KOBAYASHI PHARMACEUTICAL CO., LTD.

Something New, Something Different

ANNUAL REPORT 2005

Year Ended March 31, 2005

Profile

Something New, Something Different

Kobayashi Pharmaceutical has grown steadily since its founding in 1886 through the tireless pursuit of a management policy that defines the Company's mission as providing people and society with comfort through "Creativity and Innovation." The Company will continue to seek growth by developing a unique identity in its three principal businesses: Consumer Products Operation, its core business, and Wholesale Operation and Medical Devices Operation.

As a pioneer in new markets, Kobayashi Pharmaceutical has a trailblazing record of bringing consumers a stream of diverse new products, merchandise and services, and of developing new approaches to business that give form to our management policy of "Something New, Something Different." Today, our sales network spans the globe, covering all important markets, including the U.K., the U.S., China and Hong Kong.

Unfettered by tradition and hidebound thinking, and leveraging the unique strengths of a speedy development system, we will continue to work toward realizing the concept of our brand charter, "You make a wish and we make it real," while creating new markets and differentiating our brand.

Contents

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"You make a wish and we make it real."
The Kobayashi Pharmaceutical Brand Slogan

Kobayashi Pharmaceutical Group Brand Charter

Going beyond merely satisfying our customers' fast-evolving needs, our mission is to create new products that our customers have always wanted. True to our brand slogan of "You make a wish and we make it real," we will deliver these products as early as possible.

Products and services will be developed from the standpoint of customers to the highest standard of quality, in order to live up to the trust placed in us by society and our customers.

Our dream is to share small discoveries from everyday life with people all over the world.

We are committed to being a development-focused company that contributes to society by building lasting relationships with customers and delivering new forms of satisfaction.

Corporate Brand Strategy

Corporate Brand Management

The volume of assets used to be a key benchmark for evaluating companies. The key to evaluating management performance from now on will be the measure of how effectively assets are utilized, not just the size of a company's asset base. Maximizing the value of intangible assets such as intellectual property, human resources and brands, without increasing tangible assets, will be crucial. The corporate brand concept represents a new measure of corporate value, one that embodies the unique identity that shapes a company's public image. Following the development of several valuation methods, corporate brands have become a key management indicator at many companies. Since April 2003, Kobayashi Pharmaceutical has implemented corporate brand management initiatives to raise its corporate value.

Implementing Corporate Brand Management

Corporate brand management is difficult because corporate value means different things to different stakeholders. Customers value quality products and the convenience they afford. Stockholders want to see a rising stock price. Employees seek job satisfaction. Kobayashi Pharmaceutical's position is that we must be truly customer oriented. That is why our core corporate brand management initiatives are out of the mainstream in respect of their close focus on the customer. Bringing satisfaction to a broader range of customers leads to increasing profits and raises our share price. That also brings more job satisfaction to our employees.

When we began corporate brand management initiatives, we created a brand charter and a brand slogan. The brand charter reflects the beliefs of all group employees regarding Kobayashi Pharmaceutical's defining traits, as well as our relationships of trust with customers and society, our aspirations and corporate stance. Each in-house company and group company is formulating action plans based on our brand charter. The goal of these action plans is to first satisfy customers and then all other stakeholders, with the overriding aim of consistently improving corporate value.

Consolidated Financial Highlights

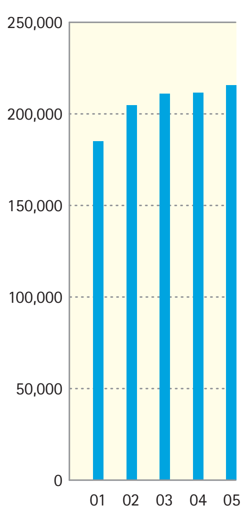
Years ended March 31

	2003	2004	(Millions of yen) 2005	% Change
For the Year				
Net Sales	¥210,922	¥211,670	¥215,708	1.9
Operating Income	15,853	16,123	15,699	(2.6)
Net Income	6,606	6,677	6,731	0.8
Per Share Data (Yen)				
Net Income	231.25	157.25	160.64	2.2
Shareholders' Equity	1,747.98	1,307.16	1,443.30	10.4
Dividends	21.00	21.00	33.00	57.1
At Year-End				
Total Assets	125,680	128,326	134,629	4.9
Shareholders' Equity	49,267	54,454	60,116	10.4
Ratios (%)				Change
ROA	5.4	5.3	5.0	(0.3)
ROE	14.1	12.9	11.7	(1.2)
Shareholders' Equity	39.2	42.4	44.7	2.3

Notes: 1. On November 20, 2003, the Company conducted a 1.5-for-1 stock split. Net income per share and shareholders' equity per share for the year ended March 31, 2004 are calculated assuming that the stock split took place at the beginning of the year.
2. Net income per share and shareholders' equity per share for the year ended March 31, 2003 were ¥154.17 and ¥1,165.32, respectively, if calculated assuming the Company split its stock at the beginning of that fiscal year.

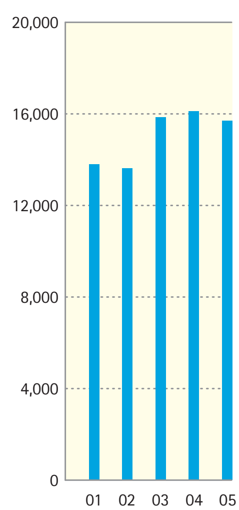
Net Sales

(¥ million)



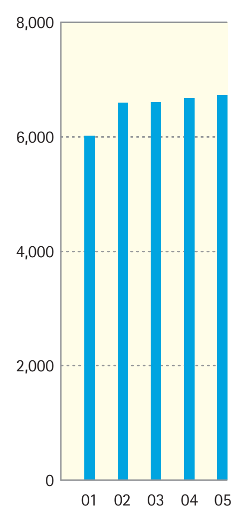
Operating Income

(¥ million)



Net Income

(¥ million)



Consolidated Segment Information Highlights

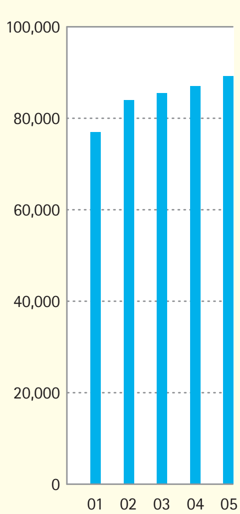
Years ended March 31

For the Year	2003	2004	(Millions of yen) 2005
Consumer Products Operation			
Net Sales	¥85,559	¥87,055	¥89,274
Operating Income	14,438	14,631	14,493
Wholesale Operation			
Net Sales	125,859	126,080	128,356
Operating Income	256	535	799
Medical Devices Operation			
Net Sales	16,114	15,609	16,056
Operating Income	829	645	190
Other Operations			
Net Sales	11,706	11,859	12,205
Operating Income	265	153	140

Net Sales by Segment

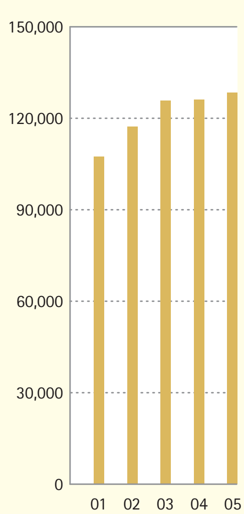
Consumer Products Operation

(¥ million)



