS results			
Revenues	491.8	498.8	(1.4)
Operating profit	76.9	86.8	(11.4)
Net income	54.4	62.4	(12.8)

Consolidated financial highlights (IFRS results)

Revenues for the fiscal year under review were ¥491.8 billion (a decrease of 1.4% year on year), operating profit for the fiscal year under review was ¥76.9 billion (a decrease of 11.4% year on year), and net income for the fiscal year under review was ¥54.4 billion (a decrease of 12.8% year on year). These results include non-Core items, such as amortization of intangible assets of ¥1.3 billion and impairment loss of intangible assets of ¥2.4 billion, which are excluded from the Core results that Chugai adopts to manage recurring business activities.

Consolidated financial highlights (Core results)

Revenues for the fiscal year under review were ¥491.8 billion (a decrease of 1.4% year on year) due to the decrease in royalties and other operating income.

Of revenues, sales excluding Tamiflu were ¥459.2 billion (a decrease of 0.2% year on year). Domestic sales excluding Tamiflu were comparable to the levels of the previous fiscal year at ¥379.7 billion (an increase of 0.4% year on year) due to the steady growth in sales of new products and major products, which absorbed the effects of the NHI drug price revisions in April. Although income associated with Actemra and others remained robust, royalties and other operating income amounted to ¥19.1 billion (a decrease of 37.2% year on year) due to the recording of smaller amount of one-time income such as milestone income for the fiscal year under review.

Cost to sales ratio was 52.2%, 1.2 percentage points deterioration compared with the previous fiscal year, due to the effect of the weaker yen, the NHI drug price revisions and supply price reduction on Actemra export etc. As a result, gross profit amounted to ¥245.0 billion (a decrease of 5.8% year on year).

Expenditures were ¥164.5 billion (a decrease of 2.8% year on year). Marketing and distribution expenses were ¥69.8 billion (a decrease of 6.6% year on year) due mainly to the effects of foreign exchange rate fluctuations and decrease of various expenses, while research and development expenses amounted to ¥82.6 billion (an increase of 0.9% year on year) due to the increase in research and development activities in line with the progress in development projects, albeit the effects of foreign exchange rate fluctuations. General and administration expenses amounted to ¥12.1 billion (a decrease of 5.5% year on year) due to the decrease of various expenses.

As a result, Core operating profit was ¥80.6 billion (a decrease of 11.1% year on year).

Chugai have filed the Advance Pricing Arrangement covering the certain transactions with F. Hoffmann-La Roche Ltd., to Japanese and Swiss tax authorities in accordance with a tax treaty between Japan and Switzerland. Both tax authorities concluded the tentative agreement that will decrease taxable income of Chugai and increase that of Roche. As a result of this agreement, Chugai will transfer a part of the deducted amount of corporate tax etc. to Roche as the estimated tax payable for Roche, in accordance with the license agreement between Chugai and Roche, and posted ¥3.5 billion of adjustment from transfer pricing taxation as other expense.

As a result, Core net income was ¥56.8 billion (a decrease of 12.5% year on year).

Note: Core results
Chugai discloses its results on a Core basis from 2013 in conjunction with its transition to IFRS. Core results are the results after adjusting non-recurring items recognized by Chugai to IFRS results, and are consistent with the Core concept disclosed by Roche. Core results are used by Chugai as an internal performance indicator, for explaining the status of recurring profits both internally and externally, and as the basis for payment-by-results.

For further details regarding the adjustment to IFRS results, please refer to the Supplementary Materials on page 5, entitled "Reconciliation of IFRS results to Core results."

Sales breakdown in billions of yen

	Year ended December 31		
	2016	2015	% change
Sales	**472.7**	**468.4**	**+0.9**
Domestic sales (excluding Tamiflu)	**379.7**	**378.0**	**+0.4**
Oncology	220.3	215.7	+2.1
Bone and joint diseases	86.1	79.4	+8.4
Renal diseases	41.1	45.4	(9.5)
Transplant, immunology, and infectious diseases	13.7	15.9	(13.8)
Others	18.5	21.7	(14.7)
Tamiflu sales	**13.5**	**8.2**	**+64.6**
Ordinary use	12.0	8.2	+46.3
Government stockpiles	1.5	0.0	—
Overseas sales	**79.5**	**82.2**	**(3.3)**

Domestic sales (excluding Tamiflu)
Domestic sales excluding Tamiflu were ¥379.7 billion (an increase of 0.4% year on year) due to the steady growth in sales of new products and mainstay products in oncology and bone and joint diseases area, which absorbed the effects of the NHI drug price revisions including special market-expansion re-pricing of Avastin (an anti-VEGF humanized monoclonal antibody, anti-cancer agent).

Oncology products sales were ¥220.3 billion (an increase of 2.1% year on year). This increase was due primarily to the steady growth in sales of the products launched in 2014, which are Alecensa (an ALK inhibitor, anti-cancer agent) and Kadcyla (an anti-HER2 antibody - tubulin polymerization inhibitor conjugate), in addition to the robust sales of mainstay products such as Rituxan (an anti-CD20 monoclonal antibody), Perjeta (an anti-HER2 humanized monoclonal antibody, anti-cancer agent) and Xeloda, an anti-cancer agent which obtained an approval for the indication of postoperative adjuvant chemotherapy for gastric cancer in 2015. Sales of Avastin amounted to ¥92.1 billion (a decrease of 1.8% year on year) due to the impact of special market-expansion re-pricing, despite robust sales on a volume basis.

Bone and joint diseases products sales were ¥86.1 billion (an increase of 8.4% year on year). This increase was due to the robust sales of mainstay products such as Edirol, a top brand in the domestic market of oral therapeutic agents for osteoporosis, Actemra (a humanized anti-IL-6 receptor monoclonal antibody) and Bonviva (a bisphosphonate for osteoporosis).

Renal diseases products sales amounted to ¥41.1 billion (a decrease of 9.5% year on year) due to a decline in sales of Oxarol (an agent for secondary hyperparathyroidism) resulting from the effects of competitions including generic products.

In the area of transplant, immunology, and infectious diseases products (excluding Tamiflu), sales were ¥13.7 billion (a decrease of 13.8% year on year) due to a substantial decline in sales of Pegasys (a peginterferon-α-2a agent) as a result of the newly launched third party products.

Tamiflu sales
Sales of Tamiflu (an anti-influenza agent) for ordinary use were ¥12.0 billion (an increase of 46.3% year on year), while sales to government stockpiles etc. were ¥1.5 billion.

Overseas sales
Although exports of Alecensa increased, overseas sales amounted to ¥79.5 billion (a decrease of 3.3% year on year) due mainly to supply price reduction on Actemra export, and decrease in sales of Neutrogin (a recombinant human G-CSF) as a result of the effects of foreign exchange rate fluctuations and intensified competitions.

