

K O B A Y A S H I

Pharmaceutical Co., Ltd.

ANNUAL REPORT 2001

Year ended March 31 2001

consumer products operation

wholesale operation

medical devices operation



Company Profile

Kobayashi Pharmaceutical Co., Ltd. was established in 1886 as Kobayashi Seidaido, a retailer of household sundries, cosmetics and western alcoholic beverages. In 1919 the business was incorporated as Kobayashi Daiyakubo Co., Ltd. Since that time, the company has sought to carry out its management policy of “Creativity and Innovation” and expanded the scope of its business activities.

Over the years, the company has developed into a conglomerate made up of three core businesses: the wholesale operation that sells household pharmaceuticals to pharmacies and drugstores, the consumer products operation that manufactures and sells household pharmaceuticals, deodorizing air fresheners, sanitary products and oral hygiene products, and the medical devices operation that imports and distributes state-of-the-art medical equipment. In August 2000 the company’s shares were listed on the First Section of the Tokyo Stock Exchange, and the business is developing favorably.

During the fiscal year ended March 31, 2001, Kobayashi Pharmaceutical recorded net sales of ¥185,001 million and net income of ¥6,020 million, marking the third consecutive year of sales and earnings increases since the company began reporting on a consolidated basis. In the coming years we aim to achieve still greater growth by bringing out our spirit of “Creativity and Innovation” and being ahead of the times in which everything is changing at accelerating speed.

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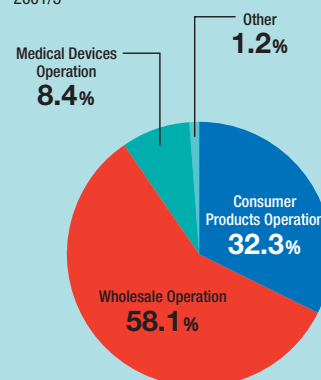
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Forward-looking Statements

Plans and strategies concerning future business performance included in this annual report are forward-looking statements based not on historical facts but on management’s assumptions and beliefs in the light of the information currently available to it, and include risk and uncertainty.

Net Sales by Segment

2001/3

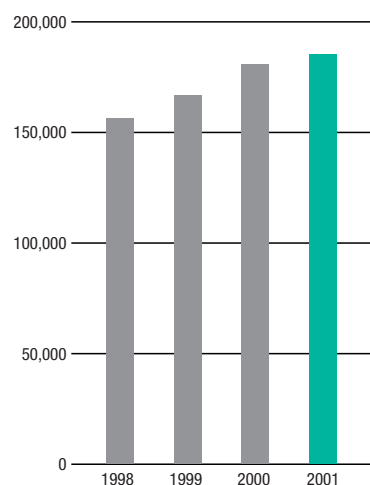


Consolidated Financial Highlights

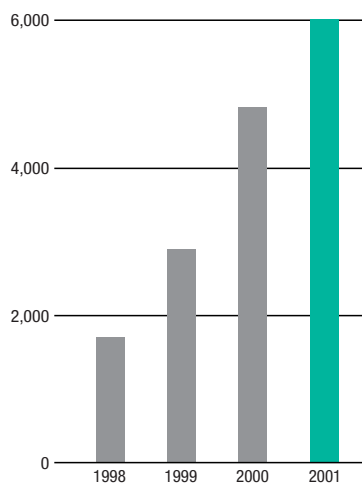
Years Ended March 31	Millions of yen		Thousands of U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
For the Year			
Net Sales	¥ 185,001	¥ 180,731	\$ 1,493,154
Operating Income	13,807	12,871	111,438
Net Income	6,020	4,822	48,587
Per Share Data			
Net Income (Yen)	212.80	170.80	1.717
Shareholder's Equity (Yen)	1,355.78	1,133.78	10.94
At Year End			
Total Assets	106,391	104,331	858,688
Shareholders' Equity	38,436	32,142	310,220
Ratios			
ROA (%)	5.7	5.0	—
ROE (%)	17.1	19.2	—

Note: U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥123.90 = U.S. \$1, the approximate Tokyo Foreign Exchange Market rate as of March 31, 2001.

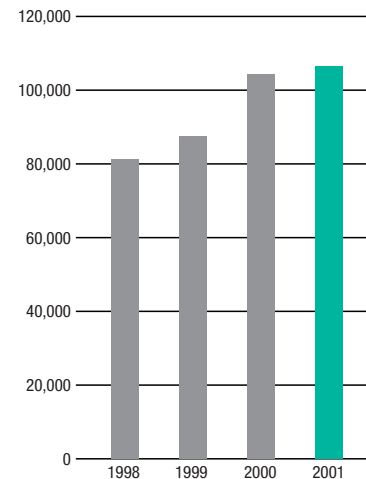
Net Sales (¥ million)



Net Income (¥ million)



Total Assets (¥ million)



During the fiscal year ended March 31, 2001, Kobayashi Pharmaceutical generated the highest sales and earnings in the history of the company.

It gives me great pleasure to report to our shareholders on the results of the fiscal year ended March 31, 2001.

Business Overview

Kobayashi Pharmaceutical posted the most outstanding results in its history for the fiscal year ended March 31, 2001, the third consecutive year of sales and earnings increases since the change to consolidated accounting. Our consumer products operation continued to aggressively pursue new product development and product improvements, striving to create new markets and reinforce the power of our brands. At the same time, we acquired new customers in the area of direct marketing business of nutritional supplement food — a market sector we entered in 1999 — by providing products and services with the distinctive characteristics and quality that can be offered by a pharmaceuticals company. As a result of these efforts, we were able to grow sales satisfactorily. However, some of our mainstay products — specifically, ***Netsusama Sheet, Breath Care, Eyebon, and Shoshugen*** — decreased market share due to the impact of competitors' sales offensives and discount selling.

In regard to earnings, the medical devices operation returned to profitability after consecutive years of operating losses. Also, we were well rewarded for our long-term aggressive efforts to reduce selling and administrative expenses. To cite a noteworthy example, we established advertising placement criteria utilizing point-of-sale data to ensure an effective advertising spend. We attribute the achievement of the highest earnings ever in large part to the results of these measures.

Measures to Generate Future Growth

In July 2000 we introduced an in-house company system, aiming to speed up a decision-making process and improve management efficiency. As a result, each company is able to manage itself independently and the employees' awareness of the need to achieve goal is enhanced. Far-reaching authority was transferred to the president of each company. And the group structure was reformed. The number of organizational layers was halved from ten to five. Quick-processed decision-making is steadily progressing after these structural reforms.

Moreover, in April 2001 management spun off the wholesale operation into a separate legal entity. The wholesale industry is currently undergoing a restructuring as companies strive to

achieve broad-based geographical coverage, product line completeness, and management efficiency. We decided that in order for the wholesale operation to successfully grapple with these issues it should be established as an independent company rather than being one operation of the main group of Kobayashi Pharmaceutical. So structured, the wholesale operation has the option of entering into mergers or alliances with other companies. We believe that the company will be able to carve out a firm position for itself in the industry by expanding its product range and increasing the scale of its operation through a variety of management techniques, including mergers and acquisitions.

Further, as demonstrated by the consumer products operation's acquisition of Whitehall Japan Corporation in January 2001, and Kiribai Chemical Co., Ltd. in June 2001, we will aggressively engage in strategic alliances with or acquisitions of companies that would possibly have synergy effects with our existing business areas.

To Our Shareholders

The Japanese economy creeps along without any sign of a recovery. Furthermore, the US economy upon which Japan has been relying has begun to show signs of slowing and the outlook for future economic conditions is by no means clear. Against this macroeconomic backdrop, we will assiduously cultivate the ability to develop the distinctive products, which is regarded typical of Kobayashi. At the same time, we will promote mergers and acquisitions, brand acquisition, new business development and overseas expansion. In this way, the management of Kobayashi Pharmaceutical aims to cope with the times of uncertainty and sweeping changes and take the Company to a still higher stage of development. We are determined to carry out strong group management and spare no effort in meeting the expectations of our loyal shareholders. Your continued guidance and support would be very much appreciated.

July 2001

川村一雅

President and CEO
Kazumasa Kobayashi



President and CEO
Kazumasa Kobayashi

The Kobayashi Group Management Strategy

“Something New, Something Different”

“We at Kobayashi Pharmaceutical constantly and consistently strive through our creative and innovative endeavors to offer something different, something new that will give great pleasures and comfort to people and society” — that is the concept at the heart of the management philosophy of Kobayashi Pharmaceutical. All of our operations manage their businesses to achieve its goals.

We believe that in this age characterized by the accelerating pace of change and ever intensifying competition, it is indispensable for our future growth to strive each day to create new markets by implementing the motto “Something New, Something Different” and to develop new products and services to satisfy the needs of customers. We further believe that this is the core competence of the company.

Further, in preparation for future development we have established management themes: further globalization and the expansion of the scope of our activities through mergers and acquisitions and strategic operating tie-ups. Management believes that full commitment to pursue these themes is the key that will open the door to a bright new future for Kobayashi Pharmaceutical.

Everyone in the Kobayashi Group will continue to work as one, sparing no effort to meet the challenge of growing together with society in our chosen role as a company that makes life more pleasant by providing health, comfort, invigoration, and gratification.

Customer Products
Wholesale
Medical Devices
Mergers and Acquisitions
Creating New Markets
Overseas Business Development

Market Creation: A Niche Marketer

The core competence of our mainstay consumer products operation is the creation and expansion of niche markets rather than entry into existing markets. This role as a niche marketer involves identifying markets which have not previously existed or are extremely small in scale, introducing innovative products into these niches, and developing them into hit products. This strategy involves expanding the market itself, in that process we will grow to be the market share leader. This concept of “starting out small and developing something big” — a strategy that reflects the Kobayashi Pharmaceutical management policy in our business development activities — is an absolute ideology of the company.

Turning to the subject of product development, we begin the process by gathering ideas. We have many sources of information, including our employees, marketing and research specialists, our advertising agency and raw materials suppliers. We go on to distill and refine the ideas collected from these sources through careful market research, singling out those with commercial potential. This process is the very essence of new product development. We promptly move to commercialize the selected ideas and introduce them into the market in the form of new products. Nearly all products developed in this way, including **Eyebon** eyewash, **Sarasarty** sanitary products, and **Bluelet** and **Sawaday** air fresheners, are the share leaders in their respective markets.

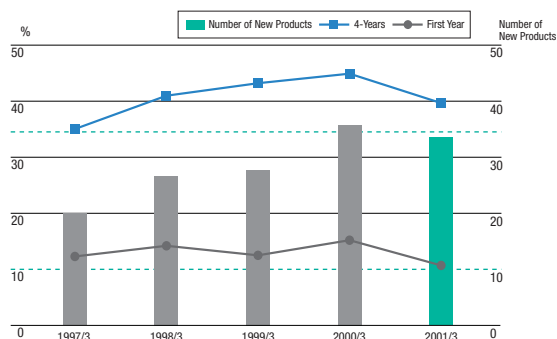
However, some may have a concern that there is a limit to growth potential based on product ideas targeting at niche markets and that in the end we may find ourselves having reached the limit of growth which could be expected with this approach. Indeed, we have been discussing this point internally for the past ten years or more. Nevertheless, people's lifestyles and preferences change from day to day and it is a fact that these changes give rise to new markets. We intend to engage in product development for as many market sectors as possible, firm in our belief that there is no limit to the future of ideas.

Kobayashi Pharmaceutical uses new product contribution to measure success in new product development. This is the ratio of new product sales (excluding reformulated or repackaged products) to total sales of the consumer products operation. Our objective is to attain a 10% or greater contribution to sales for products launched during the previous year and a 35% or greater contribution for products launched during the last four years. The development, manufacturing, sales, and administration sections of the consumer products operation make every effort to achieve this strategic objective. With new product contribution of 10.7% of products launched during the previous year and 39.8% of products launched during the last four years, we achieved the objective in the year ended March 31, 2001 as well. In future, as total sales — the denominator in the product contribution equation — rise we anticipate that it will become increasingly difficult to achieve this objective. For this reason we are conscious of the need to devise a strategy for growth involving other means to be pursued in parallel with our current niche marketing approach.



New Products Launched in Spring 2001

Change in the ratio of new products sales (Non-consolidated)



Kobayashi Pharmaceutical on the World Stage: Overseas Business Development

A declining birthrate is projected to bring about a decline in the population of Japan in coming years, and it will be difficult to sustain high growth relying only on the domestic market. For this reason, we are setting our sights on overseas markets. This strategy is grounded in our conviction that it will be possible to create markets overseas with original, creative brands that have been nurtured in Japan.