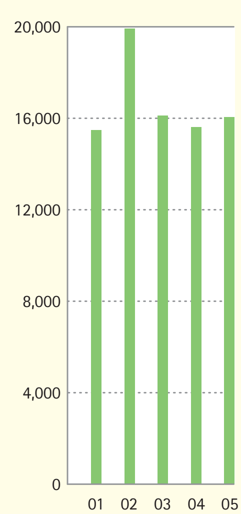
Wholesale Operation

(¥ million)



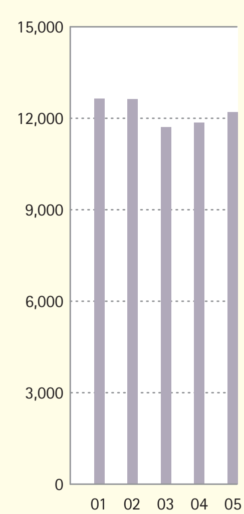
Medical Devices Operation

(¥ million)



Other Operations

(¥ million)



Message From the CEO

Kazumasa Kobayashi *Chairman and Chief Executive Officer*

Looking Back on the First Year as Chairman

In April 2004, Kobayashi Pharmaceutical reformed its management organization and established the operating divisions, separating management supervision and execution functions. As chairman, I have overseen operations since we made these changes. The primary goal of the changes was to create an organizational structure that promoted independence and responsibility. While one year is too short a time for an organization to change completely, I can nonetheless see that my policies are steadily taking root and that Kobayashi Pharmaceutical is moving in the right direction.

Another Year of Sales and Earnings Growth

Although the earnings rebound at many Japanese companies was welcome news on the economic front in the fiscal year ended March 2005, it failed to revive consumer sentiment. Consumer spending remained sluggish and, consequently, our operating environment has also remained severe. Furthermore, restructuring continued in the OTC drug wholesaling industry and price-based competition intensified.

I am pleased to report that despite this challenging environment, sales and earnings growth were favorable. In fact, in the fiscal year ended March 31, 2005 we posted our seventh consecutive increase in sales and earnings since we began releasing consolidated business results.

A Company Contributing to People and Society

Established in 1886, Kobayashi Pharmaceutical has a history of close to 120 years. The Company made its start as a household sundries and cosmetics shop.

Over the years, the Company has established its business model, diversifying into the manufacture, wholesaling and sale of OTC drugs and deodorizing air fresheners, among other products, and the manufacture and sale of medical equipment. We are convinced that the source of our growth lies in creating products and services that are welcomed by customers. That is why our core corporate brand management initiatives are unusual in respect of their concentrated focus on the customer.

We deeply believe that the solid consumer support that we enjoy brings us rising sales and profit. We are also convinced that a company is more than the sum of its products. As a responsible corporate citizen contributing to society, Kobayashi Pharmaceutical is committed to following transparent and prudent management policies geared to raising the satisfaction of all stakeholders, including customers, stockholders and employees. By doing so, we will maximize our corporate value.

July 2005

Kazumasa Kobayashi

Kazumasa Kobayashi
Chairman and Chief Executive Officer

To Our Stakeholders

Yutaka Kobayashi *President and Chief Operating Officer*

Results of Operations

The year under review, ended March 31, 2005, began with challenging conditions in the operating environment. For example, consumers unfamiliar with a new label pricing system introduced in April 2004 that required prices to be shown inclusive of tax exercised a high degree of caution that led to increased price pressures as retailers tried to absorb the consumption tax.

The business environment remained volatile during the rest of the year, characterized by scorching summer heat, an unusually large number of typhoons making landfall in Japan, and unseasonably mild winter weather, all of which heightened concerns for our business performance. However, with flu and hay fever becoming more prevalent from the end of the year, customers turned to our products and demand rose for *Netsusama Sheet* cooling gel sheets and *Eyebon* eyewash. As a result, we reported top- and bottom-line growth, with consolidated net sales rising 1.9% from the previous fiscal year to ¥215.7 billion and net income increasing 0.8% to ¥6.7 billion.

Issues Identified in My First Year

Since my appointment as president on June 29, 2004, I have devoted my energies to achieving management targets. I am pleased to report that we had a successful year in which we achieved another year of higher sales and earnings.

During the year, I identified issues that the Company needs to address if we have to assure continuing growth. I am convinced that the time for achieving earnings growth through cost reductions alone is past. We need to seek real growth based on boosting sales, on strengthening our organization and the skills of our employees, and on reinforcing our presence at the point of purchase, the real-world interface with consumers.

Building a Powerful Organization That Shares Success

My job is to build on the corporate culture and strengths that have been created over nearly 120 years, and to pass on concrete gains to the next generation of leaders. Those gains will be achieved through our commitment to providing people with products and services that contribute to making their lives more healthy and comfortable, and through the spirit of challenge that drives us to create those products and services.

A corporate culture of waiting for orders from the top can take root in any organization that has known only growth for decades. That is not an approach that will bring us the true experience of success. In the absence of strong commitment to achieving corporate goals by individuals, an organization is easily weakened when it faces challenges and is unable to move toward its goals.

My mission is to build a powerful organization, on a base strong enough to support the development of self-starting employees. I have already transferred substantial decision-making authority to general managers of operating divisions and to executive officers, moves that will help to shape organizations capable of making their own decisions. Next, I will clearly define our goals and over the next few years put in place a corporate structure to achieve these objectives.

Enhancing Competitiveness Through HR Development

I believe human resources development is a central issue for the Company. The know-how and skills our employees need differ depending on the operating division. The ability to develop innovative products, successfully launch them and thereby create new markets is crucial in the Consumer Products Operation, while the ability to build relationships based on trust with customers drives the Wholesale Operation. Given the highly specialized nature of products in the Medical Devices Operation, extensive knowledge of products are the determining factors for employees in this division. Because of these differences, on-the-job training is an integral part of employee training programs. To give an example, in the Medical Devices Operation, we look for employees who have domain knowledge and experience in the medical devices sector. Junior sales staff go through training courses conducted by our training division, while top sales personnel also directly guide junior sales staff to help them acquire specialized marketing skills in such areas as product presentations.

Strengthening Marketing Skills at the Frontline

To strengthen our competitive position, we must start at the point where we come face-to-face with the customer. So far, we have concentrated our efforts on raising customer satisfaction, but now the overriding priority is to strengthen our ability to come up with proposals for customers, and to implement initiatives that will directly contribute to increased sales and profits for our customers. Specifically, we have put in place a framework for sharing with all sales people examples of successful proposals for store development, including product layouts at customer stores, that resulted in higher product consumption. As skills related to product layouts rapidly spread across the company, we benefit from an ability to create more effective proposals, thereby enhancing our overall marketing capabilities.

Our focus on combining on-the-job-training and marketing skills development translates into higher sales and revitalizes the company, which in turn strengthens our competitive advantage.

Implementing Growth Strategies

Our operating environment is encouraging. For the first time since the economic bubble burst, Japan's economy is finally showing signs of regaining vibrancy as corporate profits rebound. As a result, consumer prices are bottoming out and we may be nearing the end of the deflationary environment. In this revival phase, our first priority will be to brighten the top line (boost sales). This will mean a raft of initiatives, outlined below, designed to increase earnings on the back of rising sales.

