Message from the CFO

We are currently enjoying growth momentum. Nonetheless, we will remain vigilant and forge ahead with further structural reforms and innovation. We will also keep the balance of economic and social value in mind in our dialogue with stakeholders.

Toshiaki Itagaki

Executive Vice President & CFO
In charge of Finance & Accounting, Corporate Communications, Purchasing, Digital Strategy and IT Solution

The Global Expansion of Chugai Products is Driving Our Growth Momentum

Mid-term business plan IBI 21 got off to a strong start in 2019, as results exceeded expectations. Chugai made significant upward revisions to its financial forecasts during the year, yet still outperformed the revised figures with revenues of ¥686.2 billion (up 18.4 percent year-on-year), Core operating profit of ¥224.9 billion (up 72.6 percent) and a ratio of operating profit to revenues of 32.8 percent. It was our third consecutive year of record revenues and profit.

We expect revenues and profit growth to continue in 2020. Our targets are revenues of ¥740.0 billion (an increase of 7.8 percent year-on-year), Core operating profit of ¥275.0 billion (up 22.3 percent) and a ratio of operating profit to revenues of 37.2 percent. In addition, we have raised the IBI 21 target for Core EPS CAGR,[1] our financial KPI, from the high single digits (7-9 percent range) to around 30 percent. As with IBI 18, the previous mid-term business plan, we will make IBI 21 another three years of high growth.

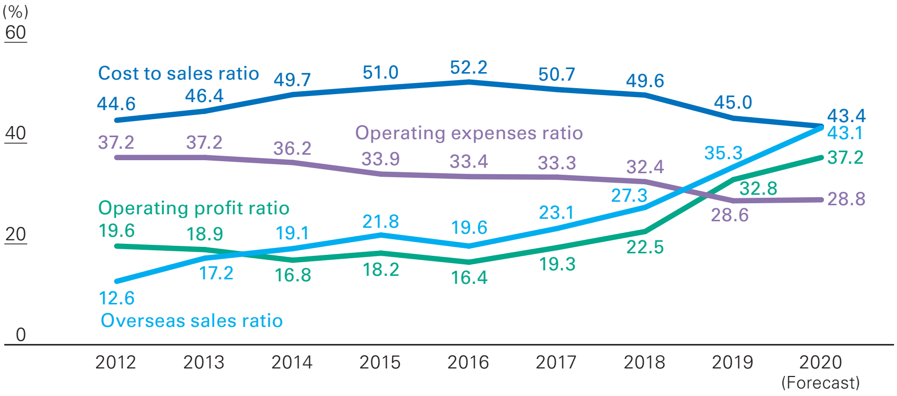
Chugai's growth momentum over the past few years has been driven by the global expansion of innovative products from in-house research. Our business outside Japan consists of our own sales through overseas affiliates plus export business through Roche's network, the latter being particularly strong. Actemra, Alecensa and Hemlibra are all manufactured and exported by Chugai and sold by Roche worldwide (except in Japan, Taiwan and South Korea). The ratio of overseas revenues to total revenues has surged in seven years to 35.3 percent from 12.6 percent. Contributions to profit by export business have also increased dramatically. The cost to sales ratio for our products is lower than that for in-licensed products. Therefore, as our product sales expand worldwide, they account for a larger proportion of profit, thus increasing our gross profit margin. Royalties and other income that we receive based on Roche's sales go directly into operating profit. For that reason, the creation and global expansion of innovative medicines from in-house research are vital to our sustainable growth and a high-profit business structure.