With the world's largest population and an economy with an extraordinary growth rate, China is a very promising market for overseas expansion. For this reason in 1998 we established a joint venture company, Shanghai Kobayashi Friendship Daily Chemicals Co., Ltd., developed a marketing and sales strategy appropriate to the local market environment, and began the manufacture and sale of **Sawaday** for China. Aggressive television commercial support to enhance its brand recognition and expanded geographical coverage of product distribution resulted in a tremendous market reception for this. Through the introduction of the product **Toire Sonoatoni** for China planned for July 2001, we aim to vitalize the Chinese market for scented deodorizers and capture market share leadership.

Market research indicated that no market for cooling gel sheets existed in the United States and Europe. The finding inspired us to introduce **Netsusama Sheet** in the U.S. and Europe market. In 1998 we established a wholly owned subsidiary in the United States, Kobayashi Healthcare Inc., and launched **Netsusama Sheet** under the brand name **BE KOOL**. Although early on we faced issues concerning distribution channels, the product is now sold at volume retailers nationwide such as Wal-Mart stores. Here too, the market responded favorably to television commercials for the product and sales through retail outlets are developing favorably.

Capitalizing on our experience in the United States, in June 2001 we established a wholly owned subsidiary, Kobayashi Healthcare Europe Ltd., in the United Kingdom and introduced **Netsusama Sheet** under the brand name **KOOL'n'SOOTHE**. Our plans involve using the United Kingdom as a base for expanding our operations to the European continent.



"Sawaday" for China



"Toire Sonoatoni" for China



"BE KOOL"



"KOOL'n' SOOTHE"

Further Expansion:

Mergers and Acquisitions

Management strategy for further growth also includes aggressive mergers and acquisitions (M&A) activity targeted at prospective brands or companies that would produce potential synergy effects for our business. The rationale behind this approach is that it is faster to supplement the resources necessary for growth through M&A than through internal procurement. Further, management's view is that M&A is the most effective means of utilizing cash generated from operations.

In January 2001 we acquired Whitehall Japan Corporation, obtaining their brands **Kimko**, the market leading refrigerator deodorizer. This acquisition enabled us to enter into a new market for us, the refrigerator deodorizer market. Simultaneously this gave us a new business opportunity: our marketing power and new product development capabilities revitalized the acquired brands as demonstrated through the launch of **Kimko Dashu Shoshucha** deodorizer in April.

In June 2001 we acquired Kiribai Chemical Co., Ltd., which is ISO9002 certified and the market leader in chemical body warmers, marking our entrance into yet another new market sector. One of a few companies in the warmer industry to operate its own factory, Kiribai excels in quality control and product improvement. With respect to sales, although the company at present enjoys overwhelmingly high market share in West Japan, its share in East Japan is low. Accordingly, we aim to increase revenues by taking advantage of our sales network to expand market share in East Japan. While at the same time, we are targeting further business expansion by seeking to develop potential overseas markets for chemical body warmers in countries where they are yet to be marketed. Moreover, we are engaged in new product development targeted at creating new markets for items such as thermal treatment products that lessen pain or relieve stress using a thermotherapy mechanism.



"Kimco MAX Giant"



"Kiribai • Haru"



Mita Factory of Kiribai Chemical Co., Ltd.

Spinning Off the Wholesale Operation: **Kobasho Co., Ltd.**

The group's consumer products operation and wholesale operation have traditionally complemented each other. However, now that both operations have expanded greatly in scale, management has concluded that managing each operation as a separate entity offers much greater advantages to the entire Kobayashi group than the traditional approach of complementarity.

For our wholesale operation in particular, it becomes unavoidable to pursue higher operating efficiencies by means of scale expansion because the wholesale industry itself has entered an era of restructuring. For instance, these days drugstore chains operate nationwide, and wholesalers that cannot operate their business on a scale large enough to satisfy the drugstores' needs are finding it difficult to be selected as business partners. Further, in order to operate on a nationwide scale it is necessary to prepare adequate infrastructure (such as order handling systems). Investments for such infrastructure will bring us greater benefits, as the operational scale becomes greater. Moreover, although Kobasho's products account for no more than about 20% of the products sold in drugstores, by expanding the product categories handled and increasing that proportion it will be possible to pursue increased delivery efficiencies.

The pursuit of scale benefits is the most effective means of increasing management efficiency in wholesaling, which is an industry with traditionally low gross profit margins. It is necessary to realize scale-benefit alliances and mergers with other wholesalers. Although many companies might find it difficult to consider an alliance or merger with Kobayashi Pharmaceutical, both a manufacturer and wholesaler, there are many who might consider Kobasho, a wholesaler pure and simple, as a potential business partner.

By including M&A or alliances in the scope of Kobasho's strategic management options, the group aims to increase current sales of ¥100 billion threefold to fivefold in the near future and survive the process of natural selection that the wholesale industry is facing.



Digital Picking System in Distribution Center

For Rapid Progress toward the Twenty-first Century: Medical Devices Operation

The arrival of the era of the aging society and the desire for enhanced quality of life have given rise to high expectations of further advanced medical technologies among the citizens of Japan. However, at this moment the development of leading-edge medical technology in Japan relies heavily on the highly advanced level of the medical industry in the United States. With the rapid progress of medical technologies, new medical equipment is constantly being developed in the United States, and some of that equipment is imported into Japan to be used in medical institutions.

Kobayashi Pharmaceutical entered this highly promising business in 1972 when we established Medicon Co., Ltd. in a joint venture with C.R. Bard, a major American manufacturer of medical equipment. We have distributed C.R. Bard's state-of-the-art medical equipment, primarily in the fields of urology and surgery in Japan. In the process we have accumulated expertise in the area of marketing and license formalities and developed highly capable personnel. Later, in 1992, we established the Kobayashi Medical Division within the parent company, by utilizing this expertise and human resources, and expanded the line of products to include products for orthopedics, neurosurgery and other medical fields not covered by Medicon. We thus have succeeded in establishing a firm position in the medical equipment industry in Japan. Bluebird, our subsidiary established in California in 1996, will gather information on state-of-the-art medical equipment and we will continue our endeavors to introduce excellent products into Japan at the earliest possible time.

However, our traditional approach of only importing and distributing medical products limits our market coverage to Japan, leaving us with little hope of larger growth. For this reason, it is necessary for us to step forward into the area of product development and manufacture to make ourselves self-sufficient in medical equipment. However, because developing products from scratch would involve a tremendous investment of time and effort, management believes the best approach is to pursue an M&A strategy targeted at overseas companies that possess advanced technologies. In 1998 we acquired Aquarius Medical Corporation, an American company identified by Bluebird. Aquarius has developed a leading-edge body temperature control system scheduled for launch in the autumn of 2001. With this product we will start worldwide marketing activities.

To ensure still greater future growth in the medical business, we aim to enlarge our operations by aggressively engaging in product range expansion and M&A activities.



Staff of Aquarius Medical Corporation



Patient Rewarming Device by Aquarius Medical Corporation

Kobayashi Pharmaceutical at a Glance

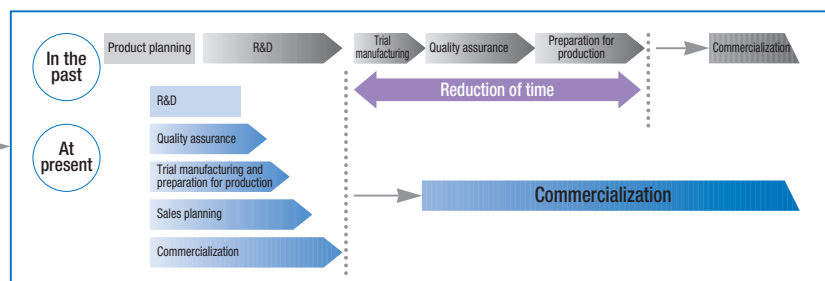
Consumer Products Operation

Characteristics Development of new products

Sources of ideas

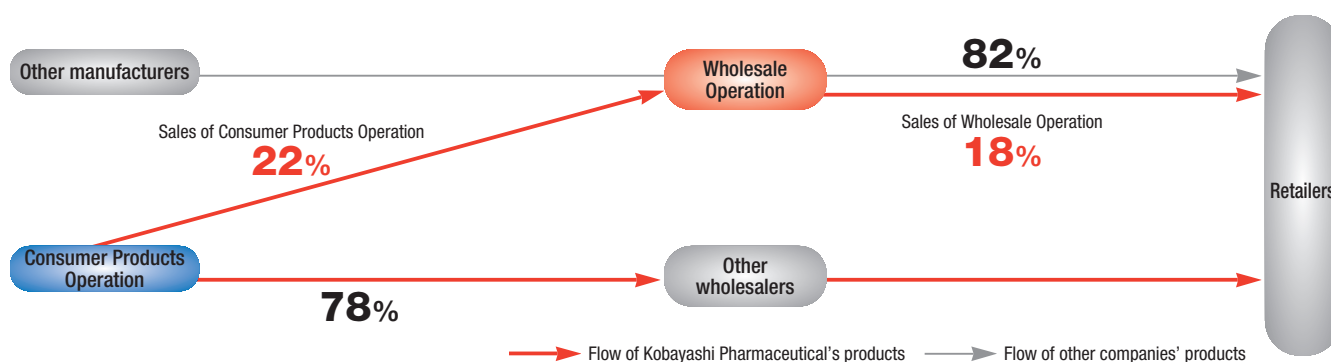
- Proposals by employees
- Proposals by marketing and research staff
- Meeting
- Top-down
- Proposals by overseas operations
- External parties (ad agencies, raw material manufacturers, developers)

Concurrent development

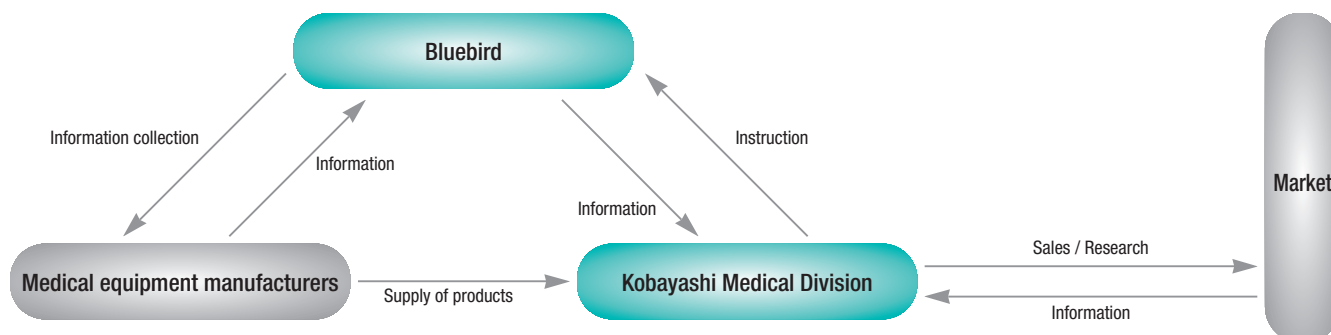


Wholesale Operation

Characteristics Flow of products



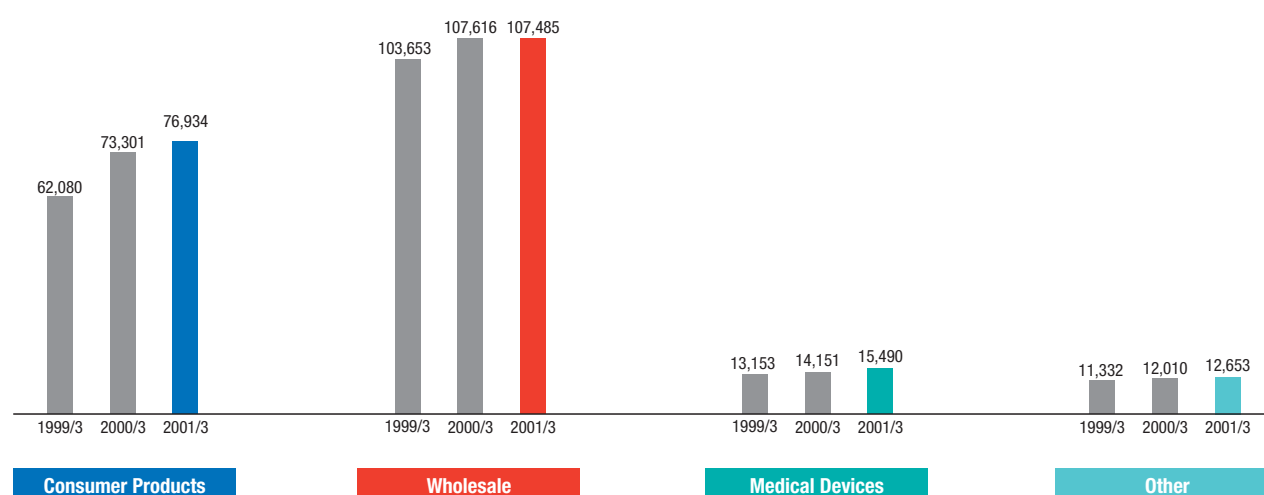
Characteristics Business model proposed by Kobayashi Medical Division