2) R&D activities

In Japan and overseas, the Chugai Group ("the Group") is actively engaged in prescription pharmaceutical R&D activities and is working to develop innovative products with global application. In Japan, the Group has established research bases in Fuji Gotemba and Kamakura, which are collaborating to develop new pharmaceuticals, and its research facilities in Ukima are conducting industrialization research. Overseas, Chugai Pharma USA, Inc. (United States); Chugai Pharma Europe Ltd. (United Kingdom); Chugai Pharma Science (Beijing) Co., Ltd. (China); and Chugai Pharma Taiwan Ltd. (Taiwan) are engaged in clinical development and submission of applications in their respective countries. Chugai Pharmabody Research Pte. Ltd. (Singapore) and jointly controlled businesses C&C Research Laboratories (South Korea) are engaged in pharmaceutical research and development.

In the fiscal year under review, R&D expenses on a Core basis totaled ¥82.6 billion.

3) Outlook for the next fiscal year

Forecast assumptions
In preparing this performance outlook, Chugai has assumed exchange rates of ¥106/CHF, ¥122/EUR, ¥115/USD, and ¥80/SGD. Chugai has also assumed that the magnitude of the influenza epidemic will be about the same as the average since 2007, excluding the epidemic of the novel influenza in the 2009/2010 season.

Outlook for the fiscal year
Revenues
Our outlook for sales of Tamiflu is ¥8.2 (a decrease of 39.3% year on year) billion, including orders for government stockpiles of ¥1.6 billion.Domestic sales, excluding Tamiflu, are forecast to rise to ¥393.9 (an increase of 3.7% year on year) billion due to growth in the oncology domain centering on Alecensa and the HER2 franchise including Kadcyla, and growth in the bone joint area driven by Actemra, Edirol and Bonviva. Exports to Roche are expected to show a steady increase to ¥67.4 (an increase of 7.3% year on year) billion, reflecting the continued growth in sales of Actemra overseas and the steady growth in Alecensa which has been exported since 2015. Overseas sales of other products are forecast to be ¥20.9 (an increase of 24.4% year on year) billion due to the weaker Japanese yen and the growth in sales of new products. Royalties and other operating income are forecast to rise to ¥30.0 (an increase of 57.1% year on year) billion because of increases in one-time income and revenues from Roche for co-promotion and royalties.

Core Operating Profit / Core EPS
Gross profit is expected to rise to ¥268.5 (an increase of 9.6% year on year) billion due to an increase in revenues. Total expenses are expected to amount to ¥176.5 (a ¥12.0 billion increase compared to the previous year) billion based on the increase of research and develop activities such as progress in development themes originating at Chugai and the conclusion of a comprehensive collaboration agreement for advanced research in immunology with the Osaka University Immunology Frontier Research Center (IFReC).Core operating profit is forecast to be ¥92.0 (an increase of 14.1% year on year) billion. Core EPS will be ¥124.11 (an increase of 21.1% year on year).

(Billions of yen)

	Outlook for the year ending Dec. 2017	% change
Revenues	520.5	+5.8
Sales excluding Tamiflu	482.2	+5.0
Core operating profit	92.0	+14.1

Note: Core EPS
Core EPS is diluted earnings per share attributable to shareholders of Chugai, after subtraction of non-recurring profit and loss items determined by Chugai.

Note: Figures mentioned in (1) are rounded to the nearest ¥0.1 billion, and changes in amounts and percentages have been calculated using data denominated in ¥0.1 billion units.

(2) Analysis concerning financial status

1) Assets, liabilities, and net assets in billions of yen

	December 31, 2016	December 31, 2015	% change
Movements of assets and liabilities			
Net working capital	258.5	214.6	+20.5
Long-term net operating assets	172.7	165.8	+4.2
Net operating assets (NOA)	**431.1**	**380.4**	**+13.3**
Net cash	204.9	235.4	(13.0)
Other non-operating assets – net	10.5	11.5	(8.7)
Total net assets	**646.5**	**627.3**	**+3.1**
Consolidated balance sheet (IFRS basis)			
Total assets	806.3	787.4	+2.4
Total liabilities	(159.8)	(160.1)	(0.2)
Total net assets	646.5	627.3	+3.1

Net working capital at December 31, 2016 was ¥258.5 billion (an increase of ¥43.9 billion since December 31, 2015). This was because the sum of the increase in inventories and the decrease in accounts payable-other outweighed the increase in accounts payable-trade. Long-term net operating assets increased by ¥6.9 billion since the end of the previous fiscal year to ¥172.7 billion, due mainly to the increase in intangible assets. As a result, net operating assets (NOA) were ¥431.1 billion, ¥50.7 billion higher than at the end of the previous fiscal year.

As the table entitled “Cash flows” on the next page indicates, net cash, including marketable securities and interest-bearing debt, decreased by ¥30.5 billion since December 31, 2015 to ¥204.9 billion. Other non-operating assets - net decreased by ¥1.0 billion from the end of the previous fiscal year to ¥10.5 billion, due mainly to a decrease in investment securities, etc.

As a consequence, total net assets were ¥646.5 billion (an increase of ¥19.2 billion since December 31, 2015).

Note: Movements of assets and liabilities

The consolidated balance sheet has been prepared in accordance with International Accounting Standards (IAS) No. 1, “Presentation of Financial Statements.” On the other hand, “Movements of assets and liabilities” including net operating assets (NOA) are a reconfiguration of the consolidated balance sheet as internal indicators and are identical to the indicators disclosed by Roche. Furthermore, no items from the assets and liabilities have been excluded, as the Core results concept only applies to the income statement.

For further details, please refer to the Supplementary Materials on page 9, entitled “Movements of assets and liabilities.”

Note: Net operating assets (NOA)

Net operating assets allow for an assessment of the Group’s operating performance of the business independently from financing and tax activities. Net operating assets are calculated as net working capital, long-term net operating assets that includes property, plant and equipment, intangible assets, etc. minus provisions.

2) Cash flows in billions of yen

	Year ended December 31		
	2016	2015	% change
Movements of free cash flows			
Operating profit - IFRS basis	76.9	86.8	(11.4)
Operating profit, net of operating cash adjustments	98.5	105.4	(6.5)
Operating free cash flows	26.0	64.6	(59.8)
Free cash flows	4.3	37.0	(88.4)
Net change in net cash	(30.5)	5.5	—
Consolidated statement of cash flows (IFRS basis)			
Cash flows from operating activities	38.8	62.9	(38.3)
Cash flows from investing activities	(10.1)	(45.3)	(77.7)
Cash flows from financing activities	(33.4)	(28.5)	+17.2
Net change in cash and cash equivalents	(6.3)	(12.3)	(48.8)
Cash and cash equivalents at December 31	95.4	101.7	(6.2)

Operating profit, net of operating cash adjustments, amounted to ¥98.5 billion. This is calculated by adjusting for depreciation and other items that are included in operating profit but are not accompanied by cash inflows or outflows and all inflows and outflows related to NOA that are not accompanied by profit and loss. The principal items influencing this result were a total of ¥14.8 billion in depreciation of property, plant and equipment.