1. Core earnings per share compound annual growth rate

Defending Value Creation Capabilities in a Tough Domestic Market

Our business in Japan, on the other hand, will be facing headwinds for some time to come. In 2020, growth products Perjeta, Actemra and Hemlibra are subject to repricing based on market expansion. Avastin and Xeloda, which have been domestic revenue drivers, will lose premium pricing status, leading to

Earnings Structure



* Cost to sales ratio is the comparison of product sales to total sales.
Overseas sales ratio, operating expenses ratio and operating profit ratio are comparisons to revenues.

a substantial cut in the prices for both products. In addition, the launch of biosimilars and generics will bring fierce competition to mainstay products Avastin, Herceptin, Rituxan, Xeloda, Edirol and Mircera. In these challenging conditions, we are projecting negative growth of 5.9 percent for domestic revenues in 2020. In 2021 and beyond, drug price revisions will be implemented annually, and other healthcare cost-containment measures may be implemented and strengthened, and the market itself is expected to shrink.

In terms of size, Japan accounts for no more than about seven percent of the global market. Increasing the proportion of revenues from overseas is necessary for Chugai as it seeks to be a top innovator in the healthcare industry. Nevertheless, Japan is where our research, development, production, marketing and all other supply chains are located, and its importance as a business area will not change.

Even in an age of increasing uncertainty marked by the evolution of drug discovery modalities, the advancement of digital technology, the entry of competitors from other industries, and restrictions on drug detailing and sales promotion, Chugai will remain focused on innovation. This is because solving social issues with innovation is our mission, and without innovation we cannot grow. The networks we have built with academia, medical institutions and healthcare professionals, startup companies, suppliers and others will be instrumental in creating and delivering innovative medicines with world-class quality. We will maintain and strengthen this foundation.

Concentration and Selection Are the Key to Structural Reform

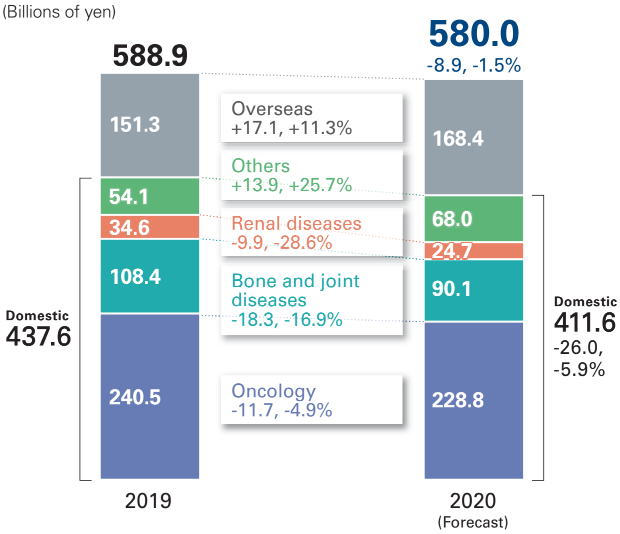
Since the alliance with Roche began, Chugai has continued business process re-engineering (BPR) and other cost optimization initiatives. Although profitability has increased to a certain extent, there is still room for improvement in productivity and efficiency.

We cannot afford to be complacent about our current growth momentum. We have made fundamental structural reform one of the growth strategies in IBI 21 to further establish a solid cash generation cycle. Our basic policy for structural reform is concentration and selection. We will upgrade core functions by concentrating resources in innovation and improve business efficiency in ways such as using shared services and business process outsourcing (BPO) for selected non-core businesses and functions.

Specific activities in 2019 are summarized in the chart on the next page. As a move toward “concentration,” we decided to establish the new Chugai Life Science Park Yokohama and close the Fuji Gotemba and Kamakura Research Laboratories. Other initiatives included the start of construction on a new manufacturing facility for active pharmaceutical ingredients (APIs) for small and middle molecule drugs, the launch of the FMI business, and in-licensing of an oncolytic viral immunotherapy. We also began improving our business foundation to support growth by establishing the

2020 Sales Forecast

(Billions of yen)