Sales by Operation

Consolidated basis

(¥ million)

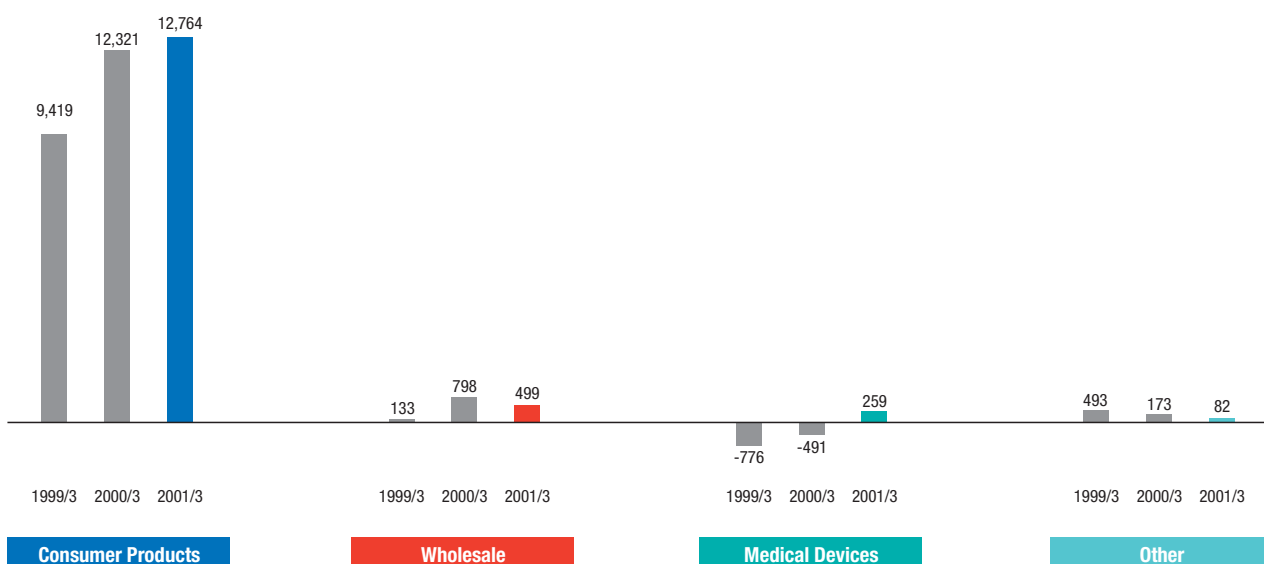


*Intersegment sales and transfer are included.

Operating Income by Operation

Consolidated basis

(¥ million)



Consumer Products Operation

A portfolio of flourishing products rather than relying on a single blockbuster

This niche marketing approach defines Kobayashi Pharmaceutical

The Consumer Products Operation manufactures and sells pharmaceuticals, oral hygiene products, sanitary products, deodorizing air fresheners, and household sundries. In May 1999 it started production and sales of nutritional supplement food products.

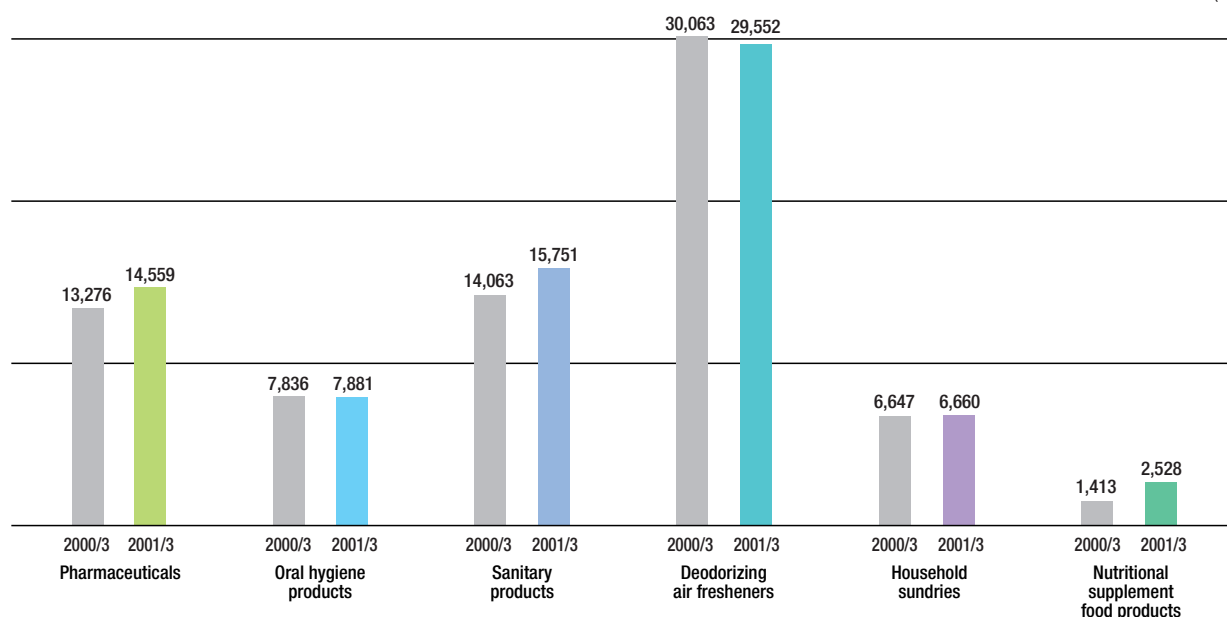
Kobayashi Pharmaceutical has a successful track record of developing niche products that create new markets. At present, we market 130 different brands. To ensure that each brand keeps the number-one market share, we continually improve product performance, enhance our product lines by adding new items, and raise brand awareness through vigorous placing of television commercial. To enhance the efficiency of operations, profitability targets are applied to each brand.

During the fiscal year ended March 2001, the Consumer Products Operation achieved sales of ¥76,934 million and operating income of ¥12,764 million, contributing 32.3% of the Company's consolidated net sales and 92.4% of its operating income.

Sales by Product Category

Consolidated basis

(¥ million)



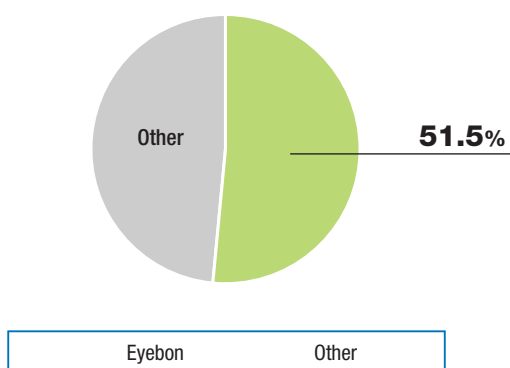
*Intersegment sales and transfer are included.

Market share of principal brands (year ended March 31, 2001)

— Kobayashi Pharmaceutical brands with No.1 market shares —

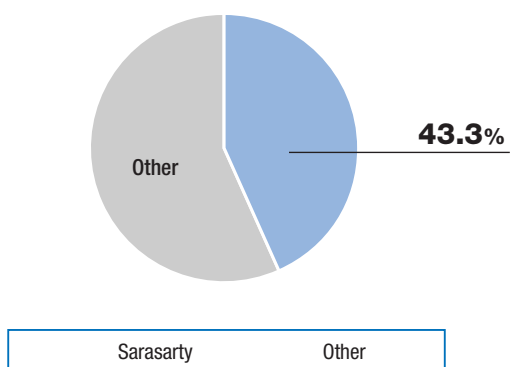
Pharmaceuticals

Eyewash

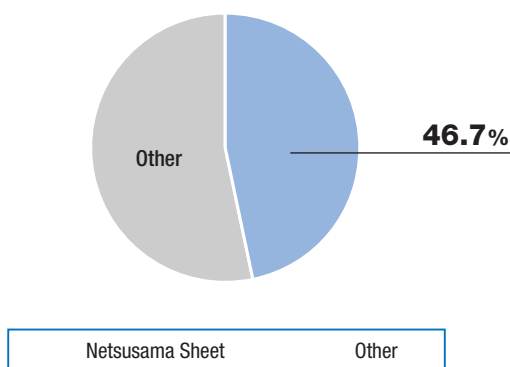


Sanitary products

Feminine protection pads

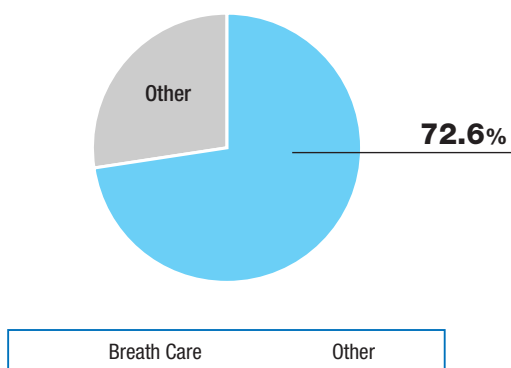


Cooling gel sheets



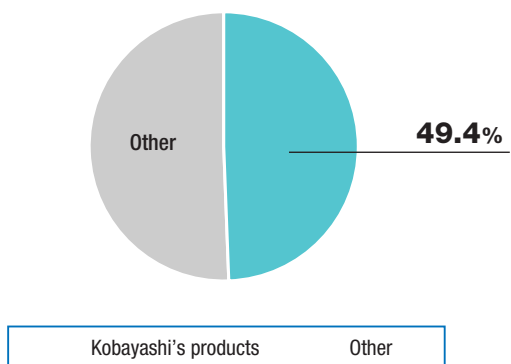
Oral hygiene products

Breath fresheners



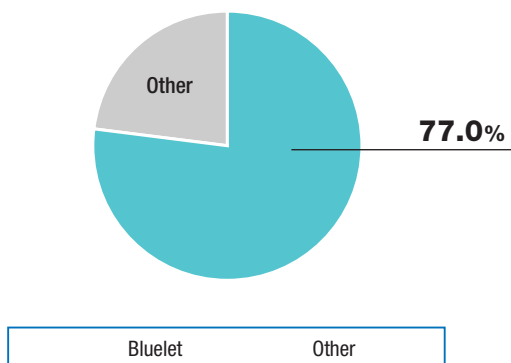
Deodorizing air fresheners

Deodorizing air fresheners



*Sawaday, Shoshugen, Toire Sonoatoni, etc.

Toilet bowl cleansing products



The nutritional supplements direct marketing business holds great promise for the Company's future. Already, in the second year since we launched this business, sales reached ¥2.5 billion.

In May 1999 the Company began direct marketing of nutritional supplement food products (supplements). We entered this market with the objective of establishing an additional mainstay business for the Consumer Products Operation. By offering products and services that capitalize on our expertise as a pharmaceuticals company, we think we are well placed to succeed despite our relatively late entry to the market. Another factor prompting us to make inroads in this market is the growing popularity of nutritional supplement food products. There is a definite shift toward self-medication, reflecting a growing interest in health and wellness. The existence of huge markets for such products in North America and Europe, worth ¥3 trillion a year in total, strongly suggests that excellent prospects exist for the expansion of this business in Japan, too.

We think that the key to success in the nutritional supplement food products business is to attract consumers by making it possible for them to select and combine items from an extensive product offering. For this reason, we started marketing an extensive range, comprising 33 items. Because retailers are reluctant to stock so many different products due to limited shelf-space constraints, the direct marketing sales channel was a natural choice.