Consumer Products Operation: Enhancing Product Development Capabilities

Product development capabilities are the most important factor for this segment. Effective April 2005, we appointed brand managers, product development managers and technology managers for each product category, creating a consistent system for all stages from product development through to brand building. The involvement of senior management from the early development stages will also accelerate product development and further shorten times to product launch. Major themes in medium-term product development based on anticipated consumer needs will be stress relief, immunological disorders, obesity and menopause. We will complement our development skills by fully leveraging our marketing and technology capabilities.

Recent trends show that consumers are willing to pay higher prices for products with superior quality. Our focus on developing higher priced value-added products is based on the contention that consumers are tired of price competition in products that have the same quality. Fortunately, we derive our strength from superior and rapid product development capabilities. Combining them with the close relationships we have built up with subcontractors specializing in small lot productions will allow us to try out new product approaches.

Wholesale Operation: Becoming a National Wholesaler

Competition based on price is ferocious in the over-the-counter (OTC) drug market, and turning a profit is becoming ever more difficult. The only way to stay competitive in this operating environment is to expand our service area and boost sales, and by doing so achieve a decisive competitive advantage.

In April 2005, Kobashou Co., Ltd., a subsidiary, acquired the OTC pharmaceutical wholesale business of Suzuken Co., Ltd. Kobashou also accepted capital participation from this major pharmaceutical wholesaler. This move has significant advantages. It not only transformed Kobashou into the largest OTC drug wholesaler in Japan, but also made it a national wholesaler by expanding its service area to the Hokkaido and Chubu regions, not formerly covered by the company.

Taking this opportunity, we will quickly build an organization capable of serving every corner of Japan. At a time when Japan's pharmaceutical sector is witnessing mega mergers, Kobayashi Pharmaceutical will continue to actively seek M&A opportunities that generate mutual benefits.

Medical Devices Operation: Expanding the Lineup of Proprietary Products

The Kobayashi Medical Division is involved in the import and marketing of medical devices from the U.S. and other countries, and the marketing of medical devices developed in-house. In April 2004, the division launched its first proprietary product under the *Kobamed* brand. As a result, we now sell four product lineups of medical devices. Future plans call for a bigger product portfolio and expanding sales to 25% of total sales. In particular, we will focus on orthopedics, an area that we believe has great growth potential.

Staying Focused on R&D

As a research and development-oriented firm, Kobayashi Pharmaceutical will continue to pursue "Something New, Something Different," the guiding principle embodied in our corporate philosophy. Decisions about products will be taken from the standpoint of the consumer and based on the approach defined in our brand slogan: "You make a wish and we make it real." Our commitment to in-house product development is not just about producing and selling a steady stream of new products. It is also dictated by our wish to confirm the justification of our existence and our social value as a company. If we can create and supply useful products and services that are welcomed by customers, Kobayashi Pharmaceutical will able to win the support of customers, boost sales, increase its market capitalization and bring satisfaction to all its stakeholders, including shareholders.

Going forward, we will work to maximize the company's enterprise value by continuing to bring a stream of unique products and services to the market. I look forward to your support and encouragement as we push ahead to achieve these goals.

July 2005

Yutaka Kobayashi
President and Chief Operating Officer

Organizational Chart

Kobayashi Pharmaceutical's In-house Systems Foster a Creative and Innovative Corporate Culture

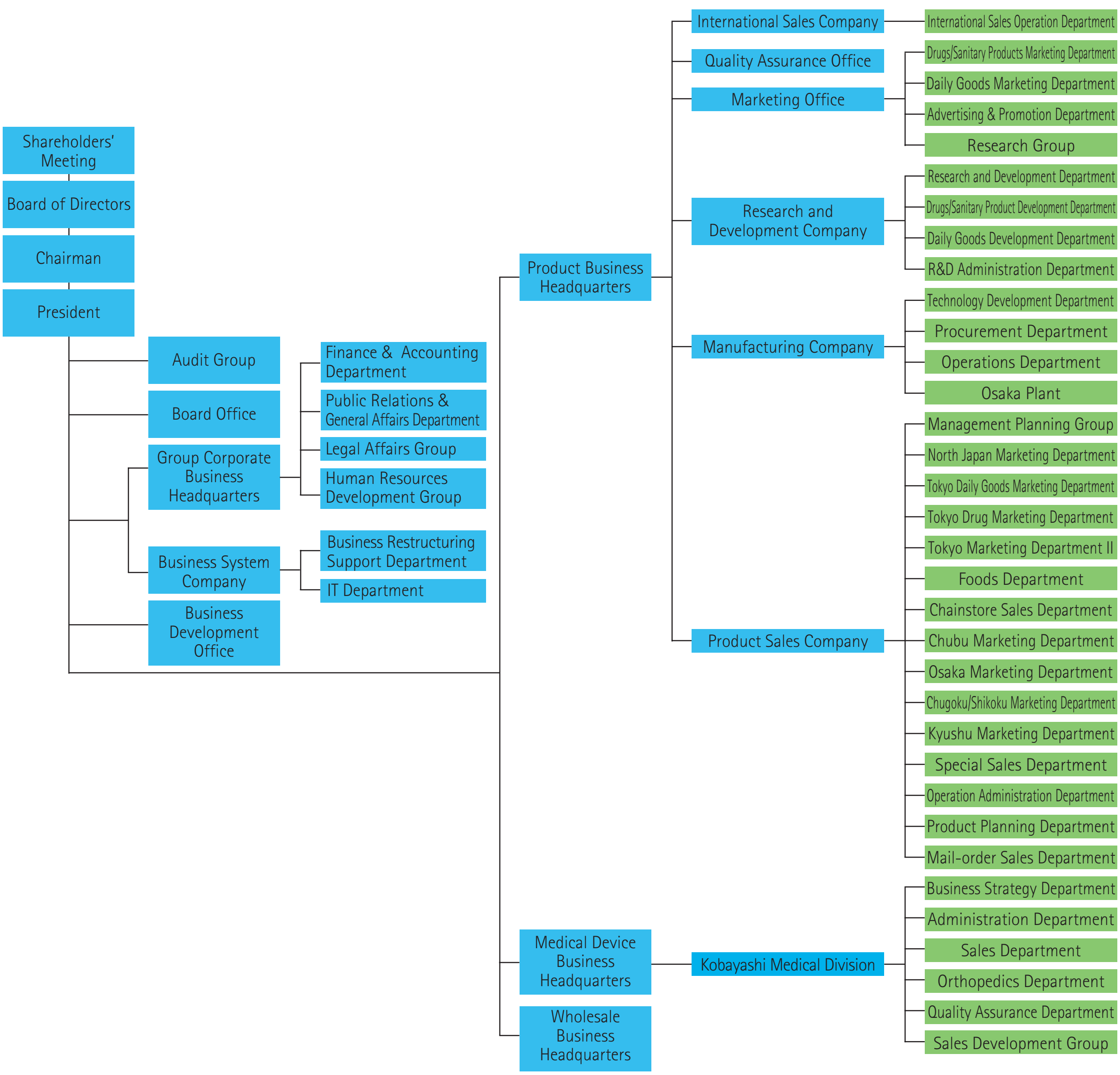
Kobayashi Pharmaceutical has a system to encourage employees to submit ideas. This is a source that allows us to deliver on our goal defined in the brand slogan: "You make a wish and we make it real." Introduced more than two decades ago, this system is one of Kobayashi Pharmaceutical's defining strengths.

Kobayashi Pharmaceutical is also committed to human resources development, through the MBO (management by objectives) and OJT (on-the-job training) systems. The latter is designed to encourage employees to participate in in-house projects. To foster potential management candidates, Kobayashi Pharmaceutical has introduced a selective training system comprising three stages.