Operating free cash flows, which are calculated by subtracting an increase in net working capital of ¥36.2 billion and also subtracting expenditures of ¥36.3 billion for the purchase of property, plant and equipment and intangible assets from operating profit, net of operating cash adjustments, amounted to a net inflow of ¥26.0 billion. Factors accounting for the increase in net working capital are as shown on the previous page in the table entitled “Assets, liabilities, and net assets.” Purchases of property, plant and equipment were mainly expenditures for purchase of land for business, buildings and equipment of the laboratories and plants.

Free cash flows were a net cash inflow of ¥4.3 billion. This is calculated by subtracting a total of ¥21.7 billion of non-operating cash outflows from financial asset management, income taxes paid from operating free cash flows.

As a result, the net change in net cash, after dividends paid and foreign currency translation adjustments, was a decrease of ¥30.5 billion in comparison with the end of the previous fiscal year. The net change in cash and cash equivalents, excluding changes in marketable securities and interest-bearing debt, was a net cash outflow of ¥6.3 billion. The cash and cash equivalents balance at the end of this period amounted to ¥95.4 billion.

Note: Movements of free cash flows (FCF)
The consolidated statement of cash flows has been prepared in accordance with International Accounting Standard (IAS) No. 7, “Statement of Cash Flows.” FCF is a reconfiguration of the consolidated statement of cash flows as internal indicators and is identical to the indicators disclosed by Roche. Furthermore, no items from FCF have been excluded, as the Core results concept only applies to the income statement.

Previously, FCF represents the amount net of dividends paid. However, effective from the second quarter of FY 2016, FCF represents the amount before the deduction of dividends paid to conform to the general definition of FCF, following Roche’s change in definition of FCF. This change is reflected from the financial results for the second quarter of FY 2016, and FCF for the year ended December 31, 2015 has been amended for comparison purpose. The change has no effect on operating FCF.

For further details, please refer to the Supplementary Materials on page 10, entitled “Movements of free cash flows.”

Note: Figures mentioned in 1) and 2) of (2) are rounded to the nearest ¥0.1 billion, and changes in amounts and percentages have been calculated using data denominated in ¥0.1 billion units.

3) Cash flow related indicators

	Year ended December 31			
	2016	2015	2014	2013
Ratio of equity attributable to Chugai shareholders (%)	80.1	79.5	80.6	82.0
Ratio of equity attributable to Chugai shareholders on a market basis (%)	227.3	294.0	218.6	181.7
Interest-bearing debt to cash flows ratio (%)	1.7	1.2	0.6	0.4
Interest-coverage ratio (times)	4,708.4	8,582.4	6,547.7	4,989.9

Ratio of equity attributable to Chugai shareholders:	Equity attributable to Chugai shareholders / Total assets
Ratio of equity attributable to Chugai shareholders on a market basis:	Total market capitalization / Total assets
Interest-bearing debt to cash flows ratio:	Interest-bearing debt / Cash flows
Interest-coverage ratio:	Cash flows / Interest payments

Notes:

1. *All of the figures in the aforementioned indicators were calculated on a consolidated basis.*
2. *Total market capitalization was calculated by multiplying the closing stock price at the end of the period by the total number of outstanding shares at the end of the period (excluding treasury stock).*
3. *Cash flows from operating activities in the consolidated statement of cash flows were used as cash flows in the calculations above.*
4. *Interest-bearing debt refers to all debt posted in the consolidated balance sheet upon which interest is paid.*
5. *Interest paid in the consolidated statement of cash flows was used as interest payment in the calculations above.*

(3) Basic profit distribution principles and dividends for the fiscal year under review and the following fiscal year

Regarding income distribution, taking into account the strategic funding needs and earnings prospects, Chugai aims for a consolidated dividend payout ratio of 50% on average in comparison with Core EPS to provide a stable allocation of profit to all shareholders. In addition, internal reserves will be used to increase corporate value through investments to attain further growth in existing strategic domains and to identify future business opportunities.

Year-end regular dividends for the fiscal year ended December 31, 2016 are planned to be ¥26 per share as previously forecasted. As a result, total dividends for the fiscal year under review will be ¥52 per share, and the Core dividend payout ratio will be 50.7% (an average of 48.9% for the past five years).

For the following fiscal year, ending December 31, 2017, Chugai expects total estimated dividends of ¥58 per share (¥6 higher than the fiscal year 2016) including interim dividend payments of ¥29 per share. Accordingly, the forecast for the Core dividend payout ratio is 46.7 % (an average of 49.0% for the past five years) in 2017.

(4) Business risks

The Group's corporate performance is subject to major impact from a range of possible future events. Listed below are what are considered to be the Group's principal sources of risk for the development of its business. The Group recognizes the possibility of these risk events actually occurring and has prepared policies to forestall such risks and take appropriate measures when they do occur.

The future risks identified in this section are based on assessments made by Chugai as of the end of the consolidated fiscal year under review.

1) New product research and development

With the goal of becoming a top Japanese pharmaceutical enterprise capable of continuously delivering innovative new medicines, the Group aggressively pursues R&D in Japan and overseas. The Group has an enriched number of development pipelines, especially in the field of oncology. However, bringing all of these drugs smoothly through to the market from the R&D stages may not be possible, and the Group expects to have to abandon development in some cases. When such a situation occurs, there is a possibility of a major impact on the Group's business performance and financial position, depending on the product under development.

2) Changes in product environments

In recent years, there have been rapid technological advancements in the pharmaceutical industry, and the Group faces fierce competition from pharmaceutical companies in Japan and overseas. The Group's business performance and financial position may be significantly affected by changes in product environments caused by the sale of competing products and generic products and also by changes in contracts concluded by the Group for marketing agreements or the licensing of technologies.

3) Side effects

Medical products are approved by regulatory authorities in each country after stringent screening. However, when drugs go into general usage, even if thorough safety measures are implemented, it is difficult to fully prevent side effects due to its distinctive nature. When the Group's pharmaceuticals go into use and side effects, particularly new and serious ones, are discovered, there is a risk of significant impact on the Group's business performance and financial position.

4) Reform of Japan's medical insurance system

Japan's medical insurance system is being reformed against a backdrop of rapid demographic change, with a falling birthrate and increasing numbers of aged citizens. As part of this process, measures are being taken to curb medical expenses. Revisions have been made to the system of reimbursement of medical fees, and debate is continuing in such areas as the NHI drug price revision. Pressure to reduce drug costs is increasing overseas as well, primarily in developed countries. Future developments of such measures to curtail drug costs in these countries could have a major impact on the Group's business performance and financial position.