In the fiscal year ended March 31, 2001, the second year after market entry, the business grew by leaps and bounds: sales generated by direct marketing reached ¥2.5 billion and the number of registered customers rose to more than 300,000, and is still rapidly increasing. The reason for this success is Kobayashi Pharmaceutical's unique and highly differentiated product strategy. For instance, we offer a good collection of supplements and each supplement being labeled as for a specific purpose. Consumers can select supplements so as to target a particular aspect of health or beauty. Moreover, by utilizing our "Pharmacist's Consulting Room" service, they can consult Kobayashi Pharmaceutical pharmacists about product ingredients and matters relating to health and wellness. These approaches enables us to earn the trust and loyalty of our increasing number of customers and to build up the business.

Since the supplements business is still in the investment-intensive phase as we build our customer base, it has not moved into profit yet. However, in the spring of 2001, the products will also go on sale at drugstores and pharmacies nationwide, and our aim is to achieve profitability in the year ending March 31, 2002, with sales climbing to ¥10 billion in the year ending March 31, 2004.



Nutritional supplement food products

Wholesale Operation

With “Your Success is Our Business” as our motto, we aim to increase market share nationwide and achieve economies of scale

During the fiscal year ended March 31, 2001, sales of the Wholesale Operation were ¥107,485 million and operating income was ¥499 million, contributing 58.1% of the Company's consolidated net sales and 3.6% of its operating income.

The Wholesale Operation has been Kobayashi Pharmaceutical's mainstay business since the Company's inception, and it is the second largest in terms of sales in the household pharmaceuticals wholesale industry in Japan. In April 2001 it was established as a separate company, Kobasho Co., Ltd. Currently, its activities focus on the Kanto and Kinki regions, the two most populous regions of Japan. From now on, the intention is to achieve nationwide coverage through strategic alliances and/or mergers.

Also, in order to meet the needs of drugstore chains and other customers, the Wholesale Operation intends to expand the range of products it handles.

Distribution Center



Kanto Distribution Center



Tokyo Distribution Center



Kanagawa Distribution Center

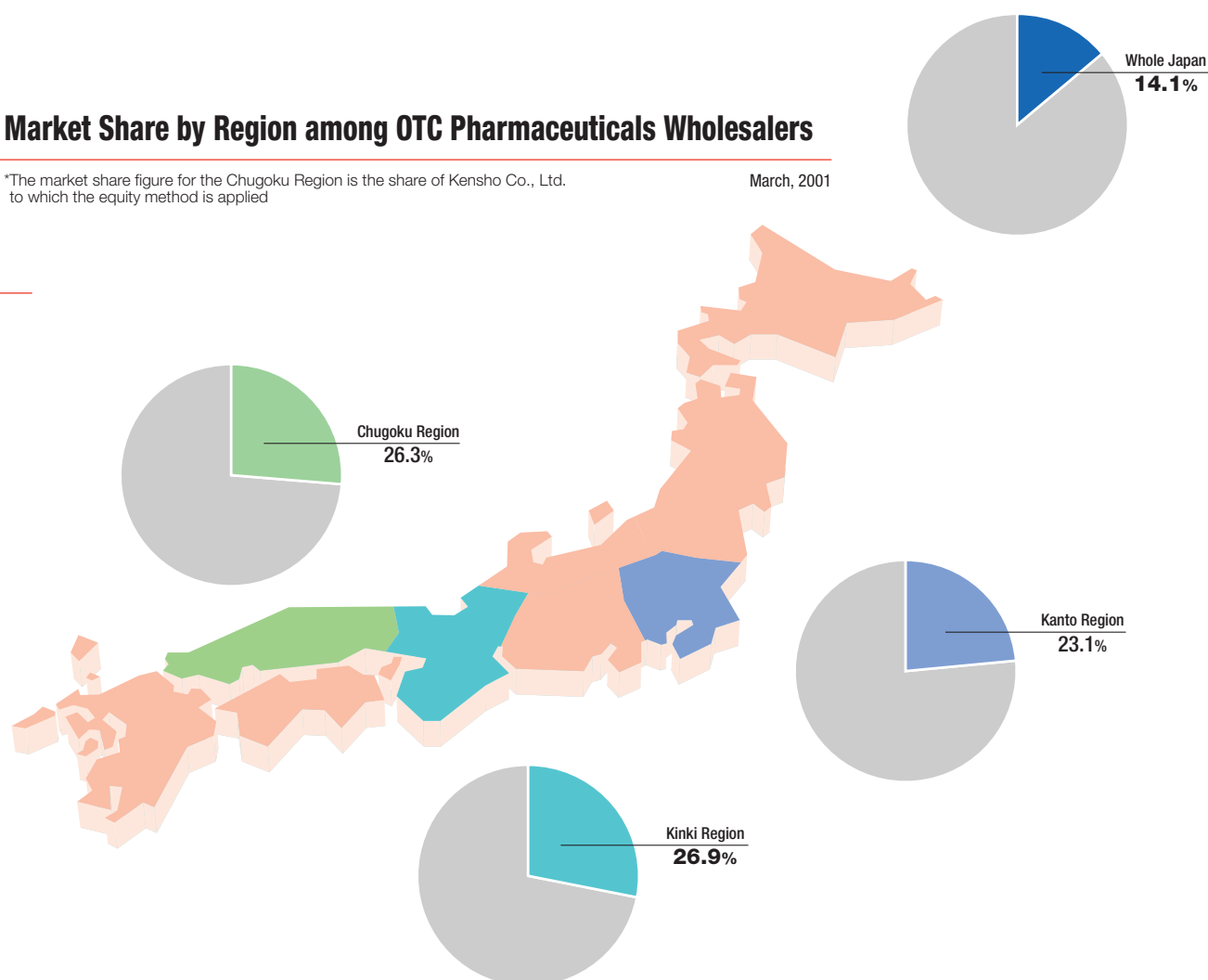


Kinki Distribution Center

Market Share by Region among OTC Pharmaceuticals Wholesalers

*The market share figure for the Chugoku Region is the share of Kensho Co., Ltd. to which the equity method is applied

March, 2001



OTC Pharmaceuticals Wholesaler Ranking

March, 2001

(¥ million)

	Company	Sales	Share
1	Tanpei Nakata	129,800	17.0%
2	Kobasho	107,485	14.1%
3	Ohki	66,946	8.8%
4	Astem Healthcare	41,767	5.5%
5	Kuraya Sanseido	35,527	4.7%
6	CS	29,016	3.8%
7	Arcos	27,951	3.7%
8	Mogi Pharmaceutical	23,341	3.1%
9	Suzuken	23,251	3.0%
10	Kobayashi Daiyakubo	22,122	2.9%

*Source: July 2001 issue of "Drug Magazine"

Main Suppliers

March, 2001

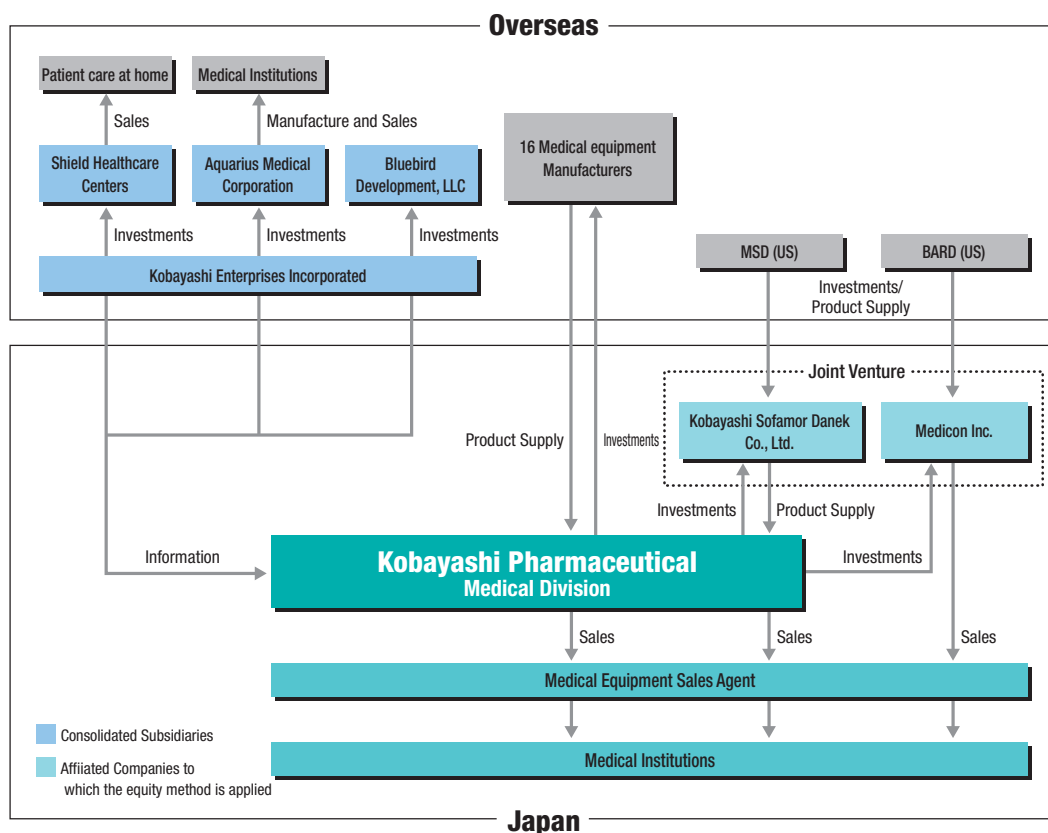
Company name
Meiji Dairies Corporation
ROHTO PHARMACEUTICAL CO., LTD.
SANKYO CO., LTD.
Kowa Company
Menicon Co., Ltd.
Hisamitsu Pharmaceutical Co., Inc.
CHUGAI PHARMACEUTICAL CO., LTD.
Eisai Co., Ltd.
Otsuka Pharmaceutical Co., Ltd.
YOMEISHU SEIZO Co., Ltd.

Medical Devices Operation

World-class medical devices fuel growth of Kobayashi Pharmaceutical

In Japan, Kobayashi Medical Devices Operation of Kobayashi Pharmaceutical, and Medicon Inc. and Kobayashi Sofamor Danek Co., Ltd., affiliated companies to which the equity method is applied, import and sell various types of medical devices. Because each unit specializes in the particular field in which it has expertise, the efficiency of sales and marketing is enhanced and introduction of new products has a direct impact on the bottom line. In the United States, Shield Healthcare Centers market medical products for patient care at home. Bluebird Development, LLC is a research firm specialized in medical equipment. Aquarius Medical Corporation manufactures and sells cutting-edge patient rewarming devices.

In the fiscal year ended March 2001, sales of the Medical Devices Operation were ¥15,490 million and operating income was ¥259 million, contributing 8.4% of the Company's consolidated net sales and 1.9% of its operating income.



Kobayashi Medical Division

Orthopedics



Headless compression screw
(Acumed, Inc.)



Intermittent pneumatic venous foot pump
(Orthofix, Ltd., U.K.)



Arthroscopy products
(Arthrex, Inc.)



Arthroscopy RF surgical unit
(ArthroCare Corporation)



Artificial hip joint
(Implex Corp., U.S.A.)



Bone fixation implant
(aap Implants AG, Germany)

Surgery



Electric surgical unit
(Conmed Corp., U.S.A.)



Disposable electrode
(Ludlow Technical Products)

Neurosurgery



Neuro intravascular surgery devices
(Concentric Medical)



Cranial perforators
(Acra Cut Inc., U.S.A.)



Shunt valve
(Christoph Miethke GmbH & Co. Kg)

Otolaryngology



ENT shaver and drill system
(Medtronic Xomed)



ENT RF surgical unit
(ArthroCare Corporation)

Anesthesiology/Respiratory



Anesthesia face mask
(Vital signs Inc.)



Infusion pumps
(I-Flow Corporation, U.S.A.)



Oxygen face mask
(Gaelmed)

Companies related to Kobayashi Medical Devices Operation

Medicon Inc.

Urology



Urinary incontinence treatment device



Closed urinary drainage system

Cardiac/Vascular surgery



Graft



PTA balloon catheter

Radiology



Inferior vena cava filter



Amplatz goose-neck snare

Dermatology/Plastic surgery



Wound dressing

Gastroenterological surgery/Internal medicine



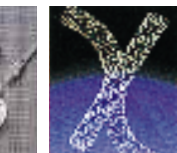
Surgical mesh



Gastrostomy feeding device



Subcutaneously implanted drug delivery system



Biliary stent

Kobayashi Sofamor Danek Co., Ltd.