To fairly evaluate execution of duties and results, the president of Kobayashi Pharmaceutical directly commends via email employees that have helped improve the Company's results or contributed in some other way to the Company. Moreover, employees themselves can actively report and emphasize their performance using the Blue Bird Card system.

These and other systems are designed to raise employee motivation and create a corporate culture of creativity and innovation.

Organizational Chart



Corporate Governance

Kobayashi Pharmaceutical recognizes raising shareholder value as a key priority for achieving our fundamental management policy of maximizing corporate value. For this reason, we are committed to providing timely and accurate disclosure of information and to heightened management transparency.

Following approval by the general shareholders' meeting held in June 2000, several measures were implemented to reshape the management structure. These included reducing the number of directors (from seven to six), introducing the executive officer system (while executive officers still number 13, the number of those who concurrently serve as directors has been reduced from seven to five) and introducing an in-house company system. The aim was to vitalize the Board of Directors and to put in place systems and procedures that facilitate swift decision-making and strengthen functions related to the execution of operations.

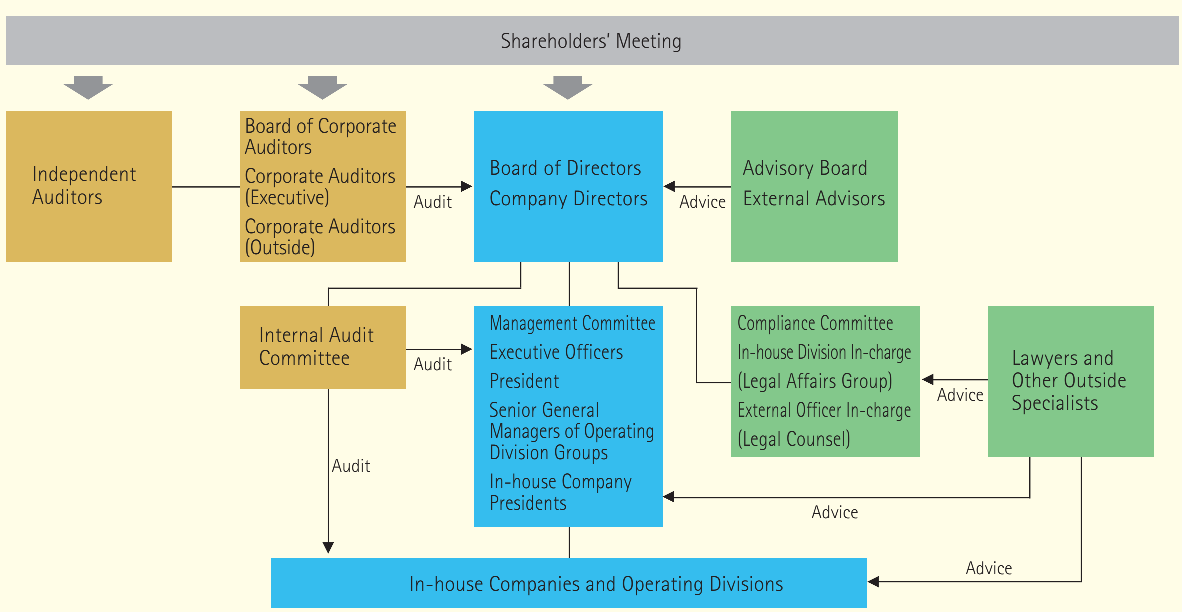
In April 2004, the Kobayashi Pharmaceutical Group was reorganized into four business headquarters: Product Business Headquarters, Wholesale Business Headquarters, Medical Device Business Headquarters and Group Corporate Business Headquarters. Executive officers execute business operations under the president and general managers of operating divisions. The Board of Directors, headed by the chairman, oversees these activities. The Board of Directors holds regular monthly meetings and special meetings as necessary. The Board decides on important matters relating to management and other issues required by law and regulations, and regularly monitors the execution of operations.

Under this new management structure, the Company has taken a number of actions designed to promote its growth strategies. Among them are the spin-off of wholesale operations in April 2001, and the acquisition of Kiribai Chemical Co., Ltd. in June 2001. Also noteworthy was the business alliance that wholesaling subsidiary Kobashou Co., Ltd. formed with Mitsubishi Corporation and Ryoshoku Ltd. in March 2004. In September 2004, Kobashou Co., Ltd. and Suzuken Co., Ltd. announced an equity-based business alliance. In January 2005, Kobayashi Pharmaceutical acquired exclusive sales rights to a general-purpose women's health medication. In March 2005, joint venture Kobayashi-Combe Ltd. was made a wholly owned subsidiary of Kobayashi Pharmaceutical. In parallel with these steps, we have also made progress in withdrawal from and realignment of unprofitable businesses.

The Company has not appointed outside directors, but is confident that decision-making authority rests with people who understand and can faithfully implement our management philosophy. However, reinforcing governance structure based on corporate auditors remains a key priority. The Board of Corporate Auditors consists of four corporate auditors, two of whom are outside corporate auditors. There are no equity relationships or business ties between the Company and its outside auditors. The Company exchanges views on improving its operations with its independent auditor, Shin Nihon & Co., through regular monthly meetings and other means. As part of the decision-making process, management also refers to advice from legal counsel and other experts on issues related to company management and day-to-day business affairs, as necessary.

In April 2003, the Company established a Compliance Committee to foster a strong spirit of compliance with laws and regulations in all corporate activities. In September 2003, the Compliance Committee formulated Basic Policies on Corporate Behavior and Standards of Conduct for Directors and Employees. We are taking measures to apply these standards throughout the organization, and to enhance awareness of company policy and the standards. In January 2003, Employee Consulting Centers were established both inside and outside the Company to facilitate internal reporting and ensure that the Company gathers and responds effectively to the latest information.

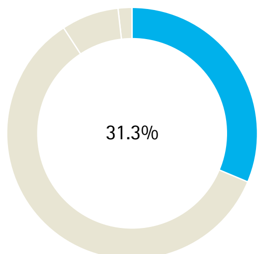
Corporate Governance Organization



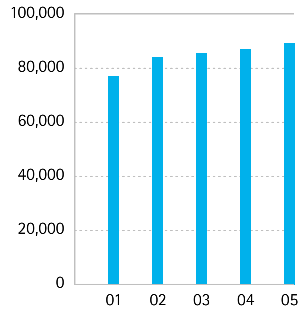
Business Segments at a Glance

Consumer Products Operation

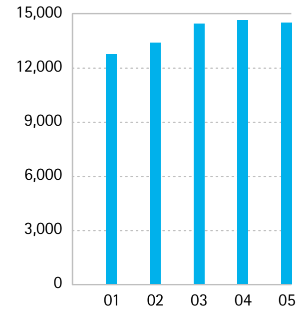
Share of Sales
(%)



Sales
(¥ million)

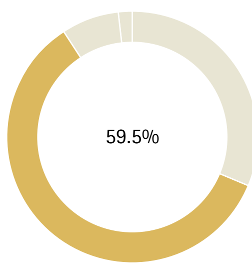


Operating Income
(¥ million)