Change in Sales of Main Products

Sales Forecast		Year-on-Year Change (Billions of yen/%)
Overseas		
Hemlibra	23.9	+20.3 (+563.9%)
Alecensa	39.0	-6.3 (-13.9%)
Others		
Hemlibra	42.1	+16.9 (+67.1%)
Foundation Medicine	4.5	+4.1 (11 times)
Tamiflu (ordinary)	3.4	-4.0 (-54.1%)
Renal diseases		
Mircera	15.4	-6.8 (-30.6%)
Bone and joint diseases		
Edirol	26.1	-10.6 (-28.9%)
Oncology		
Tecentriq	44.6	+24.0 (+116.5%)
Kadcyla	11.7	+2.7 (+30.0%)
Perjeta	28.8	-1.9 (-6.2%)
Xeloda	3.1	-4.9 (-61.3%)
Rituxan	6.3	-5.6 (-47.1%)
Herceptin	19.2	-7.5 (-28.1%)
Avastin	73.3	-22.3 (-23.3%)

Digital & IT Supervisory Division to lead Company-wide digital and IT strategies. Initiatives for "selection" included the transfer of long-term listed products (off-patent branded drugs) and the sale of all shares in C&C Research Laboratories, the sale of cross-held stock, the decision to outsource logistics and packaging operations, the implementation of an early retirement incentive program, the introduction of robotic process automation for back-office tasks, and the integration of expense and payment systems.

Going forward, we will also focus on strengthening our digital infrastructure and on initiatives for utilizing and applying AI, ICT and real-world data. While proactively pursuing collaboration with academia and startups for drug discovery that combines biology and technology, we will also consolidate redundant functions that overlap our corporate organization, divisions and subsidiaries.

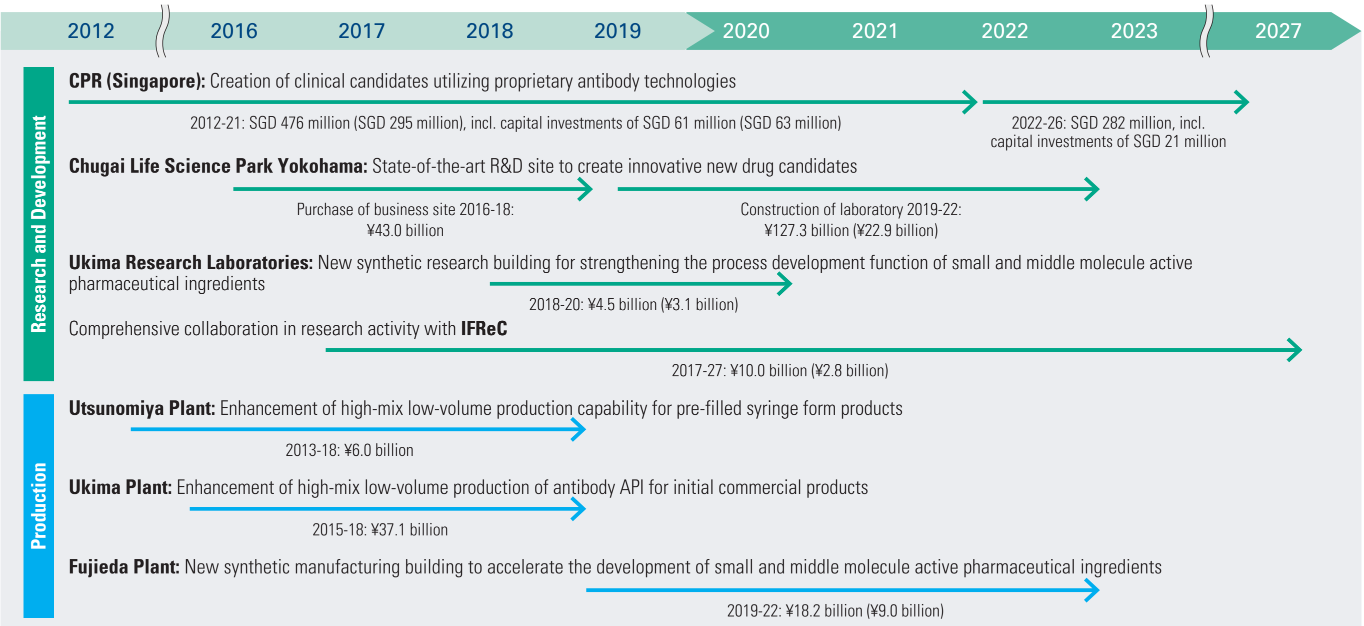
Balancing Investment for Value Creation and Shareholder Returns