5) Intellectual property (IP) rights

The Group recognizes that it applies intellectual property rights in pursuing its business activities and takes care to distinguish its own proprietary intellectual property rights and licensing arrangements recognized under law. However, the possibility remains that the Group may infringe on third-party intellectual property rights without being aware of this fact. Major disputes related to intellectual property rights relating to the Group's business could have a major impact on the Group's business performance and financial position.

6) Strategic alliance with Roche

In line with its strategic alliance with Roche, the Group is the only pharmaceutical partner of Roche in the Japanese market, and it has granted Roche the right of first refusal with respect to Chugai's products in global markets outside Japan, excluding South Korea and Taiwan. Consequently, the Group has licensed-in and out-licensed numerous products and projects from and to Roche. In the event that the Group's strategic alliance with Roche is changed for some reason, such circumstances could have a major impact on the Group's business performance and financial position.

7) International business activities

The Group engages aggressively in international business activities, including sales of pharmaceuticals and R&D activities overseas as well as exporting and importing of bulk pharmaceuticals. In these international business activities, the Group may confront changes in laws and regulations, political instability, uncertainties regarding economic trends, issues related to relationships with labor in local markets, changes in tax systems and diversity in interpretation of such systems, fluctuations in foreign currency rates, differences in business practices, and other risks. Such circumstances and the occurrence of compliance issues associated with these risks could have a major impact on the Group's business performance and financial position.

8) IT security and information control

As the Group makes full use of a wide range of IT systems in its business activities, it is subject to the risk of its operations being disrupted due to system malfunctions, computer viruses and other external factors. Additionally, the Group's business performance and financial position may be significantly affected in the event of an accident or other incidents resulting in the leakage of confidential information.

9) Effects of major disasters and other contingencies

In the event of natural disasters, such as earthquakes and typhoon, as well as accidents, such as fires and other contingencies, the Group's business sites and marketing locations as well as those of its business partners may suffer serious damage and operations may become stagnant. In addition, major expenditures may have to be made to repair equipment and other assets that suffer damage. Such circumstances could have a major impact on the Group's business performance and financial position.

10) Litigation

There is a possibility that litigation may be brought against the Group over side effects of pharmaceuticals, product liability, labor issues, fair trade and other issues associated with its business activities, which could have a major impact on the Group' s business performance and financial position.

11) Environmental issues

In terms of environmental issues, the Group, in addition to compliance with relevant laws and regulations, has established a set of even higher voluntary standards and has been making efforts to achieve them. In the course of the Group's business activities, violations of relevant laws and regulations may occur as a result of accidents or other incidents, which may result in incurring related expenses. Such circumstances could have a major impact on the Group's business performance and financial position.

2. Outline of the Chugai Group

The Group consists of the company submitting the consolidated financial statements, 19 subsidiaries, one jointly controlled business, and two subsidiaries of the parent company. The major businesses conducted by the Group and how companies in the Group are positioned in relation to those businesses are summarized in the diagram below.

PHARMACEUTICAL SEGMENT

(As of Dec. 31, 2016)

CHUGAI PHARMACEUTICAL CO., LTD.

<Domestic>

Contract research:

- *Chugai Research Institute for Medical Science, Inc. (Research and development of pharmaceuticals) **<R&D>**
- *Chugai Clinical Research Center Co., Ltd. (Clinical research for pharmaceuticals) **<R&D>**
- *Forerunner Pharma Research Co., Ltd. (Research of pharmaceuticals) **<R&D>**

Contract production:

- *Chugai Pharma Manufacturing Co., Ltd. (Contract production of pharmaceuticals) **<Production>**

Other contract operation:

- *Chugai Business Support Co., Ltd. (Administrative support service) **<Others>**
- *Chugai Distribution Co., Ltd. (Storage and transportation) **<Others>**
- *Medical Culture Inc. (Literature documentation) **<Others>**

<Overseas>

Raw materials / Collaborative research / Products:

- -F. Hoffmann-La Roche Ltd (Research and development, production, and sales of pharmaceuticals) **<R&D, Production, Sales>**

Contract production:

- -Genentech, Inc. (Research and development, production, and sales of pharmaceuticals) **<R&D, Production, Sales>**

Contract research / Products / Other contract operation:

- *Chugai Pharma USA, Inc. (Clinical development and submission of applications for new drugs in the U.S.) **<R&D>**
- *Chugai Pharma Science (Beijing) Co., Ltd. (Clinical development and submission of applications for new drugs in China) **<R&D>**
- *Chugai Pharmabody Research Pte. Ltd. (Research of pharmaceuticals in Singapore) **<R&D>**
- #C&C Research Laboratories (Research and development of pharmaceuticals in South Korea) **<R&D>**
- *Chugai Pharma Europe Ltd. (Sales administration/Sales of pharmaceuticals, Clinical development and submission of applications for new drugs in Europe) **<Sales, R&D>**
- *Chugai Pharma U.K. Ltd. (Sales of pharmaceuticals in the U.K.) **<Sales>**
- *Chugai Pharma France S.A.S. (Sales of pharmaceuticals in France) **<Sales>**
- *CHUGAI sanofi-aventis S.N.C. (Clinical development and submission of applications for new drugs, import and sales of pharmaceuticals in Europe) **<Sales, R&D >**
- *Chugai Pharma Taiwan Ltd. (Import and sales of pharmaceuticals, clinical development and submission of applications for new drugs in Taiwan) **<Sales, R&D>**
- *Chugai Pharma China Co., Ltd. (Import and sales of pharmaceuticals, provision of medical information in China) **<Sales, other>**

* Subsidiaries
\# Jointly controlled businesses
\- Subsidiaries of parent company

- There is no subsidiary listed on a stock exchange.
- Chugai Pharma Technology Taizhou Co.,Ltd. incorporated in June 2016, has not been included in the Outline of the Chugai Group above as it is preparing for the opening of business at present (as of December 31, 2016).
- Chugai Pharma (Shanghai) Consulting Co., Ltd. and Chugai Pharma Development Ltd. have not been included in the Outline of the Chugai Group above as they are suspending their activities at present.
- We have omitted disclosure about the status of subsidiaries and jointly controlled businesses since there have not been any material changes since we disclosed the status of subsidiaries and jointly controlled businesses in our most recent securities report filed on March 24, 2016.

3. Management Principles and Goals

(1) Basic management principles

In line with its strategic alliance with the world-leading pharmaceutical company Roche, the Group has established "dedicating itself to creating new values through the provision of innovative medical products and services for the benefit of the medical community and human health around the world" as its mission and "becoming a top Japanese pharmaceutical company which provides a continuous flow of innovative new medicines domestically and internationally" as its fundamental management objective.

As the Group works to achieve these goals, it will carry out its business activities in line with its core values of "the primary focus of all our activities is patients and consumers" and "committing to the highest ethical and moral standards" as befits a corporate group involved in the healthcare industry.