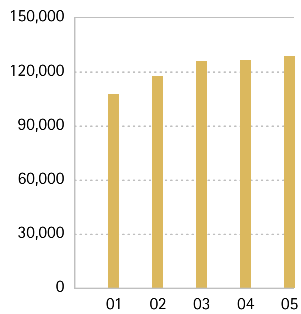


Wholesale Operation

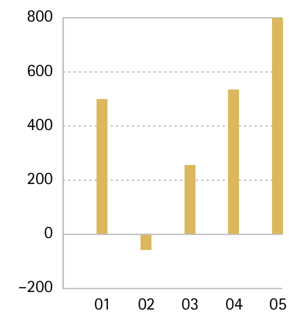
Share of Sales
(%)



Sales
(¥ million)

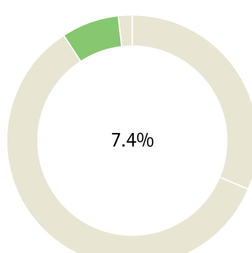


Operating Income (Loss)
(¥ million)

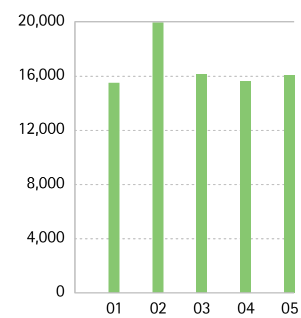


Medical Devices Operation

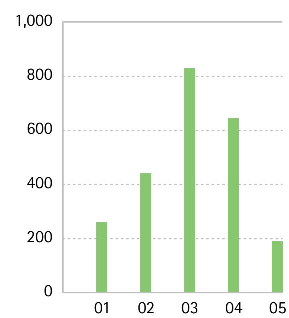
Share of Sales
(%)



Sales
(¥ million)

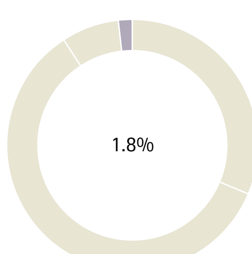


Operating Income
(¥ million)

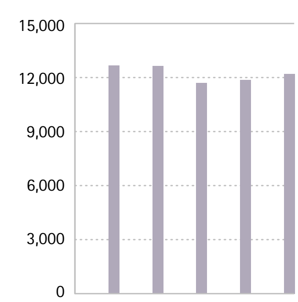


Other Operations

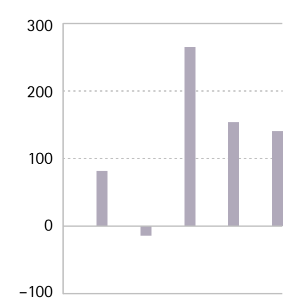
Share of Sales
(%)



Sales
(¥ million)



Operating Income (Loss)
(¥ million)



Effective April 2005, we now form teams made up of brand managers, product development managers, researchers and technicians for each product category, creating a consistent system for all stages from product development through to brand building. The involvement of top management from the early development stage on accelerates product development and shortens the time to product commercialization.

Major themes for medium-term product development focus on products for stress relief, immunological disorders, obesity and menopausal disorders. We will complement our development skills by fully leveraging our marketing and technology skills.

Combining these with the close relationships we have built up with subcontractors specializing in small-lot production allows us to take on new challenges.

Main Group Companies

- Kobayashi Pharmaceutical Co., Ltd.
- Sendai Kobayashi Pharmaceutical Co., Ltd.
- Toyama Kobayashi Pharmaceutical Co., Ltd.
- Ehime Kobayashi Pharmaceutical Co., Ltd.
- Kiribai Chemical Co., Ltd.
- Kobayashi-Combe Ltd.
- Kobayashi Healthcare Inc.
- Kobayashi Healthcare Europe, Ltd.
- Shanghai Kobayashi Daily Chemicals Co., Ltd.
- Kobayashi Pharmaceutical (Hong Kong) Co., Ltd.

In April 2005, Kobayashi Pharmaceutical subsidiary Kobashou Co., Ltd. acquired the OTC pharmaceutical wholesaling business of Suzuken Co., Ltd. The company also accepted capital participation by this major pharmaceutical wholesaler. This move established Kobashou as the largest OTC drug wholesaler in Japan and expanded its service area to Hokkaido and Chubu, regions not formerly covered by the company. Kobayashi Pharmaceutical aims to create a nationwide wholesale network by promoting joint ventures and alliances going forward.

Main Group Companies

- Kobashou Co., Ltd.
- Kenshou Co., Ltd.
- KS Hokkaido Co., Ltd.
- KS Tokai Co., Ltd.
- Seiei Co., Ltd.

The Kobayashi Medical Division imports and markets medical devices from manufacturers in the U.S. and other countries and also manufactures and sells proprietary medical devices. In April 2004, it formed an organization for the development of proprietary products and started sales under the *Kobamed* brand. We now sell four product lineups of medical devices. Future plans call for adding more brands and expanding their sales to 25% of total sales of the division. There is plenty of growth potential in orthopedics, a growing market we have defined as a business priority.

Main Group Companies

- Kobayashi Pharmaceutical Co., Ltd.
- Shield California Healthcare Centers, Inc.
- Shield Denver Healthcare Centers, Inc.
- Mail Order Medical Supplies Inc.
- Medicon, Inc.

Other Operations are conducted in support of the Company's three businesses, Consumer Products Operation, Wholesale Operation and Medical Devices Operation, to provide materials and services. These include transportation, sales promotion, and market research.

Main Group Companies

- Aoitori Distribution Co., Ltd.
- Kobayashi Seiyaku Plax Co., Ltd.
- Suehiro Sangyo Co., Ltd.
- Archer Corp.
- SP-Planning, Inc.
- Kobayashi Pharmaceutical Life Service Co., Ltd.

Consumer Products Operation

Marketing Strategy

The Consumer Products Operation is Kobayashi Pharmaceutical's mainstay business, generating 31.3% of sales and 92.3% of operating income. This segment focuses on the planning, development, manufacturing and sales of unique products targeting niche markets.

In line with our management policy of prioritizing sales growth, the Consumer Products Operation concentrates on expanding sales of highly distinctive proprietary products by bolstering new product development and marketing.

Developing Niche Markets

Ever since Kobayashi Pharmaceutical opened for business, our management policy has been to provide people and society with comfort through "Creativity and Innovation." Our Consumer Products Operation has made the provision of comfort its principal mission; through the development and commercialization of products to meet the needs and wants of society it has carved out a unique position for itself.

Our Consumer Products Operation concentrates on developing and expanding markets for products that aim at completely fulfilling needs that have not been adequately met or markets in which such products already exist but consumers are not yet fully aware of their availability. We are good at quickly launching powerful products that expand small existing markets or market niches and win dominant market shares. This has been made possible by the continuing stream of new ideas that we generate, a challenging spirit directed at developing niche markets, fast product development that keeps competitors at bay, and the ability to combine these strengths with marketing strategies that successfully present the functions and concepts behind the new products.