Orthopedics



Spinal implant

Aquarius Medical Corporation

Anesthesiology



Patient rewarming device

Directors, Corporate Auditors and Officers (As of July 1, 2001)



Kouichi Watanabe

Akira Horiguchi

Kazumasa Kobayashi

Yutaka Kobayashi

Yoshiharu Shimatani

Masaaki Tanaka

**President and Representative Director,
Chief Executive Officer**
Kazumasa Kobayashi

**Executive Vice President and Representative
Director, Chief Operating Officer**
Yutaka Kobayashi

Senior Executive Directors
Yoshiharu Shimatani
Executive Officer,
President, Product Sales Company

Akira Horiguchi
Executive Officer,
President, Global Healthcare Company

Kouichi Watanabe
Executive Officer,
President and Chief Executive Officer,
Kobasho Co., Ltd.

Director
Masaaki Tanaka
Executive Officer,
Senior General Manager, Headquarters' Operations

Corporate Auditors
Toshiyuki Morii

Tetsuo Nakata

Tamotsu Sakota

Ikuo Hata

Executive Officers
Takashi Tsujino
President, Research and Development Company

Akira Suita
President and Chief Executive Officer, Kiribai
Chemical Co., Ltd.

Jyoji Miki
General Sales Manager, Product Sales Company

Akihiro Kobayashi
President, Manufacturing Company

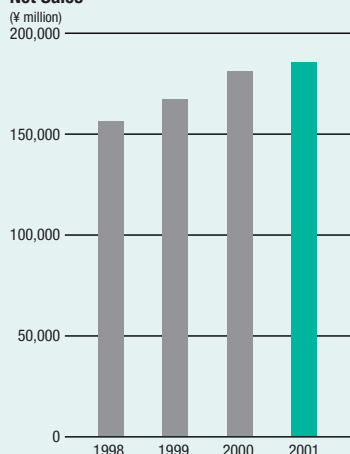
Consolidated Financial Summary

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years Ended March 31

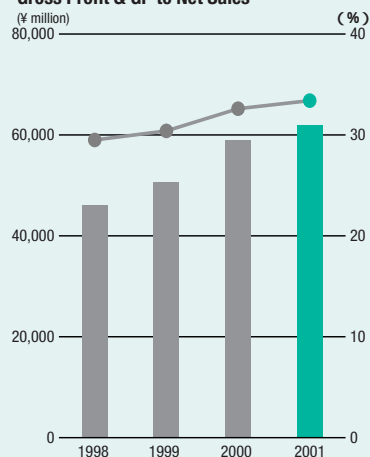
		Millions of yen			
		2 0 0 1	2 0 0 0	1 9 9 9	1 9 9 8
For the Year					
Net Sales	185,001	180,731	166,585	156,062	
Cost of Sales	123,140	121,739	115,993	110,061	
Gross Profit	61,861	58,992	50,591	46,000	
SG & A Expenses	48,054	46,121	41,137	39,541	
Operating Income	13,807	12,871	9,453	6,458	
Income before Income Taxes	11,453	9,389	8,001	4,534	
Income Taxes	5,433	4,567	5,096	2,959	
Net Income	6,020	4,822	2,904	1,695	
Net Income per Share (Yen)	212.80	170.80	166.91	97.41	
At Year End					
Total Assets	106,391	104,331	87,485	81,214	
Property, Plant and Equipment	26,000	23,513	21,906	19,923	
Current Liabilities	57,871	62,977	57,857	57,732	
Long-term Liabilities	10,068	9,197	11,623	7,982	
Minority Interests	16	15	13	15	
Shareholders' Equity	38,436	32,142	17,990	15,377	
Ratios					
ROE (%)	17.1	19.2	17.4	—	
ROA (%)	5.7	5.0	3.4	—	
Shareholders' Equity Ratio (%)	36.1	30.8	20.6	18.9	

Management's Discussion and Analysis

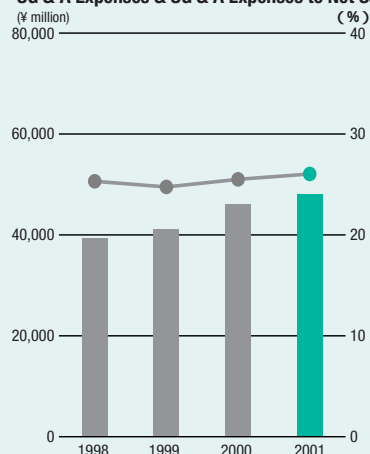
Net Sales



Gross Profit & GP to Net Sales



SG & A Expenses & SG & A Expenses to Net Sales



Scope of Consolidation and Application of the Equity Method

Kobayashi Pharmaceutical has 18 consolidated subsidiaries (11 in Japan, 7 overseas) and 3 affiliated companies in Japan to which the equity method is applied. The Company classifies its business activities into four segments: consumer products operation (6 consolidated subsidiaries and 1 affiliated company to which the equity method is applied), wholesale operation (1 consolidated subsidiary), medical devices operation (5 consolidated subsidiaries and 2 affiliated companies to which the equity method is applied and other (6 consolidated subsidiaries).

Overview

During the fiscal year ended March 31, 2001, the Japanese economy showed signs of a recovery centered on the private sector, with corporate profitability and capital investment developing favorably. However, the second half saw a continuation of sluggish personal consumption that reflected concerns about personal incomes and the employment situation, and the economy was characterized by concurrent deflation and recession.

In this macroeconomic climate, the Company fully demonstrated the spirit of “Creativity and Innovation” that informs our management policy and developed latent customer needs by offering products and services to create new markets. As a result, consolidated net sales for the period were ¥185,001 million, a year-on-year increase of 2.4%, and net income was ¥6,020 million, a 24.8% increase, the highest income in the history of the Company.

Income Statement Analysis

Consolidated net sales for the period were ¥185,001 million, an increase of 2.4% compared to the previous year. The main factors contributing to the increase were the introduction by the consumer products operation of new products aimed at creating new markets, the gaining of new customers for direct sales of nutritional supplement food products, and the expansion of the range of medical products. However, the percentage sales increase fell short of expectations due to flat revenues for the wholesale operation — business that accounts for a high proportion of total sales — decrease in in-store selling prices, and a reduction in market share due to intensified competition.

Cost of sales was ¥123,140 million, an increase of ¥1,401 million or 1.2% compared to the previous year. Although this was a natural increase in line with the increase in net sales, because the contribution to sales of the wholesale and medical devices operations — businesses with a low ratio of cost of sales to net sales — increased, the ratio of cost of sales to net sales decreased from 67.4% to 66.6%. As a result, gross profit was ¥61,861 million, an increase of 4.9% compared to the previous year.

Selling, general and administrative expenses were ¥48,054 million, up 4.2% compared to the previous year. The ratio of selling, general, and administrative expenses to net sales increased 0.5 percentage points compared to the previous year. This was attributable to an increase in sales promotion expenses necessitated by intensifying competition in the market and an increase in depreciation costs accompanying the relocation and construction of the Central Research Laboratory. On a positive note, effective use of advertising

expenditures on the basis of data captured by POS systems brought about a 4.0% reduction in advertising expenses compared to the previous year.

As a result of these developments, consolidated operating income was ¥13,807 million, a year-on-year increase of 7.3%. The ratio of operating income to net sales was 7.5%, an increase of 0.4 percentage points compared to the previous year. The transition from successive operating losses to an operating profit for the medical operation contributed greatly to the improvement.

Regarding other income and expenses, foreign exchange gains were recorded, in contrast the foreign exchange losses recorded for the previous year. Also, unlike in the previous year, no severance indemnities was booked as a lump sum. Because of these factors, consolidated net income before income taxes increased 22.0% compared to the previous year to ¥11,453 million.

These developments resulted in consolidated net income of ¥6,020 million, a year-on-year increase of 24.8%. As a result, the ratio of net income to net sales was 3.3%, an improvement of 0.6 percentage points compared to the previous year. Net income per share was ¥212.8, an increase of ¥42.0 or 24.6% over the previous year's ¥170.8.

Segment Analysis

The Company's business is classified into four segments: consumer products operation, wholesale operation, medical devices operation, and other. As more than 90% of sales are recorded in Japan, geographical segment information has been omitted from this analysis.

Internal sales and transfers among the Company's business segments are included in segment sales. These amounted to ¥26,347 million for the previous year and ¥27,561 million for the year under review.

Consumer Products Operation

Consumer products, the Company's mainstay business, accounted for 32.3% of consolidated net sales and 92.4% of consolidated operating income.

Within Japan, factors such as the continuing weakness of personal consumption and intensification of competition in the product categories in which the Company is active led to reductions in in-store prices of certain products and harsh business conditions persisted. While household pharmaceuticals, oral hygiene products and household sundries performed comparatively well and nutritional supplement food products achieved a sharp 78.9% increase in sales, sales of deodorizing air fresheners that account for nearly 40% of sales for this segment decreased 1.7% compared to the previous year.

Turning to overseas results, in the United States sales of Be Koolool cooling gel sheets began to take off and we invested aggressively in advertising to build brand recognition.

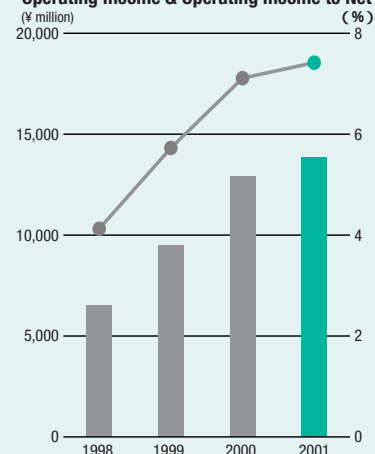
As a result of these developments, sales were ¥76,934 million, a year-on-year increase of 5.0%, and operating income was ¥12,764 million, an increase of 3.6%.

Wholesale Operation

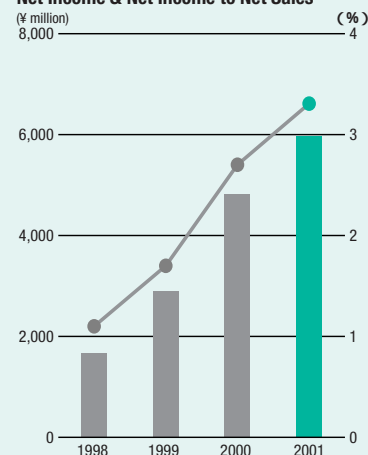
This segment contributed 58.1% of consolidated net sales and 3.6% of consolidated operating income for the period under review.

Sales were about level with the previous year due to the positive impact of the opening of new outlets by

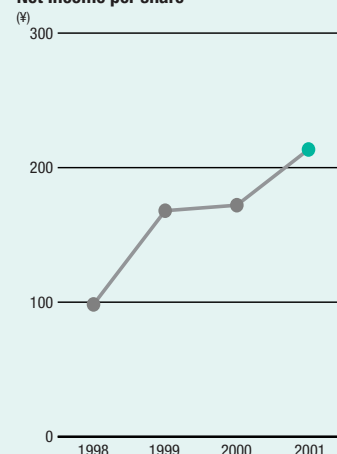
Operating Income & Operating Income to Net Sales



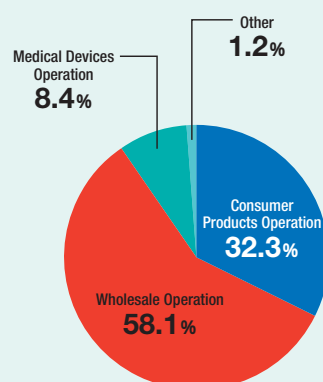
Net Income & Net Income to Net Sales



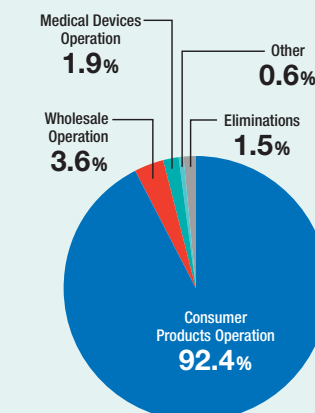
Net Income per share



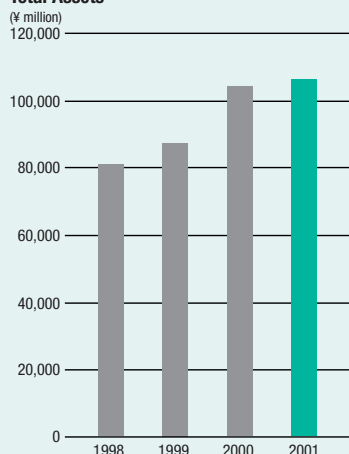
Net Sales by Segment



Operating Income by Segment



Total Assets



the drugstore chains that are our principal customers and our focus on the health foods sector, a field that continues to expand thanks to the growing preoccupation with health and wellness. However, center fees (fees for work performed within the distribution centers of drugstore chains) levied by drugstore operators are rising each year, and these had a negative effect on profit.