Under these basic management principles, the Group is making continuous efforts to pursue innovation in line with the philosophy "Innovation all for the patients." In addition, by progressively enhancing business efficiency, the Group is aiming to meet the expectations of patients, medical care professionals, shareholders, and other stakeholders and realize its objective of becoming a top pharmaceutical company.

(2) Medium-to-long-term business strategy and tasks

Amid increasing needs for pharmaceuticals due to an increase in the world population and progressive demographic graying in each country, how to realize sustainable medical care with limited resources has become a common issue in the world. While the dramatic progress of life sciences and ICT has expanded opportunities to generate innovation for solving medical issues, competition among companies to rapidly realize innovation has intensified more than ever. In addition, amid mounting pressure to curb drug costs against the backdrop of financial difficulties in each country, extremely harsh measures to suppress prices are expected to be adopted especially in the Japanese market.

Through its previous medium-term business plan "ACCEL 15," the Group has achieved top-class growth in Japan and expansion of top share of the domestic oncology market based on numerous innovative new medicines. As for R&D activities, the Group has also achieved numerous results such as building a strong development pipeline by means of leading-edge in-house drug discovery capabilities, such as antibody engineering technologies, and a wealth of development compounds from Roche. In late-stage development, there are numerous new leading drug candidates such as ACE910 (emicizumab, expected indication: hemophilia A) discovered in-house and RG7446 (atezolizumab, immune checkpoint inhibitor) under the development of multiple cancers, licensed-in from Roche, which are bringing opportunities for great progress as the growth driver. On the other hand, during the next several years until the contribution of new growth driver products become full swing, sales growth is expected to slow down than before due to substantial drug price reductions for existing major products.

Amid such a mixture of opportunities and threats, the Group formulated its new medium-term business plan "IBI 18," which covers the period from fiscal year 2016 through fiscal year 2018, and commenced new initiatives to aim to transform into a company that continues making progress globally through demonstration of its competitive strengths by leveraging its strategic alliance with Roche. The name of the new medium-term business plan "IBI 18" reflects our commitment to thoroughly pursue innovation captured in the slogan "Innovation Beyond Imagination" toward 2018, the final year of the plan.

The Group will focus on issues in the following fields in line with "IBI 18," based on the two priority themes of "acquisition and implementation of competitiveness at a top global level" and "selection and concentration strategy for acceleration of growth."

1) Drug discovery

The Group has moved ahead with the generation of innovative drugs in both biopharmaceuticals and small molecule drugs. Efforts in the biopharmaceutical field have been successful, leading to the world's most advanced results with respect to the establishment of antibody engineering technologies such as recycling antibody and sweeping antibody technologies. Regarding small molecule drugs also, the Group has successfully supplemented its own accumulated technologies with Roche's compound library to achieve a dramatic strengthening of its drug discovery base.

The Group's drug discovery capabilities have been highly evaluated worldwide, with three drugs generated by Chugai being designated as Breakthrough Therapy by the United States Food and Drug Administration (FDA).

Under “IBI 18,” the Group will make priority investment in the world’s leading-edge antibody engineering technologies to further accelerate the generation of innovative R&D projects. In addition, the Group will select technologies for middle molecules as the candidate for next-generation core technology following small molecule and antibody engineering, and aim at the establishment of technologies through concentrated investment and early generation of R&D projects. Furthermore, through cooperation with academic institutions and collaboration with Roche in the molecular information field, the Group will work to strengthen its research foundation with emphasis on oncology and immunology.

Going forward, the Group will be leveraging these innovative drug discovery technologies and drug discovery research systems to seek to continuously generate first-in-class and best-in-class pharmaceutical products.

2) Development

The Group holds a development pipeline well-stocked with items generated by its own research units as well as items obtained from Roche. The Group has concentrated its own global development resources in the early development stage by utilizing the unique business model resulting from the strategic alliance with Roche, and moved ahead with efficient activities linked to global clinical development trials in domestic development, leading to achievement of a high level of R&D productivity.

Under “IBI 18,” the Group will give top priority to allocating resources to development and promotion of medical plans for ACE910 (emicizumab) and RG7446 (atezolizumab), which are expected to play a key role in dramatic growth in the future with a view to obtaining approval early and building evidence. In addition, regarding global development projects comprising numerous products generated in-house, the Group will press ahead with early development with global top-class quality and speed under the promotion system for Translational Clinical Research (TCR) centered on three regions, namely Japan, the United States and Europe.

In order to promptly push ahead with global late-stage development of Chugai’s drug discovery and development projects and market penetration in cooperation with Roche, where the Group licenses out products, or a third party, it is extremely vital to prove that Chugai’s projects are attractive and show great potential both medically and economically by the completion phase of early development. To this end, the Group will also make efforts to strengthen the systems for generating and accumulating evidence through collaboration under a strategy for which the functions are integrated from the drug discovery stage.

3) Pharmaceutical Technology

The Group has advanced manufacturing technologies such as biopharmaceuticals and stably supplies highly reliable pharmaceuticals. Going forward, the promotion of global simultaneous development of multiple products and accelerated market launches of numerous Chugai creations and R&D projects and the further enhancement of cost competitiveness are critical challenges.

Under “IBI 18,” the Group will move ahead with setting up a flexible system for facilities and staff that supplies investigational drugs in a timely manner for promptly carrying out global simultaneous development of multiple products. At the same time, the Group will work to further strengthen manufacturing technologies for R&D projects with a high degree of difficulty in formulation such as middle molecule drugs.

In addition, in order to realize high-value-added, low-cost manufacturing, the Group will promptly set up a production system that takes an integrated approach to the processes from late-stage development to early-stage production, and enhance quality control, quality assurance and regulatory functions that accurately respond to the trends of major global markets.

4) Sales, medical affairs and safety

Amid the major challenge of providing sustainable medical care, the medical care provision environment has started to change significantly for the realization of optimal patient-centered medical care.

By effectively making the most of Avastin, Actemra, and numerous other promising new products developed in-house or licensed-in from Roche, the Group has been building solid presences in the markets it entered for drugs in the oncology, renal disease, bone and joint disease, rheumatic diseases as well as other fields.

Going forward, it will be a critical challenge to further strengthen the system for providing solutions to meet the sophisticated and diversified needs of patients, medical care professionals, and other stakeholders while utilizing such foundation.

Under “IBI 18,” the Group will move ahead with providing sophisticated information and resolving medical issues through the division and collaboration of functions centered on marketing, medical affairs and safety by conducting activities focused on growth driver products such as Actemra, ACE910(emicizumab) and RG7446 (atezolizumab) in Japan and overseas. By doing so, the Group will aim to contribute to the realization of optimal medical care and accelerate its growth.