Pull-type Marketing Strategy

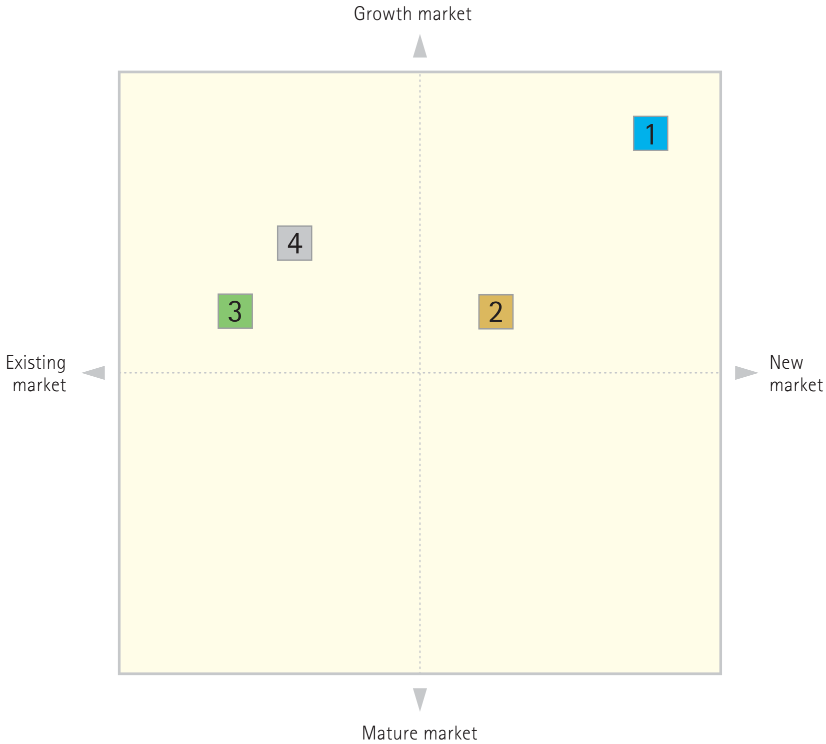
Marketing is a key to the success of new-concept products. New products for niche markets, in which we excel, are often products that have never been on the market before so consumers are not familiar with their applications and functions. Unless they understand these products, we will not generate sales. Fully aware of this, our strategies on packaging, naming and advertising and in-store promotions focus on making it easy for consumers to understand our products. We name products in a way that allows consumers to easily identify their applications and functions. In this pull-type marketing strategy we also come up with suggested applications to create new wants, thus nurturing new markets.

Product Types

Our products fall into four types: Products for Creating New Demand, Products for Expanding Existing Demand, Products for Taking on Competition and Products for Brand-based Line Extension.

We excel at offering products for the first category, that is, developing entirely new products that have never been in the market, and in the process creating new markets. In products for expanding existing demand, Kobayashi Pharmaceutical launches powerful products in undeveloped markets to expand them quickly. Competitors soon follow once we have introduced new products and created markets in this way. Our strategy at this stage is to move on to products for taking on the competition, by developing and launching products that will allow us to maintain our market position. Products for brand-based line extension are also important for our marketing strategies. This is achieved by adding value to existing products in a brand, thus further strengthening the brand. Representative products in this category include *Bluelet, Netsusama Sheet* and *Breath Care*. Kobayashi Pharmaceutical has an excellent track record in line extensions that have taken small brands and transformed them into mega-brands.

Strategy Portfolio



1 **Products for Creating New Demand**
Creating entirely new markets by introducing innovative products that anticipate consumer needs is what Kobayashi Pharmaceutical does best.

2 **Products for Expanding Existing Demand**
Developing and introducing new products in existing markets and then winning recognition for them through our unique marketing style is another Kobayashi Pharmaceutical forte.

3 **Products for Taking on Competition**
These are products designed specifically to compete with like products launched by competitors and protect our brand. They also aim to improve brand positioning.

4 **Products for Brand-based Line Extension**
Here, we grow brands by adding variations in terms of formulation and functionality to products with established market positions.

Brand Management

Kobayashi Pharmaceutical thoroughly evaluates products it plans to develop and launch in order to assure efficient use of management resources. Potential markets are exhaustively researched before R&D commences, and once products are launched they are heavily promoted, including extensive sales promotions at retailers, thus assuring that each new product gets all the attention it needs. This approach has significantly raised our capital utilization efficiency and shaped an optimum product portfolio. Furthermore, brand managers regularly check the progress in brand development and sales promotion. Poorly performing brands undergo brand renewal or are withdrawn, thus assuring that we always have an optimal portfolio that continues to boost sales and profit.

Examples of Products for Creating New Demand

Consumer Products Operation

The R&D System and Its Unique Features

Kobayashi Pharmaceutical must bring a steady stream of new products quickly to market to assure that the Consumer Products Operation maintains and expands its market share.

Participation of Top Management at the Idea Meeting Stage Speeds Up Product Development

New product development is the most important activity in the Consumer Products Operation. It lives up to its mission of providing people and society with comfort through "Creativity and Innovation" by developing new products to precisely meet consumer needs.

The sources of the new ideas that allow us to bring a constant stream of unique products to the market are our employees, our advertising agencies and our customers. We have a system to encourage employees to submit new ideas, and in recent years it has generated about 20,000 proposals a year. Ideas are screened and refined at the product development managers' meeting and brought to top management at the monthly Idea Meeting. Decisions on whether or not to take up an idea for R&D and product development are made immediately. Management participation in decision-making at such an early stage allows Kobayashi Pharmaceutical to rapidly bring innovative products to market.

Category-based Product Development

In April 2005, we switched to a system of six product categories for developing products. These include pharmaceuticals, oral care, foods, sanitary products, deodorizing air fresheners, detergents and sundries. A team of brand managers, product development managers, researchers and technicians is put together to develop new products in each product category and to strengthen existing brands in their respective categories. This supports implementation of initiatives for product development, line extensions and product renewals in each category. It also helps us to identify priority areas and develop well-balanced strategies for each category. We bolster our competitive position by implementing category-specific strategies.

Speedy Concurrent Development

We start mass production and put a new product on the shelf just 13 months on average after conception of an original product idea. This rate of development has won high recognition in and outside the industry.

We employ the so-called "concurrent method" in which planning, development, prototypes, quality assurance, preparation for mass production, and sales planning are carried out concurrently. Unlike in the conventional relay system, these processes are vertically integrated and implemented concurrently to bring products quickly to the market.

Mother Concept for R&D

The "Mother Concept" approach to development helps us to maintain our unique identity and strengthen our brand power. The idea is to identify the needs created by major social trends, set major themes that anticipate consumers' future needs and then build brands. Creating a brand in a category based on a single theme enables us to make efficient use of management resources for marketing, advertising and sales promotion.

One promising area in this model is treatment of menopause-related problems, which are expected to increase along with the aging society. Our medium- to long-term product development will concentrate on the development of products in the categories of treatment, prevention, beauty care and mental care. To strengthen our product line of drugs for treatment, Kobayashi Pharmaceutical acquired exclusive sales agency rights to *Inochi no Haha A*, a general-use medication for women's health issues. Kobayashi Pharmaceutical began sales as the sole supplier of this drug in June 2005.

Mother Concept Development (Menopause Care)

New Products

We launched seven products in spring 2005 and expect their combined sales to reach ¥4.6 billion in the first year.