Sales for this segment were ¥107,485 million, a year-on-year decrease of 0.1%, and operating income was ¥499 million, a decrease of 37.5%.

Medical Devices Operation

This segment accounted for 8.4% of consolidated net sales and 1.9% of consolidated operating income.

In Japan the Kobayashi Medical Devices Operation initiated new business relationships with U.S. orthopedics products manufacturer Acumed Inc. and German brain surgery products manufacturer Kristof Mitoke GmbH, contributing to sales expansion. Also, increased awareness of the dangers of deep vein thrombosis (DVT) and methods of prevention has heightened interest among the medical profession, resulting in favorable sales of the DVT preventative AV Impulse System manufactured by Orthofix, Ltd. of the U.K. This enhancement of the product line brought a vast improvement in productivity per employee that took the division past the breakeven point into profit.

Overseas, although three Shield Healthcare companies performed well, Aquarius Corp. still did not manage to achieve profitability. Aquarius is developing deep temperature recovery equipment.

Sales of this segment were ¥15,490 million, a year-on-year increase of 9.5%, and operating income was ¥259 million, signaling a decisive turnaround from the operating loss recorded in the previous year.

Other Operations

Other operations are conducted by Kobayashi Pharmaceutical's subsidiaries with the objective of supporting the Company's three principal businesses and contributing to the profits of those businesses. The Group reviewed the transfer values of the materials and services these subsidiaries provide.

Sales of this segment were ¥12,653 million, a year-on-year increase of 5.4%, and operating income was ¥82 million, a decrease of 52.6%.

Analysis of Financial Position

Total assets as of March 31, 2001, were ¥106,391 million, ¥2,060 million or 2.0% higher than the figure at the end of the previous year. The increase was mainly attributable to an increase in property plant and equipment due to the completion of the Central Research Laboratory.

Current assets were ¥64,849 million at year-end, ¥4,399 million or 6.4% lower than the figure at the end of the previous year. The decrease was mainly attributable to a decrease in cash and bank deposits due to repayment of borrowings and the impact of the sale of MMF instruments and the reclassification of short-term securities as investment securities.

Property, plant and equipment were ¥26,000 million at year-end, ¥2,487 million or 10.6% higher than the figure at the end of the previous year, primarily due to an increase in buildings of ¥2,368 million following completion of the Central Research Laboratory.

Investments and other assets were ¥15,542 million at year-end, ¥4,593 million or 41.9% higher than the figure at the end of the previous year. This was due to recognition of mark-to-market profits because current assets were reclassified as investment securities in line with the introduction of financial instruments accounting.

Total liabilities were ¥67,939 million as of March 31, 2001, ¥4,235 million or 5.9% lower than the figure at the end of the previous year.

Current liabilities were ¥57,871 million, ¥5,106 million or 8.1% lower than the figure at the end of the previous year. The main factor contributing to the decrease was a reduction in short-term loans of ¥5,438 million due to repayment of borrowings. Although shortened promissory note payment terms and changes in settlement methods brought about a major reduction in trade notes payable and trade accounts payable, nearly all of these amounts payable has been reclassified as other accounts payable.

Long-term liabilities were ¥10,068 million at year-end, ¥871 million or 9.5% higher than the figure at the end of the previous year. The change was due to an increase in long-term debt and buildup of the reserve for severance indemnities.

Shareholders' equity was ¥38,436 million as of March 31, 2001, ¥6,293 million or 19.6% higher than the figure at the end of the previous year. Although this was mainly due to an increase in retained earnings due to the rise in net income, ¥1,375 million resulted from recognition of appraisal gains on investment securities in line with the introduction of financial instruments accounting.

As a result of these developments, the ratio of shareholders' equity was 36.1% as of March 31, 2001, 5.3 percentage points higher than the figure at the end of the previous year. Influenced by the increase in shareholders' equity, the return on shareholder equity decreased 2.1 percentage points to 17.1%. Shareholders' equity per share increased ¥222 to ¥1,355.78, compared to ¥1,133.78 at the end of the previous year.

Cash Flow Analysis

Net cash provided by operating activities for the period fell ¥3,345 million or 45.8% from the previous year to ¥3,961 million. The main reason for the decrease was an increase in working capital due to lower trade payables resulting from higher sales of products with comparatively short supplier payment terms by the household products wholesale operation.

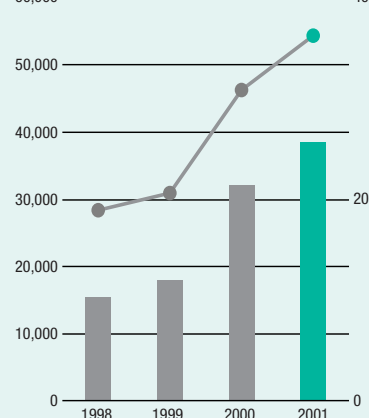
Net cash used in investing activities amounted to ¥4,779, an increase of ¥136 million or 2.9% compared to the previous year. This was mainly due to expenditure for the relocation and construction of the Central Research Laboratory and the acquisition of Whitehall Japan Corp.

These developments resulted in a cash outflow of ¥818 million, a year-on-year reduction of ¥3,481 million in free cash flow for the period.

Net cash used in financing activities amounted to ¥5,395 million, compared to net cash provided by financing activities amounting to ¥5,705 million in the previous year. The main reason for the change was the lump-sum repayment of bank borrowings during the year under review prior to the due date, whereas ¥6,627 million in proceeds from the issue of new shares was recorded in the previous year.

Cash and cash equivalents at year-end amounted to ¥8,188 million, ¥6,175 or 43.0% lower than the figure at the end of the previous year.

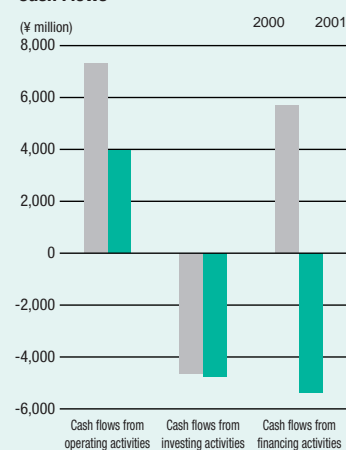
Shareholders' Equity & Shareholders' Equity Ratio
(¥ million) (%)



Return on Equity



Cash Flows



Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Consolidated Balance Sheets

As of March 31, 2001 and 2000

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2 0 0 1	2 0 0 0	2 0 0 1
Assets			
Current assets:			
Cash and time deposits	¥ 4,632	¥ 7,227	\$ 37,387
Short-term investments (Note 2(d), 3)	4,093	8,866	33,037
Trade notes and accounts receivable	39,468	37,685	318,548
Inventories (Note 4)	11,580	10,960	93,459
Deferred income taxes (Note 12)	1,172	919	9,459
Other current assets	4,219	3,995	34,055
Allowance for doubtful accounts	(315)	(404)	(2,546)
Total current assets	64,849	69,248	523,399
Property, plant and equipment (Note 2(f)):			
Land	10,884	10,976	87,848
Buildings and structures	19,875	17,019	160,415
Machinery and equipment	2,728	2,443	22,020
Construction in progress	806	1,314	6,508
Others	4,747	4,049	38,301
	39,040	35,801	315,092
Accumulated depreciation	(13,040)	(12,288)	(105,246)
Net property, plant and equipment	26,000	23,513	209,846
Investments and other assets:			
Investment in securities (Note 2(d), 3)	6,905	2,740	55,726
Deferred income taxes (Note 12)	2,377	2,723	19,188
Other assets	6,392	6,038	51,593
Allowance for doubtful accounts	(132)	(552)	(1,064)
Total investments and other assets	15,542	10,949	125,443
Foreign currency translation adjustments (Note 2(b))	—	621	—
Total assets	¥ 106,391	¥ 104,331	\$ 858,688

Notes: U.S. dollar amounts are converted, for convenience only, at the rate of ¥123.90=US\$1, the approximate rate of exchange at March 31, 2001.
The accompanying notes are an integral part of these statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2 0 0 1	2 0 0 0	2 0 0 1
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term loans (Note 5)	¥ 2,288	¥ 7,726	\$ 18,468
Trade notes and accounts payable	36,747	44,199	296,592
Income taxes (Note 12)	3,504	2,985	28,278
Accrued expenses	2,789	2,193	22,512
Other current liabilities	12,543	5,874	101,230
Total current liabilities	57,871	62,977	467,080
Long-term liabilities:			
Long-term debt (Note 5)	1,173	706	9,470
Accrued severance indemnities (Note 6)	7,231	6,951	58,361
Other liabilities	1,664	1,540	13,427
Total long-term liabilities	10,068	9,197	81,258
Total liabilities	67,939	72,174	548,338
Minority interests	16	15	130
Contingencies (Note 7):			
Shareholders' equity (Note 10):			
Common stock, par value, ¥50 per share			
Authorized			
2001 - 113,400,000 shares			
2000 - 75,600,000 shares			
Issued 28,350,000 shares	3,450	3,450	27,845
Additional paid-in capital	4,183	4,183	33,768
Retained earnings	30,060	24,510	242,616
Unrealized gains on investment in securities	1,375	—	11,097
Foreign currency translation adjustments (Note 2(b))	(632)	—	(5,103)
	38,436	32,143	310,223
Treasury stock, at cost:	(0)	(1)	(3)
	38,436	32,142	310,220
Total liabilities, minority interests and shareholders' equity	¥ 106,391	¥ 104,331	\$ 858,688

Notes: U.S. dollar amounts are converted, for convenience only, at the rate of ¥123.90=US\$1, the approximate rate of exchange at March 31, 2001.
The accompanying notes are an integral part of these statements.

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Consolidated Statements of Income

For the years ended March 31, 2001 and 2000

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2 0 0 1	2 0 0 0	2 0 0 1
Net sales	¥ 185,001	¥ 180,731	\$ 1,493,154
Cost of sales	123,140	121,739	993,874
Gross profit	61,861	58,992	499,280
Selling, general and administrative expenses	48,054	46,121	387,842
Operating income	13,807	12,871	111,438
Other income (expenses):			
Interest and dividend income	159	234	1,283
Interest expense	(110)	(169)	(888)
Equity in earnings of affiliated companies	809	952	6,533
Exchange gain (loss)	284	(737)	2,296
Other, net	(3,496)	(3,762)	(28,227)
Income before income taxes	11,453	9,389	92,435
Income taxes (Note 12):			
Current	6,115	5,299	49,353
Deferred	(682)	(732)	(5,505)
	5,433	4,567	43,848
Net income	¥ 6,020	¥ 4,822	\$ 48,587
	Yen		U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
Net income per share	¥ 212.80	¥ 170.80	\$ 1.717
Cash dividends per share	15.00	12.00	0.121

Notes: U.S. dollar amounts are converted, for convenience only, at the rate of ¥123.90=US\$1, the approximate rate of exchange at March 31, 2001.
The accompanying notes are an integral part of these statements.

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Consolidated Statements of Shareholders' Equity

For the years ended March 31, 2001 and 2000

	Number of shares issued (thousands)	Millions of yen					
		Common stock	Additional paid-in capital	Retained earnings	Net unrealized holding gains on securities	Foreign currency translation adjustments	Treasury stock
Balance at April 1, 1999	17,400	¥ 900	¥ 106	¥ 16,983	¥	¥	¥ 0
Prior years' tax effect				2,966			
Net income for the year				4,822			
Cash dividends				(217)			
Bonuses to directors and statutory auditors				(44)			
Public offering of common stock	1,500	2,550	4,077				
Free share distribution	9,450						
Net change in treasury stock							(1)
Balance at March 31, 2000	28,350	3,450	4,183	24,510			(1)
Net income for the year				6,020			
Unrealized gains on investment in securities					1,375		
Foreign currency translation adjustments						(632)	
Cash dividends				(425)			
Bonuses to directors and statutory auditors				(45)			
Net change in treasury stock							1
Balance at March 31, 2001	28,350	¥ 3,450	¥ 4,183	¥ 30,060	¥ 1,375	¥ (632)	¥ (0)

	Thousands of U.S. dollars (Note 1)					
	Common stock	Additional paid-in capital	Retained earnings	Net unrealized holding gains on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2000	\$ 27,845	\$ 33,768	\$ 197,820	\$	\$	\$ (9)
Net income for the year			48,587			
Unrealized gains on investment in securities				11,097		
Foreign currency translation adjustments					(5,103)	
Cash dividends			(3,432)			
Bonuses to directors and corporate auditors			(359)			
Net change in treasury stock						6
Balance at March 31, 2000	\$ 27,845	\$ 33,768	\$ 242,616	\$ 11,097	\$ (5,103)	\$ (3)

Notes: U.S. dollar amounts are converted, for convenience only, at the rate of ¥123.90=US\$1, the approximate rate of exchange at March 31, 2001.