Chugai believes that the establishment of middle molecule technologies to complement its small molecule and antibody technologies will lead to drug discovery innovation, and has therefore been conducting related research and development for more than a decade. With a middle molecule candidate about to move into clinical trials, we have started construction of a synthetic research building and manufacturing facility for middle molecule APIs and other compounds. In addition, investment in Chugai Life Science Park Yokohama has begun in earnest, comprehensive collaboration with Osaka University Immunology Frontier Research Center (IFReC) has entered the joint research stage, and we have decided to continue investing in Chugai Pharmabody Research in Singapore. We are also proactively investing in efficiency, productivity and other improvements across the supply chain with AI use in drug discovery, digitalization and utilization of digital information, and use of ICT. Furthermore, if opportunities arise, we will allocate

Main Fundamental Structural Reforms in 2019

Concentration Upgrading of innovation and core functions	• Entered into exclusive licensing agreement for Telomelysin and capital tie-up agreement with Oncolys BioPharma Inc. (Announced April 8) • Construction of new manufacturing facility for APIs at Fujieda Plant (Announced April 24) • Decided to construct Chugai Life Science Park Yokohama and close Fuji Gotemba Research Laboratories and Kamakura Research Laboratories (Announced May 21) • Launched genomic mutation analysis program and began providing testing services (June 3) • Comprehensive alliance with Preferred Networks, Inc. extended for two years (September 1) • Established Digital & IT Supervisory Div. to lead integration of Company-wide digital and IT strategy (October 1) • Established Marketing & Sales Planning Dept. and made Business Development Dept. and Intellectual Property Dept. corporate organizations (October 1)
Selection Increase of efficiency through business concentration and outsourcing	• Introduction of Concur Expense as expense management system (January 1) • Business transfer of Ulcerlmin to Fuji Chemical Industries Co., Ltd. by September 30, 2019 (Announced April 1) • 172 people retired at end of June under early retirement incentive program • Full outsourcing of logistics operations to Mitsubishi Logistics starting in January 2021 (Announced June 14) • Introduced and began using robotic process automation for Company-wide back-office tasks • Transferred rights for Oxarol Ointment and Oxarol Lotion to Maruho Co., Ltd. (Completed December 1) • Transferred shares of C&C Research Laboratories in Korea to JW Pharmaceutical Corporation (Completed by December 31, 2019)

Current Status/Plan for Major Investments



( ): Cumulative amount as of December 31, 2019 funds to drug discovery technologies and modalities, in-licensing of development projects to supplement our pipeline, and cooperation and capital alliances with startup companies.

Innovation in the age of VUCA[2] will require greater diversity in human capital, technologies, information and funding. Amid remarkable advances in life science and digital technology, creating new business value will require a strong financial footing that enables flexible and focused strategic investments.

After considering factors including the variability of earnings growth and the strength of our financial base going forward, we changed our target Core EPS payout ratio to 45 percent on average from 50 percent on average. This will better position us to maintain stable dividends.

2. VUCA: Acronym for volatility, uncertainty, complexity and ambiguity

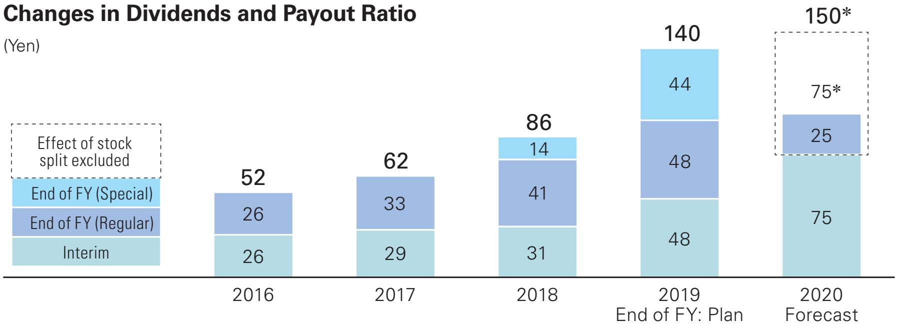
Managing Efficiency with KPIs That Fit Our Business Model