Anmerutsu Yokoyoko Ferbinac Ace
A stiff shoulder and muscular pain reliever containing 3% Ferbinac, an antiphlogistic

Shoyo Ekiyaku
A highly effective treatment for gum boils with four effective ingredients that penetrate the affected area for a complete cure

Shoyo Eki
A medicated dental rinse with such natural ingredients as cypress oil

Door Cologne
A deodorizing air freshener released every time a room door is opened or closed

Sarasaty Yawaraka Silk Touch
A comfortable sanitary sheet with a soft, smooth touch

Keshimin Gel
A skin care gel with vitamin effectiveness for discoloration and freckles from sun exposure and aging

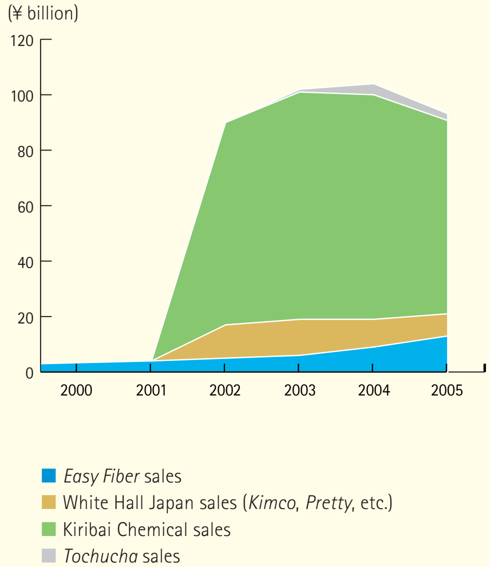
Fan de Rich
A deodorizing air freshener with a fan to spread the aroma and deodorize every corner of a room

Consumer Products Operation

M&A Strategies

Kobayashi Pharmaceutical's strength lies in developing innovative products. However, we also actively conduct mergers and acquisitions to shorten the time required to develop and nurture brands, thereby enhancing investment efficiency. In our merger and acquisition strategy, we actively seek to acquire high-quality products and products with superior functions in fields we are developing.

Boosting Sales Through M&A



December 2002 Acquisition of goodwill for *Tochucha*

June 2001 Acquisition of Kiribai Chemical Co., Ltd.

January 2001 Acquisition of White Hall Japan (*Kimco*, *Pretty*, etc.)

February 1998 Acquisition of goodwill for *Easy Fiber*

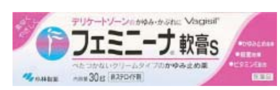
M&A – Objectives and Achievements

Kobayashi Pharmaceutical has expanded its product lineup by actively pursuing M&A strategies, including acquisition of goodwill. The products that we have added through M&As have a number of shared characteristics: they are firms with reputable, well-known brands, and their markets have developed to a certain degree, and they have large market shares. M&As offer the advantage of considerably shortening the time required to create markets and increase product recognition while reducing capital investment for technology development and production facilities.

Our M&A policy is to target brands and companies, both Japanese and foreign, capable of generating synergies with our existing businesses. The main focus will be on healthcare, in view of the increasing number of elderly and the growing interest in lifestyle-related ailments. M&A deals will be financed mainly through free cash flows. We will concentrate on strengthening acquired brands and firms to achieve sales and earnings growth that justify the investment.

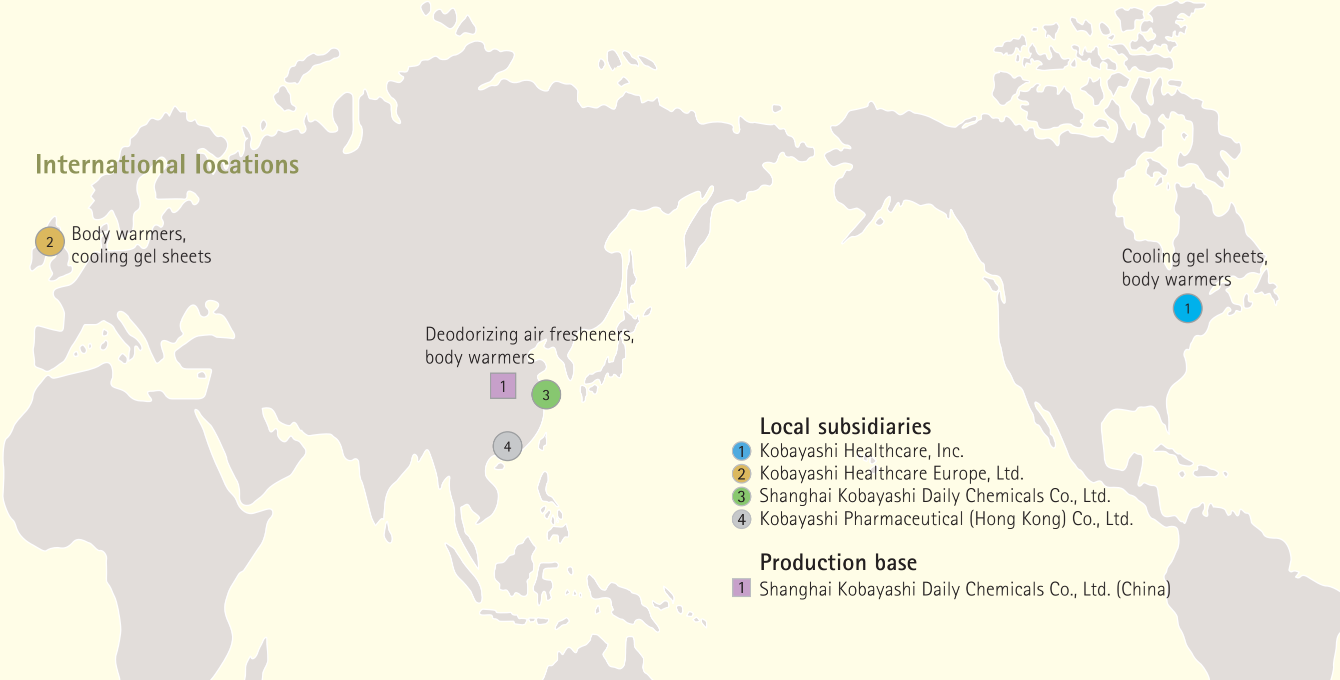
Recent M&A Deals

In March 2005, we acquired trademark rights to *Lanacane* and *Feminina* from Combe, Inc. of the U. S., adding them to the lineup of Kobayashi Pharmaceutical brands. We also took over *Ashi No Hienai Fushigi Na Kutsushita* business the same month. These are socks made from a special heat insulation resin that keeps the feet warm.



Kobayashi Pharmaceutical acquired exclusive sales agency rights to *Inochi no Haha A*, a general-use medication for women's health issues, from Sasaoka Yakuhin Corporation. Acquisition of distribution rights will support our Mother Concept for the development of products for menopause-related problems while bolstering our OTC drug lineup, which we have positioned as one of our priority areas.

In July 2005, Kobayashi Pharmaceutical Co., Ltd. concluded a contract for a capital tie-up with Itoh Pharmaceutical Co., Ltd. Itoh Pharmaceutical operates in nutritional supplements and pharmaceuticals and operates manufacturing plants in China.



International Operations

Kobayashi Pharmaceutical's medium- to long-term strategy envisions aggressive expansion and a higher profile in overseas markets.

Focusing on East Asia and Body Warmers

Currently, we market our original products through local subsidiaries in the U.S., the U.K., China and Hong Kong. Effective from the fiscal year under review, Shanghai Kobayashi Daily Chemicals Co., Ltd. and Kobayashi Pharmaceutical (Hong Kong) Co., Ltd. became consolidated subsidiaries.

In China, we manufacture and sell deodorizing air fresheners, body warmers and cooling gel sheets. In the U.S. and the U.K., we market cooling gel sheets and body warmers. However, East Asia's rapidly expanding markets, particularly China, are priority areas. Interest in personal hygiene and sanitation products is increasing in China, along with rising living standards. We thus expect sales of such products as *Sawaday* (sold as Shang Fa Rei in China) and *Oheyano Shoushugen* (sold as Shang Chu Yuen in China) to increase going forward.