The accompanying notes are an integral part of these statements.

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

Consolidated Statements of Cash Flows

For the years ended March 31, 2001 and 2000

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2 0 0 1	2 0 0 0	2 0 0 1
Cash flows from operating activities:			
Income before income taxes	¥ 11,453	¥ 9,389	\$ 92,435
Adjustments for:			
Depreciation	2,157	1,921	17,409
Amortization of goodwill	67	50	540
Loss on sales of property, plant and equipment	190	172	1,533
Reversal of allowance for doubtful accounts	(529)	(106)	(4,269)
Equity in earnings of affiliates	(809)	(952)	(6,533)
Unrealized loss on securities	—	251	—
Provision for accrued severance indemnities	110	1,009	887
Interest and dividend income	(159)	(234)	(1,283)
Interest expenses	110	169	888
Exchange (gain) loss	(330)	672	(2,663)
Changes in assets and liabilities:			
Increase in notes and accounts receivable	(1,055)	(1,793)	(8,514)
Increase in inventories	(453)	(930)	(3,656)
Increase (Decrease) in notes and accounts payable	(7,319)	2,263	(59,071)
Increase (Decrease) in consumption taxes	202	(175)	1,630
Bonuses to directors paid	(45)	(44)	(359)
Other	5,894	1,059	47,571
Sub total	9,484	12,721	76,545
Interest and dividend income received	183	339	1,476
Interest expenses paid	(110)	(171)	(887)
Income taxes paid	(5,596)	(5,583)	(45,165)
Net cash provided by operating activities	3,961	7,306	31,969
Cash flows from investing activities:			
Increase of time deposits	11	97	88
Increase of short-term investments	(540)	(1,340)	(4,358)
Purchase of property, plant and equipment	(3,814)	(3,427)	(30,782)
Proceeds from sales of property, plant and equipment	48	10	387
Purchase of intangible assets	(399)	(202)	(3,220)
Increase of investments in securities	(551)	(293)	(4,447)
Purchase of other assets	(340)	(226)	(2,744)
Proceeds from sales of other assets	391	139	3,155
Decrease in short-term loan receivable	336	424	2,711
Increase in long-term loan receivable	(15)	(39)	(121)
Recovery of long-term loan receivable	50	63	404
Others	44	151	355
Net cash used in investing activities	(4,779)	(4,643)	(38,572)
Cash flows from financing activities:			
Decrease in short-term loans, net	(2,001)	(553)	(16,150)
Repayment of long-term debt	(3,504)	(143)	(28,281)
Issuance of common stock	—	6,627	—
Proceeds from minority shareholders' payment	0	2	6
Dividends paid	(425)	(217)	(3,432)
Proceeds from sales of treasury stock	54	169	435
Purchase of treasury stock	(55)	(180)	(444)
Others	536	—	4,326
Net cash used in financing activities	(5,395)	(5,705)	(43,540)
Effect of exchange rate changes on cash and cash equivalents	38	(815)	306
Net increase (decrease) in cash and cash equivalents	(6,175)	7,553	(49,837)
Cash and cash equivalents at beginning of year	14,363	6,810	115,924
Cash and cash equivalents at end of year	¥ 8,188	¥ 14,363	\$ 66,087

Notes: U.S. dollar amounts are converted, for convenience only, at the rate of ¥123.90=US\$1, the approximate rate of exchange at March 31, 2001.

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

1. Basis of Presenting Consolidated Financial Statements

Kobayashi Pharmaceutical Co., Ltd. (the “Company”) and its domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Commercial Code of Japan and the Securities and Exchange Law and in conformity with accounting principles and practices generally accepted in Japan, which may differ in some material respects from accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

The Company’s overseas subsidiaries maintain their accounts and records in conformity with generally accepted accounting principles and practices prevailing in their respective countries of their domicile.

The accompanying consolidated financial statements are prepared based on the consolidated financial statements of the Company and its subsidiaries (the “Group”) which were filed with the Director of Kanto Local Finance Bureau as required by the Securities and Exchange Law.

In preparing the accompanying consolidated financial statements, certain reclassifications have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The United States dollar amounts included herein are given solely for convenience and are translated, as a matter of arithmetical computation only, at the rate of ¥123.90 to \$1, the approximate exchange rate at March 31, 2001. The translation should not be construed as a representation that Japanese yen have been or could be converted into United States dollars at such rate.

2. Summary of Significant Accounting Policies

(a) Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its significant subsidiaries. Consolidation of the remaining subsidiaries would have had no material effect on the accompanying consolidated financial statements.

Investments in significant affiliates are accounted for by the equity method. Investments in insignificant affiliates are stated at cost.

All significant intercompany accounts and transactions have been eliminated in consolidation.

The excess of cost over the underlying net assets at the dates of investments in subsidiaries is being amortized over a five-year period.

(b) Foreign Currency Translation

Foreign currency transactions are translated into Japanese yen at rates in effect at the dates they occurred, and the gains or losses arising on the settlement of the related receivables or payables are included in other income (expenses). Non-current receivables and payables denominated in foreign currencies used to be translated at the rate when acquired or incurred. However, starting from the fiscal year ended March 31, 2001,

receivables and payables, including non-current portions, are translated at the rate of balance sheet date, due to the revision of Accounting Standard for Foreign Currency Transactions. Due to this revision, income before income taxes for the fiscal year ended March 31, 2001, is decreased by ¥313 million (\$2,526 thousand).

Assets and liabilities of foreign subsidiaries are translated into Japanese yen at the exchange rates in effect on the respective balance sheet dates. Revenues and expenses are translated at the average rates of exchange for the respective years. Difference arising from the translation of financial statements are reflected under the caption "Foreign currency translation adjustments" in Assets, but due to the revision of Accounting Standard for Foreign Currency Transactions, those accumulated "Foreign currency translation adjustments" are stated in Shareholders' equity for the fiscal year ended March 31, 2001.

(c) Cash and Cash Equivalents

For the purpose of the Statements of Cash Flows, cash and cash equivalents comprise cash on hand and deposits held with banks and all highly liquid investments with original maturities of three months or less.

(d) Short-term investments and Investment in Securities

Through March 31, 2000, marketable securities included in short-term investments and investments in securities were stated at the lower of cost or market. Other investments are stated at cost. The cost is determined by the moving average method.

Due to the revision of financial accounting standards of Japan, marketable securities are stated at market from the fiscal year starting April 1, 2000. Unrealized gains or losses, net of tax, on marketable securities in investment securities are stated in Shareholders' equity on the balance sheet.

Other investments are stated at cost. The cost is determined by the moving average method.

The Company reviewed the purpose of investment and transferred ¥1,673 millions (\$13,503 thousand) of securities from short-term investments to investment in securities.

(e) Inventories

Commodities and raw materials are principally stated at cost, determined by the moving average method. Finished goods, work in process and supplies are principally stated at cost, determined by the total average method.

(f) Property, Plant and Equipment

Property, plant and equipment are stated at cost. The Company and domestic subsidiaries compute depreciation using the declining-balance method except for buildings acquired on April 1, 1998 and after, for which the straight-line method is applied. Foreign subsidiaries compute depreciation using the straight-line method.

(g) Accrued Severance Indemnities

The company has a non-contributory unfunded defined retirement plan which provides for lump-sum severance indemnity, based on length of service and other various conditions, for substantially all its employees. In addition to lump-sum severance payment, the Company has a non-contributory funded pension plan to cover benefits upon retirement at mandatory retirement age.

During the fiscal year ended March 31, 2000, the Company changed its method of accounting for employee retirement and severance benefits from the method which provided for retirement allowance at 100% of the voluntary liability (the required amount which would be paid if employee retire voluntarily), to the method which provides for retirement allowance based on the present value of employee retirement and severance benefits attributable to service to date, covering future obligations or the payments to regular employees, less the amounts being funded through the qualified pension plans. This change was made to report periodic employee retirement and severance benefits more accurately and to maintain sufficient retirement allowance for the accrued employee retirement and severance benefits. This accounting change decreased operating profit by ¥132 million (\$1,065 thousand) and income before income taxes by ¥1,132 million (\$9,136 thousand).

Some domestic subsidiaries have unfunded employees retirement allowance plans, which provide for lump-sum payments upon termination of employment. The liability for retirement allowance is provided at 100% of the voluntary liability.

Some foreign subsidiaries have funded defined contribution plans for employees.

The Company and a domestic subsidiary have provided for directors' and statutory auditors' retirement and severance benefits in the financial statements for the estimated unfunded liability.

(h) Software Development Expenses

Software development expenses are charged to income as incurred. Development cost for computer software which contribute future cost savings in the Company is capitalized as asset and amortized by over 5 years.

(i) Net Income and Cash Dividends Per Share

Net income per share is computed based on the weighted average number of shares of common stock outstanding during each year and cash dividends per share upon shares outstanding at the end of the applicable period.

Cash dividends per share represent actual amount applicable to the respective fiscal year.

(j) Appropriation of retained earnings

Cash dividends, transfer to legal reserve and bonuses to directors and statutory auditors are recorded in the fiscal year in which a proposed appropriation is approved by the shareholders' meeting.

3. Short-term Investments and Investment in Securities

Marketable equity securities included in short-term investments (current assets) and investment in securities (noncurrent assets) at March 31, 2001 are summarized as follows:

	Millions of yen		
	March 31, 2001		
	Carrying amounts	Market value	Unrealized Gain, net
Current assets	¥ 0	¥ 0	¥ 0
Noncurrent assets	¥ 675	¥ 2,998	¥ 2,323
	¥ 675	¥ 2,998	¥ 2,323

	Thousands of U.S. dollars		
	March 31, 2001		
	Carrying amounts	Market value	Unrealized Gain, net
Current assets	\$ 0	\$ 0	\$ 0
Noncurrent assets	\$ 5,448	\$ 24,197	\$ 18,749
	\$ 5,448	\$ 24,197	\$ 18,749

4. Inventories

Inventories as of March 31, 2001 and 2000 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
Commodities	¥ 4,669	¥ 4,986	\$ 37,680
Finished goods	5,415	4,855	43,704
Raw materials, work in process and supplies	1,496	1,119	12,075
	¥ 11,580	¥ 10,960	\$ 93,459

5. Short-term loans and long-term debt

Long-term debt at March 31, 2001 and 2000 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
Loans from Japanese banks, due in December, 2005			
Interest rate 1.39% - 6.60%	¥ 1,241	¥ 4,210	\$ 10,025
	1,241	4,210	10,025
Less amounts due within one year	68	3,504	555
	¥ 1,173	¥ 706	\$ 9,470

As of March 31, 2001, ¥60 million (\$484 thousand) of time deposits and ¥317 million (\$2,559 thousand) of property, plant and equipment and ¥588 million (\$4,746 thousand) of investment in securities are pledged as collateral for long-term debt of ¥137 million (\$1,109 thousand) and short-term bank loans of ¥319 million (\$2,572 thousand).

The aggregated annual maturities of long-term debt as of March 31, 2001 are as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2002	¥ 68	\$ 555
2003	68	554
2004	68	554
2005	500	4,035
2006 and after	537	4,327
	¥ 1,241	\$ 10,025

Short-term bank loans are generally represented by note payables and bear interest at average rate of 0.9% and 1.3% in 2001 and 2000, respectively.

As is customary in Japan, short-term and long-term bank loans are made under general agreements which provide that under certain circumstances, security and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right, as the obligations become due, or in the event of their default, to offset cash deposits against such obligations due the bank.