We use Core EPS CAGR as one of our financial KPIs in the mid-term business plan. The intention behind this can be explained in terms of our expanded formula for return on equity (ROE). Chugai specializes in biopharmaceuticals, which have long production lead times, and we have to keep safety stocks because many of our products have a large market share. Consequently, our ability to increase the asset turnover ratio is limited. Moreover, to maintain management independence in our alliance with Roche, we must keep Roche's shareholding ratio within a certain range, so our ability to use share buybacks to increase financial leverage is also limited. Therefore, the key to raising ROE is to increase the profit margin in our core business. For that reason, we use Core EPS CAGR as a mid-term financial KPI to show sustainable growth of the margin in clear terms from the viewpoint of shareholders.

We are also mindful of the cost of capital. When developing medium- to long-term business plans, we set out our growth strategy by factoring in the equity spread to clarify the gap between targets and current conditions. In assessing the business feasibility of investments and

Changes in Dividends and Payout Ratio

(Yen)



		2016	2017	2018	2019 End of FY: Plan	2020 Forecast
Core payout ratio	5-year average	49.2%	48.4%	48.6%	47.4%	45.0%
	Single FY	50.7%	44.7%	48.7%	45.8%	41.0%

* Three-for-one split of ordinary shares planned for July 1, 2020. Amount shown excludes effect of the stock split.

development projects, the concept of cost of capital is built into our internal decision-making processes and mechanisms in ways such as calculating present value by discounting at the weighted average cost of capital (WACC).[3]

In addition, in 2019 we began using ROIC[4] as a long-term financial KPI. In the pharmaceutical business, new drugs are brought to market at a success rate of one in tens of thousands, despite large investments over long periods of time. For that reason, we believe that it is necessary to use material accounting to manage with long-term investment efficiency in mind, and not be swayed by short-sighted thinking about earnings.

Core ROIC in 2019 was 31.9 percent, which is well above WACC, a return on investment that shareholders and other capital providers expect. As such, we judge that management is maintaining high capital efficiency.

3. The most common method of calculating cost of capital, WACC is the weighted average of the cost of borrowing money and the cost of raising funds through equity.

4. ROIC indicates how efficiently a company uses capital invested for business activities (invested capital) to generate profit.

Dialogue from Financial and Non-Financial Perspectives

Chugai has been using various media to carry out timely and appropriate disclosure about its Envisioned Future, strategies and specific initiatives, including ESG, and their progress. We have also been focusing on balanced dialogue.

In 2019, these efforts included visits from investors, media briefings, individual interviews and briefings for more than 350 domestic and overseas investors and analysts, and CEO roundtable conferences. We held a first-ever ESG meeting for analysts and investors, and introduced Chugai's new technologies at a presentation on antibody engineering technologies. Other activities included an online briefing for individual investors and our participation in joint investor briefings and conferences. Overall, we had more opportunities for dialogue than ever before.

Our market capitalization as of December 31, 2019 exceeded ¥5 trillion, growing 60 percent from the beginning of the year, and ranked 14th among companies on the First Section of the Tokyo Stock Exchange (ranked 10th at ¥6.6 trillion as of February 29, 2020). We see this as evidence that our shareholders and other stakeholders understand and support our initiatives, including not only the economic value we provide but also the social value of our ESG activities. This has given us confidence, but at the same time, a strong sense of responsibility to live up to expectations.

Chugai's business partner, Roche, is also the Company's largest shareholder. Under these circumstances, we recognize the importance of fair and open communication with minority shareholders. We will continue to engage with shareholders in balanced dialogue, with transparency and fairness in mind, and look forward to receiving honest opinions and feedback.