At the same time, the Group will work to establish a system for building and executing strategies by cross-functional teams for each area in order to push ahead with the provision of solutions according to the various characteristics of each country and region.

5) Global top-level talent
In dealing with the challenges mentioned so far, human resources that drive innovation while responding to a rapidly changing environment would be extremely important.

Under "IBI 18," the Group will focus on human resources as the most important theme for strengthening the foundation throughout the Company and move ahead with selecting focus positions to be reinforced in order to accelerate innovation as well as obtaining, nurturing and assigning the right position filled by the right person.

In addition, the Group will continue to work on ensuring thorough compliance based on the highest ethical and moral standards as befits a corporate group involved in the healthcare industry and pursuing improvement of productivity.

By means of these initiatives, the Group is seeking to increase the value it provides to shareholders and all other stakeholders as it proceeds towards its objective of becoming a top pharmaceutical company.

During the period from 2015 through 2018, the final year of the medium-term business plan, the Group expects to achieve an average annual growth in its Core EPS (assuming at the average constant exchange rate of 2015) at a low single-digit rate (up to 3% range).

For further details on Core EPS, please refer to "Outlook for the next fiscal year" under (1) Analysis concerning business performance on page 4-5.

4. Basic Approach to the Selection of Accounting Standards

The Group has applied International Financial Reporting Standards (IFRS) from the first quarter of the fiscal year ended December 31, 2013.

5. Consolidated Financial Statements

(1) Consolidated income statement and consolidated statement of comprehensive income

1) Consolidated income statement in millions of yen

	Year ended December 31	
	2016	2015
Revenues	**491,780**	**498,839**
Sales	472,673	468,427
Royalties and other operating income	19,108	30,413
Cost of sales	(247,944)	(240,238)
Gross profit	**243,836**	**258,601**
Marketing and distribution	(69,770)	(74,811)
Research and development	(85,011)	(83,799)
General and administration	(12,171)	(13,207)
Operating profit	**76,884**	**86,784**
Financing costs	(86)	(67)
Other financial income (expense)	1,111	559
Other expense	(3,460)	-
Profit before taxes	**74,448**	**87,276**
Income taxes	(20,076)	(24,923)
Net income	**54,372**	**62,353**
Attributable to:		
Chugai shareholders	53,592	61,125
Non-controlling interests	780	1,228
Earnings per share		
Basic (yen)	98.12	112.00
Diluted (yen)	97.97	111.79

2) Consolidated statement of comprehensive income in millions of yen

	Year ended December 31	
	2016	2015
Net income recognized in income statement	**54,372**	**62,353**
Other comprehensive income		
Remeasurements of defined benefit plans	(3,472)	(1,519)
Items that will not be reclassified to the income statement	**(3,472)**	**(1,519)**
Available-for-sale investments	(1,735)	1,844
Cash flow hedges	5,204	(1,741)
Currency translation of foreign operations	(3,296)	(3,461)
Items that may be reclassified subsequently to the income statement	**173**	**(3,358)**
Other comprehensive income, net of tax	**(3,300)**	**(4,877)**
Total comprehensive income	**51,073**	**57,476**
Attributable to:		
Chugai shareholders	50,393	56,380
Non-controlling interests	680	1,096

(2) Consolidated balance sheet in millions of yen

	December 31, 2016	December 31, 2015
Assets		
Non-current assets:		
Property, plant and equipment	157,081	153,545
Intangible assets	19,299	13,511
Financial non-current assets	9,706	13,715
Deferred tax assets	27,474	26,025
Other non-current assets	13,965	12,832
Total non-current assets	**227,525**	**219,628**
Current assets:		
Inventories	185,440	161,135
Accounts receivable	167,482	158,668
Current income tax assets	1	49
Marketable securities	110,176	134,419
Cash and cash equivalents	95,368	101,707
Other current assets	20,293	11,796
Total current assets	**578,760**	**567,773**
Total assets	**806,285**	**787,401**
Liabilities		
Non-current liabilities:		
Long-term debt	(510)	(604)
Deferred tax liabilities	(9,146)	(10,028)
Defined benefit plan liabilities	(8,790)	(2,358)
Long-term provisions	(2,140)	(1,974)
Other non-current liabilities	(15,543)	(12,108)
Total non-current liabilities	**(36,128)**	**(27,071)**
Current liabilities:		
Short-term debt	(135)	(131)
Current income tax liabilities	(10,533)	(13,133)
Short-term provisions	(76)	(180)
Accounts payable	(72,346)	(78,353)
Other current liabilities	(40,570)	(41,260)
Total current liabilities	**(123,660)**	**(133,058)**
Total liabilities	**(159,788)**	**(160,130)**
Total net assets	**646,497**	**627,271**
Equity:		
Capital and reserves attributable to Chugai shareholders	645,508	625,857
Equity attributable to non-controlling interests	989	1,414
Total equity	**646,497**	**627,271**

(3) Consolidated statement of cash flows in millions of yen

	Year ended December 31	
	2016	2015
Cash flows from operating activities		
Cash generated from operations	102,797	110,159
(Increase) decrease in working capital	(36,159)	(15,945)
Payments made for defined benefit plans	(2,381)	(3,883)
Utilization of provisions	(77)	(510)
Other operating cash flows	(54)	2,239
Cash flows from operating activities, before income taxes paid	**64,127**	**92,059**
Income taxes paid	(25,339)	(29,141)
Total cash flows from operating activities	**38,787**	**62,918**
Cash flows from investing activities		
Purchase of property, plant and equipment	(30,084)	(18,367)
Purchase of intangible assets	(6,247)	(6,472)
Disposal of property, plant and equipment	(91)	(424)
Interest and dividends received	301	355
Purchases of marketable securities	(208,686)	(241,432)
Sales of marketable securities	232,018	221,679
Sales of investment securities	2,679	-
Other investing cash flows	4	(607)
Total cash flows from investing activities	**(10,107)**	**(45,269)**
Cash flows from financing activities		
Interest paid	(8)	(7)
Dividends paid to Chugai shareholders	(31,677)	(28,375)
Dividends paid to non-controlling shareholders	(1,105)	(1,064)
Exercise of equity compensation plans	506	1,391
(Increase) decrease in own equity instruments	(7)	15
Other financing cash flows	(1,124)	(425)
Total cash flows from financing activities	**(33,415)**	**(28,467)**
Net effect of currency translation on cash and cash equivalents	(1,604)	(1,513)
Increase (decrease) in cash and cash equivalents	**(6,338)**	**(12,331)**
Cash and cash equivalents at January 1	101,707	114,037
Cash and cash equivalents at December 31	**95,368**	**101,707**