6. Accrued Severance Indemnities

Accrued severance indemnities at March 31, 2001 are as follows:

	Millions of yen	Thousands of U.S. dollars
Projected benefit obligations	¥ 7,424	\$ 59,919
Fair value of pension plan assets	(224)	(1,808)
Unrecognized actuarial gain	31	250
Accrued severance indemnities	¥ 7,231	\$ 58,361

Pension cost is as follows:

	Millions of yen	Thousands of U.S. dollars
Service cost	¥ 600	\$ 4,845
Interest cost	216	1,747
Expected return on pension plan assets	(7)	(59)
Pension cost	¥ 809	\$ 6,533

Assumptions used in determining the actuarial present value of the projected benefit obligations are as follows:

Discount rate	3%
Expected return on plan assets	3%
Period of amortizing actuarial differences	10years

7. Contingencies

At March 31, 2001, contingent liabilities for notes discounted with recourse amounted to ¥51 million (\$412 thousand), for guarantees of bank loans of non-consolidated subsidiary and affiliate amounted to ¥582 million (\$4,697 thousand) and for guarantees for account payable of non-consolidated affiliate amounted to ¥327 million (\$2,639 thousand).

8. Leases

The Company and its subsidiaries utilize offices and other facilities under various lease arrangements. The finance leases, except for those where the legal title of the underlying property is transferred from the lessor to the lessee at the end of the lease term, are accounted for similarly to operating leases.

Information as lessee

Properties which are leased under such finance leases but not capitalized as of March 31, 2001 and 2000, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
Machinery and equipment			
Acquisition cost	¥ 8,290	¥ 5,363	\$ 66,909
Accumulated depreciation	(3,378)	(2,271)	(27,264)
	¥ 4,912	¥ 3,092	\$ 39,645
Furniture and fixtures			
Acquisition cost	¥ 1,604	¥ 1,589	\$ 12,946
Accumulated depreciation	(1,115)	(956)	(8,999)
	¥ 489	¥ 632	\$ 3,947
Others			
Acquisition cost	¥ 2,437	¥ 703	\$ 19,669
Accumulated depreciation	(433)	(191)	(3,495)
	¥ 2,004	¥ 512	\$ 16,174
Total	¥ 7,405	¥ 4,236	\$ 59,766

Future minimum lease payments under such finance leases as of March 31, 2001 and 2000 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
Due within one year	¥ 1,960	¥ 1,346	\$ 10,864
Due after one year	5,580	3,001	24,221
Total	¥ 7,540	¥ 4,347	\$ 35,085

The lease payments for such finance lease consisted of following expenses.

	Millions of yen		Thousands of U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
Lease expenses	¥ 1,996	¥ 1,687	\$ 16,109
Estimated depreciation expense	1,827	1,545	14,746
Estimated interest expense	154	130	1,243

9. Derivatives and Hedging Activities

Status of Derivative Transactions

The Company utilizes ,at present, only forward foreign exchange contracts and currency option as derivative transactions, in order to hedge foreign currency risks arising from normal business transactions.

The Company has established a controlled environment which includes policies and procedures for risk assessment and for the approval, reporting and monitoring of transactions involving derivative financial instruments. The Company does not hold or issue derivative financial instruments for trading purposes.

The Company is exposed to certain market risks arising from its forward exchange contracts and currency options. The derivative transactions are solely made with highly rated financial institution.

10. Shareholders' Equity

The Commercial Code of Japan requires that an amount not less than 10 % of cash dividends and bonuses to directors and statutory auditors be appropriated as a legal reserve until such reserve equals 25 % of stated common stock. The legal reserve is not available for dividends but may be used to reduce a deficit or transferred to stated common stock.

Legal reserve of the Company, included in retained earnings as of March 31, 2001 and 2000, amounted to ¥275 million (\$ 2,219 thousand) and ¥225 million, respectively.

11. Research and Development Cost

Research and development cost charged to income are ¥1,774 million (\$14,320 thousand) and ¥1,292 million for the year ended March 31, 2001 and 2000, respectively.

12. Income Taxes

The Company and its domestic subsidiaries are subject to several taxes based on income, which in the aggregate, resulted in normal tax rates of 42% for the years ended March 31, 2001 and 2000. Overseas subsidiaries are subject to income taxes of the countries of their domicile.

The effective rate for the year ended March 31, 2001 differs from the normal tax rate for the following reasons:

Normal tax rate	42.0 %
Loss of affiliates	10.6
Equity in earnings of affiliates	(6.1)
Taxes on retained income	4.4
Evaluation loss of investments in subsidiaries	(3.5)
Expenses not deductible for tax purposes	1.5
Dividend income deductible	(0.7)
Per capita tax	0.4
Other	(1.2)
Effective tax rate	<u>(47.4) %</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at March 31, 2001 and 2000 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2 0 0 1	2 0 0 0	2 0 0 1
Deferred tax assets:			
Accrued severance indemnities	¥ 2,403	¥ 2,258	\$ 19,397
Reserve for directors' retirement allowance	450	428	3,639
Accrued expenses	302	185	2,441
Reserve for employees' bonuses	300	231	2,423
Accrued enterprise tax	223	240	1,803
Accrued employees' bonuses	134	—	1,085
Intercompany profits	73	114	591
Allowance for bad debt	22	177	181
Other	577	185	4,630
Total gross deferred tax assets	4,484	3,818	36,190
Less valuation allowance	—	—	—
Net deferred tax assets	4,484	3,818	36,190
Deferred tax liabilities:			
Unrealized gains on investment in securities	749	—	6,047
Deferred income on sale of property	—	147	—
Other	186	29	1,496
Deferred tax liabilities	935	176	7,543
Net deferred tax assets	¥ 3,549	¥ 3,642	\$ 28,647

13. Segment Information

The Company and its consolidated subsidiaries are primarily engaged in manufacturing and sales of products and wholesale mainly in Japan.

The business segment information for the Company and its consolidated subsidiaries for the years ended March 31, 2000 and 2001 are outlined as follows:

	2001						
	Millions of yen						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other	Total	Eliminations	Consolidated
I Sales and operating income							
Sales to third parties	¥ 59,696	¥ 107,485	¥ 15,490	¥ 2,330	¥ 185,001	¥ —	¥ 185,001
Inter-group sales and transfers	17,238	—	—	10,323	27,561	(27,561)	—
Total sales	76,934	107,485	15,490	12,653	212,562	(27,561)	185,001
Operating expenses	64,170	106,986	15,230	12,571	198,957	(27,763)	171,194
Operating income or loss	¥ 12,764	¥ 499	¥ 259	¥ 82	¥ 13,605	¥ 202	¥ 13,807
II Assets, depreciation and capital expenditures							
Total assets	¥ 41,051	¥ 46,396	¥ 9,908	¥ 8,736	¥ 106,091	¥ 300	¥ 106,391
Depreciation	1,573	76	218	170	2,037	120	2,157
Capital expenditures	3,871	447	401	192	4,911	15	4,926

	Thousands of U.S. dollars						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other	Total	Eliminations	Consolidated
I Sales and operating income							
Sales to third parties	\$ 481,810	\$ 867,516	\$ 125,023	\$ 18,805	\$1,493,154	\$ —	\$ 1,493,154
Inter-group sales and transfers	139,127	—	—	83,323	222,450	(222,450)	—
Total sales	620,937	867,516	125,023	102,128	1,715,604	(222,450)	1,493,154
Operating expenses	517,915	863,486	122,926	101,465	1,605,792	(224,076)	1,381,716
Operating income or loss	\$ 103,022	\$ 4,030	\$ 2,097	\$ 663	\$ 109,812	\$ 1,626	\$ 111,438
II Assets, depreciation and capital expenditures							
Total assets	\$ 331,327	\$ 374,469	\$ 79,972	\$ 70,503	\$ 856,271	\$ 2,417	\$ 858,688
Depreciation	12,697	616	1,762	1,371	16,446	968	17,414
Capital expenditures	31,250	3,611	3,239	1,543	39,643	119	39,762

2000							
Millions of yen							
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other	Total	Eliminations	Consolidated
I Sales and operating income							
Sales to third parties	¥ 56,731	¥ 107,616	¥ 14,151	¥ 2,233	¥ 180,731	¥ —	¥ 180,731
Inter-group sales and transfers	16,570	—	—	9,777	26,347	(26,347)	—
Total sales	73,301	107,616	14,151	12,010	207,078	(26,347)	180,731
Operating expenses	60,980	106,818	14,642	11,837	194,277	(26,417)	167,860
Operating income or loss	¥ 12,321	¥ 798	¥ (491)	¥ 173	¥ 12,801	¥ 70	¥ 12,871
II Assets, depreciation and capital expenditures							
Total assets	¥ 35,735	¥ 38,367	¥ 8,261	¥ 8,736	¥ 91,099	¥ 13,232	¥ 104,331
Depreciation	1,291	101	228	171	1,791	130	1,921
Capital expenditures	2,126	328	268	878	3,600	67	3,667

Thousands of U.S. dollars							
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other	Total	Eliminations	Consolidated
I Sales and operating income							
Sales to third parties	\$ 457,884	\$ 868,571	\$ 114,206	\$ 18,027	\$1,458,688	\$ —	\$ 1,458,688
Inter-group sales and transfers	133,736	—	—	78,909	212,645	(212,645)	—
Total sales	591,620	868,571	114,206	96,936	1,671,333	(212,645)	1,458,688
Operating expenses	492,175	862,136	118,172	95,535	1,568,018	(213,212)	1,354,806
Operating income or loss	\$ 99,445	\$ 6,435	\$ (3,966)	\$ 1,401	\$ 103,315	\$ 567	\$ 103,882
II Assets, depreciation and capital expenditures							
Total assets	\$ 288,418	\$ 309,661	\$ 66,674	\$ 70,492	\$ 735,245	\$ 106,795	\$ 842,040
Depreciation	10,419	815	1,840	1,372	14,446	1,049	15,495
Capital expenditures	17,158	2,647	2,163	7,070	29,038	532	29,570

Geographic Segment information is omitted because more than 90% of sales are recorded in Japan and more than 90% of assets are located in Japan.

14. Subsequent Events

Acquisition of Kiribai Chemical Co., Ltd.

The Company decided to wholly acquire Kiribai Chemical Co., Ltd., which is specialized in heat-packs business, at the price of ¥5,711 million (\$46,093 thousand).

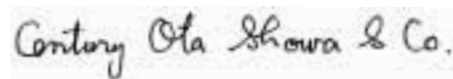
Independent Auditors' Report

**The Board of Directors and Shareholders
Kobayashi Pharmaceutical Co., Ltd.**

We have audited the consolidated balance sheets of Kobayashi Pharmaceutical Co., Ltd. and its consolidated subsidiaries as of March 31, 2001 and 2000, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, all expressed in Japanese yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements, expressed in Japanese yen, present fairly the consolidated financial position of Kobayashi Pharmaceutical Co., Ltd. and its consolidated subsidiaries as of March 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles and practices generally accepted in Japan consistently applied during the periods except for the change, with which we concur, in the method of accounting for accrued severance indemnities as described in Note 2 (g) to the consolidated financial statements.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2001 are presented solely for convenience. Our audit also included the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in note 1 to the consolidated financial statements.



Century Ota Showa & Co.

Osaka, Japan
June 29, 2001

See note 1 to the consolidated financial statements which explains the basis of preparing the consolidated financial statements of Kobayashi Pharmaceutical Co., Ltd. under Japanese accounting principles and practices.



Corporate Data

(As of March 31, 2001)

Corporate Name: Kobayashi Pharmaceutical Co., Ltd.
Foundation: August 22, 1919
Head Office: 3-6, Doshomachi 4 chome, Chuo-ku, Osaka 541-8507 Japan
Representative Director: Kazumasa Kobayashi, President and CEO
Number of Employees: 1,924
Consolidated Subsidiaries: 18
Non-consolidated Subsidiaries: 9
Affiliates: 6

Investor Information

(As of March 31, 2001)

Common Stock: ¥3,450 million
Number of Shares Authorized: 113,400,000
Number of Shares Issued: 28,350,000
Number of Shareholders: 4,115
Stock Exchange Listing: Tokyo Stock Exchange 1st Section, Osaka Securities Exchange 1st Section
Transfer Agent: The Toyo Trust & Banking Co., Ltd.
Annual Shareholders' Meeting: June
Investor Relations: Kobayashi Pharmaceutical Co., Ltd.
Corporate Communication Group
Tel. 81-6-6222-0210
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