(4) Consolidated statement of changes in equity in millions of yen

	Attributable to Chugai shareholders						
	Share capital	Capital surplus	Retained earnings	Other reserves	Subtotal	Non-controlling interests	Total equity
Year ended December 31, 2015							
At January 1, 2015	**72,967**	**60,817**	**457,720**	**4,594**	**596,099**	**1,657**	**597,756**
Net income	-	-	61,125	-	61,125	1,228	62,353
Available-for-sale investments	-	-	-	1,844	1,844	-	1,844
Cash flow hedges	-	-	-	(1,741)	(1,741)	-	(1,741)
Currency translation of foreign operations	-	-	-	(3,329)	(3,329)	(132)	(3,461)
Remeasurements of defined benefit plans	-	-	(1,519)	-	(1,519)	-	(1,519)
Total comprehensive income	-	-	**59,605**	**(3,225)**	**56,380**	**1,096**	**57,476**
Dividends	-	-	(28,372)	-	(28,372)	(1,064)	(29,436)
Equity compensation plans	-	(44)	-	-	(44)	-	(44)
Own equity instruments	-	1,801	-	-	1,801	-	1,801
Changes in non-controlling interests	-	(8)	-	-	(8)	(275)	(283)
At December 31, 2015	**72,967**	**62,567**	**488,954**	**1,369**	**625,857**	**1,414**	**627,271**
Year ended December 31, 2016							
At January 1, 2016	**72,967**	**62,567**	**488,954**	**1,369**	**625,857**	**1,414**	**627,271**
Net income	-	-	53,592	-	53,592	780	54,372
Available-for-sale investments	-	-	-	(1,735)	(1,735)	-	(1,735)
Cash flow hedges	-	-	-	5,204	5,204	-	5,204
Currency translation of foreign operations	-	-	-	(3,195)	(3,195)	(101)	(3,296)
Remeasurements of defined benefit plans	-	-	(3,472)	-	(3,472)	-	(3,472)
Total comprehensive income	-	-	**50,119**	**273**	**50,393**	**680**	**51,073**
Dividends	-	-	(31,675)	-	(31,675)	(1,105)	(32,780)
Equity compensation plans	-	276	-	-	276	-	276
Own equity instruments	-	657	-	-	657	-	657
At December 31, 2016	**72,967**	**63,500**	**507,399**	**1,642**	**645,508**	**989**	**646,497**

(5) Notes regarding the going concern assumption

None

(6) Notes regarding the consolidated financial statements

1. General accounting principles and significant accounting policies

(a) Basis of preparation of the consolidated financial statements

These financial statements are the annual consolidated financial statements (“Consolidated Financial Statements”) of Chugai, a company registered in Japan, and its subsidiaries (“the Group”). The common stock of Chugai is publicly traded and listed on the Tokyo Stock Exchange under the stock code “TSE: 4519.” The Consolidated Financial Statements were approved by the Board of Directors on February 1, 2017.

Roche Holding Ltd. is a public company registered in Switzerland and the parent company of the Roche Group, which discloses its results in accordance with International Financial Reporting Standards (“IFRS”). The shareholding percentage of Roche Holding Ltd. in Chugai is 59.89% (61.36% of the total number of shares issued excluding treasury stock). The Group became principal members of the Roche Group after entering into a strategic alliance in October 2002.

The Group meets all of the requirements for a “Specified Company under Designated International Financial Reporting Standards” as stipulated under Article 1-2 of the “Regulations Concerning Terminology, Forms, and Preparation Methods of Consolidated Financial Statements” (Ministry of Finance of Japan Regulation No. 28, 1976, “the Regulation”). Hence, in accordance with Article 93 of the Regulation, the Consolidated Financial Statements have been prepared in accordance with IFRS.

The Consolidated Financial Statements are presented in Japanese yen, which is Chugai’s functional currency and amounts are rounded to the nearest ¥1 million. They have been prepared using the historical cost convention except for items that are required to be accounted for at fair value.

(b) Changes in accounting policies

The accounting policies applied by the Group for its Consolidated Financial Statements for the fiscal year under review are the same as for the previous fiscal year.
There were minor changes in some of the standards. However, they do not materially impact the Group’s performance or financial status.

(c) Future new and revised standards

The Group is currently assessing the potential impacts of new standards and interpretations that will be effective from January 1, 2017 and beyond. Based on the analysis to date, the Group does not anticipate that these will have a material impact on the Group’s overall results and financial position.
By the date of approval of the Consolidated Financial Statements, the following new and revised standard has been issued by the International Accounting Standards Board (IASB) and has not yet been implemented by the Group.

IFRS		Mandatory adoption (from the year beginning)	Plan to be implemented by the Group	Description of new and revised standards
IFRS 15	Revenue from Contracts with Customers	January 1, 2018	FY ending Dec. 2018	Revision of accounting relating to revenue recognition
IFRS 9	Financial Instruments	January 1, 2018	FY ending Dec. 2018	Classification, measurement, recognition of financial instruments and revision of hedge accounting
IFRS 16	Leases	January 1, 2019	FY ending Dec. 2019	Revision of accounting relating to recognition of leases

2. Operating segment information

The Group has a single business of pharmaceuticals and does not have multiple operating segments. The Group's pharmaceuticals business consists of research and development of new prescription medicines and subsequent manufacturing, marketing and distribution activities. These functional activities are integrated and managed effectively.

Information on revenues by geographical area in millions of yen

	2016		2015	
	Sales	Royalties and other operating income	Sales	Royalties and other operating income
Japan	393,134	1,998	386,241	3,770
Overseas	79,539	17,109	82,185	26,643
of which Switzerland	62,780	15,563	63,084	26,555
Total	**472,673**	**19,108**	**468,427**	**30,413**

Information by major customers in millions of yen

	2016		2015	
	Revenues	Percentage (%)	Revenues	Percentage (%)
Alfresa Corporation	103,308	21.0	100,181	20.1
Mediceo Corporation	79,275	16.1	78,489	15.7
F. Hoffmann-La Roche Ltd	78,321	15.9	89,639	18.0
Suzuken Co., Ltd.	50,248	10.2	49,457	9.9

3. Financing costs and other financial income (expense)

Financing costs in millions of yen

	2016	2015
Interest expense	(8)	(7)
Net interest cost of defined benefit plans	(8)	8
Net other financing costs	(69)	(68)
Total financing costs	**(86)**	**(67)**

Other financial income (expense) in millions of yen

	2016	2015
Dividend income	201	208
Gains on sale of equity securities	1,341	2
Losses on sale of equity securities	-	-
Write-downs and impairments of equity securities	(160)	(64)
Net income from equity securities	**1,382**	**146**
Interest income	81	148
Gains on sale of debt securities	-	-
Losses on sale of debt securities	-	-
Net interest income and income from debt securities	**81**	**148**
Foreign exchange gains (losses)	452	(585)
Gains (losses) on foreign currency derivatives	(804)	849
Net foreign exchange gains (losses)	**(352)**	**265**
Total other financial income (expense)	**1,111**	**559**

4. Other expense

Chugai have filed the Advance Pricing Arrangement covering the certain transactions with F. Hoffmann-La Roche Ltd., to Japanese and Swiss tax authorities in accordance with a tax treaty between Japan and Switzerland. Both tax authorities concluded the tentative agreement that will decrease taxable income of Chugai and increase that of Roche. As a result of this agreement, Chugai will transfer a part of the deducted amount of corporate tax etc. to Roche as the estimated tax payable for Roche, in accordance with the license agreement between Chugai and Roche, and also posted ¥3,460 million of adjustment from transfer pricing taxation.

5. Earnings per share

Basic earnings per share

	2016	2015
Net income attributable to Chugai shareholders (millions of yen)	**53,592**	**61,125**
Weighted average number of common stock	559,685,889	559,685,889
Weighted average number of treasury stock	(13,506,255)	(13,912,427)
Weighted average number of shares in issue	**546,179,634**	**545,773,462**
Basic earnings per share (yen)	**98.12**	**112.00**

Diluted earnings per share

	2016	2015
Net income attributable to Chugai shareholders (millions of yen)	**53,592**	**61,125**
Weighted average number of shares in issue	546,179,634	545,773,462
Adjustment for assumed exercise of equity compensation plans, where dilutive	821,617	1,028,628
Weighted average number of shares in issue used to calculate diluted earnings per share	**547,001,251**	**546,802,090**
Diluted earnings per share (yen)	**97.97**	**111.79**

As of December 31, 2016, 5,538 stock options (2,814 stock options as of December 31, 2015) were eliminated from the weighted average number of shares in issue used to calculate diluted earnings per share since they do not have dilutive effects.

6. Statement of cash flows

Cash flows from operating activities

Cash flows from operating activities arise from the Group's primary activities including research and development, manufacturing and sales in the Pharmaceuticals business. These are calculated by the indirect method by adjusting the Group's operating profit for any operating income and expenses that are not cash flows (for example depreciation, amortization and impairment) in order to derive the cash generated from operations. Operating cash flows also include income taxes paid on all activities.

Cash generated from operations in millions of yen

	2016	2015
Net income	54,372	62,353
Financing costs	86	67
Other financial income (expense)	(1,111)	(559)
Other expense	3,460	-
Income taxes	20,076	24,923
Operating profit	**76,884**	**86,784**
Depreciation of property, plant and equipment	14,761	13,964
Amortization of intangible assets	1,608	1,603
Impairment of property, plant and equipment	61	202
Impairment of intangible assets	2,380	1,852
Operating expense for defined benefit plans	4,122	3,806
Operating expense for equity-settled equity compensation plans	433	387
Net (income) expense for provisions	12	436
Inventory write-downs	2,239	1,481
Other adjustments	298	(358)
Cash generated from operations	**102,797**	**110,159**

Cash flows from investing activities

Cash flows from investing activities are principally those arising from the Group's investments in property, plant and equipment and intangible assets. Cash flows connected with the Group's portfolio of marketable securities and other investments are also included, as are any interest and dividend payments received in respect of these securities and investments.

Interest and dividends received in millions of yen

	2016	2015
Interest received	100	147
Dividends received	201	208
Total	**301**	**355**

Cash flows from financing activities

Cash flows from financing activities are primarily dividend payments to Chugai shareholders.

Significant non-cash transactions

There were no significant non-cash transactions (2015: none).

7. Related parties

(a) Controlling shareholder

Effective from October 2002, Roche and Chugai concluded an alliance to create a leading research-driven Japanese pharmaceutical company, which was formed by the merger of Chugai and Roche's Japanese pharmaceuticals subsidiary, Nippon Roche. Through the merger, Chugai become a principal member of the Roche Group as the surviving company.

Chugai has entered into certain agreements with Roche, which are discussed below:

Basic Alliance Agreement: As part of the Basic Alliance Agreement signed in December 2001, Roche and Chugai entered into certain arrangements covering the future operation and governance of Chugai. Amongst other matters, these cover the following areas:

- The structuring of the alliance.
- Roche's rights as a shareholder.
- Roche's rights to nominate members of Chugai's Board of Directors.
- Certain limitations to Roche's ability to buy or sell Chugai's common stock.

Chugai may issue additional shares of common stock in connection with its convertible debt and equity compensation plans, and for other purposes, which affects Roche's percentage ownership interest. The Basic Alliance Agreement provides, amongst other matters, that Chugai will guarantee Roche's right to maintain its shareholding percentage in Chugai at not less than 50.1%.

Licensing Agreements: Under the Japan Umbrella Rights Agreement signed in December 2001, Chugai has exclusive rights to market Roche's pharmaceutical products in Japan. Chugai also has right of first refusal on the development and marketing in Japan of all development compounds held by Roche.

The Rest of the World Umbrella Rights Agreement (excluding Japan and South Korea) signed in May 2002 was revised and the Amended and Restated Rest of the World Umbrella Rights Agreement (excluding Japan, South Korea and Taiwan) was signed in August 2014. Under this Agreement, Roche has the right of first refusal on the development and marketing of Chugai's development compounds in markets outside Japan, excluding South Korea and Taiwan.

Further to these agreements, Roche and Chugai have signed a series of separate agreements for certain specific products. Depending on the specific circumstances and the terms of the agreement, this may result in payments on an arm's length basis between Roche and Chugai, for any or all of the following matters:

- Upfront payments, if a right of first refusal to license a product is exercised.
- Milestone payments, dependent upon the achievement of agreed performance targets.
- Royalties on future product sales.

These specific product agreements may also cover the manufacture, supply etc. of the respective products to meet the other party's clinical and/or commercial requirements on an arm's length basis.

Research Collaboration Agreements: Roche and Chugai have entered into research collaboration agreements in the areas of small-molecule synthetic drug research and biotechnology-based drug discovery.

Dividends: The dividends distributed to Roche by Chugai in respect to its holdings of Chugai shares totaled ¥19,443 million (2015: ¥17,432 million).

(b) Material transactions and balances with related parties

Transactions with F. Hoffmann-La Roche in millions of yen

	2016	2015
Sales	62,780	63,084
Purchases of inventory and other materials	120,923	131,025

Balances with F. Hoffmann-La Roche in millions of yen

	December 31, 2016	December 31, 2015
Accounts receivable	34,115	32,489
Accounts payable	(45,868)	(43,560)

(c) Remuneration of key management personnel

Remuneration of members of the board and audit & supervisory board members in millions of yen

	2016	2015
Board of directors		
- Regular remuneration	364	355
- Bonuses	191	238
- Chugai common stock options	123	117
- Chugai stock options as stock-based compensation	122	115
Total	**801**	**825**
Audit & supervisory board members		
- Regular remuneration	85	85
Total	**85**	**85**

8. Subsequent events

There were no material subsequent events (2015: none).