The market for body warmers is not fully developed overseas. Moreover, there is a universal need for keeping warm in winter and to warm the back and knees to ease pain. Looking ahead, the focus will be on promoting key products in all areas.

Shanghai Plant

Major products sold overseas

U.S.

U.K.

China

Hong Kong

Wholesale Operation

Expansion Strategies

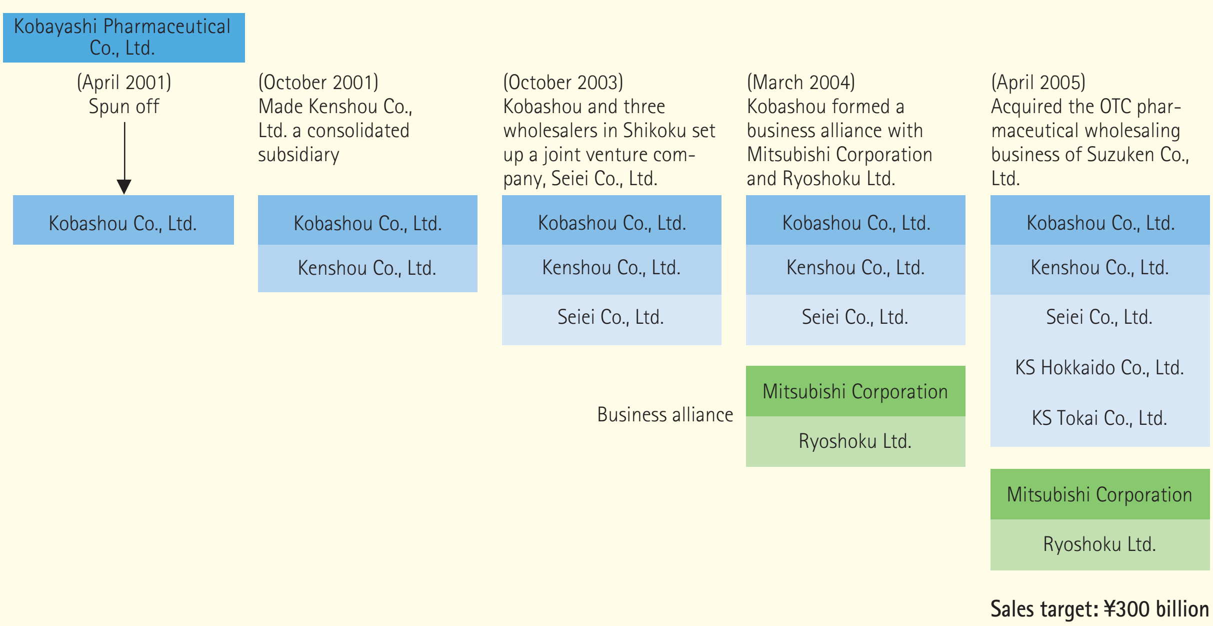
The overriding priority in OTC drug wholesale operations is to increase market share in areas where we are represented and expand the service network to cover the whole of Japan through alliances. The only regions we do not currently serve are Tohoku and Kyushu.

Well-balanced Product Mix

The Wholesale Operation started with pharmaceutical wholesaling and it still represents 59.5% of total sales.

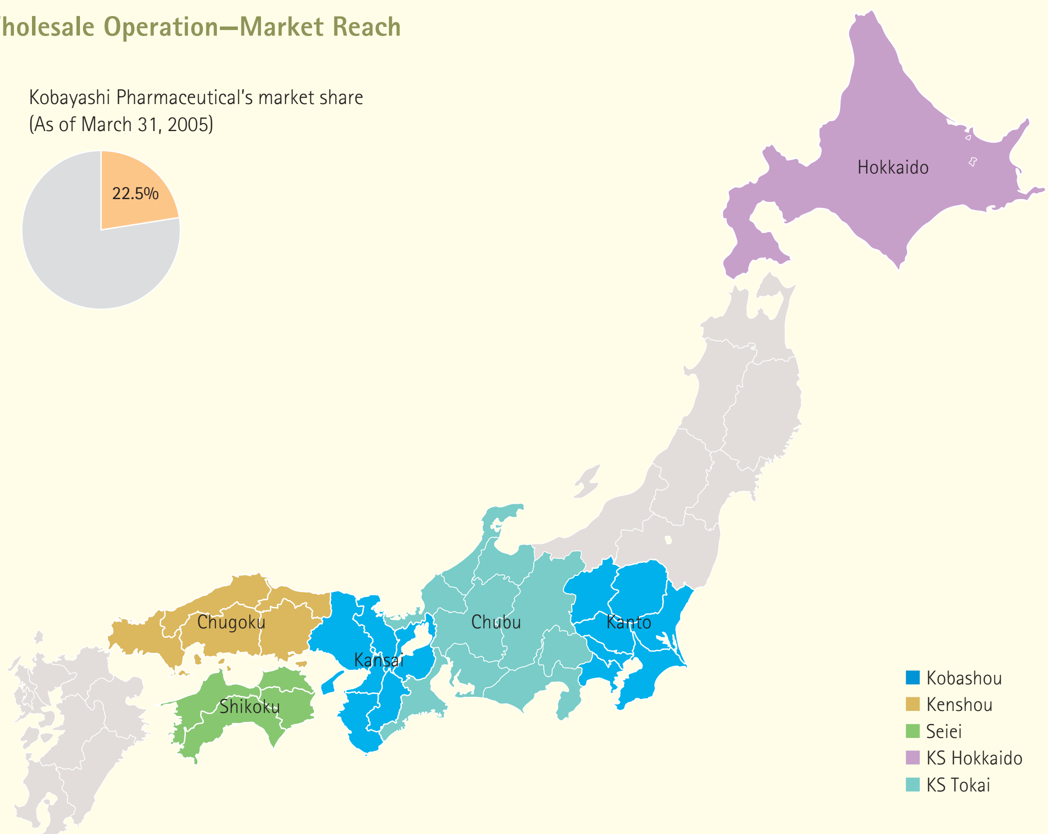
Only about 18% of the products this division handles are original products developed and manufactured in-house. The remainder is supplied by third-party manufacturers. Drugs represent approximately 40% of the total sales, sundries and food about 20% each, contact lens care products about 10% and other products about 10%. Expanding the scale of operations is the most important strategic issue. We are concentrating on expanding the lineup of foods, particularly health foods, and contact lens care products, items that are witnessing expanding sales in the drug-store channel through which our shipments have been rising in recent years.

Wholesale Operation Expansion Strategy



Note: Seiei Co., Ltd. is an affiliate to which the equity method does not apply

Wholesale Operation—Market Reach



Expanding Business and Service Areas

Kobayashi Pharmaceutical in 2001 spun off its wholesale division as Kobashou Co., Ltd. to promote nationwide development and strengthen the competitiveness of the business by expanding the size of operations. Once established as a pure wholesaler, Kobashou Co., Ltd. was positioned to build up a nationwide service network by forging alliances with regional wholesalers.

Subsequently, Chugoku-based Kenshou Co., Ltd. was made a consolidated subsidiary. In 2003, Kobashou Co., Ltd. and three Shikoku-based wholesalers set up Seiei Co., Ltd. These moves extended our original service area, which centered on the Kanto and Kansai regions, to Chugoku and Shikoku. In March 2004, Kobashou Co., Ltd. formed a business alliance with Mitsubishi Corporation and Ryoshoku Ltd., further strengthening our merchandise procurement, including of overseas products, logistics and retail support functions.

Expanding Presence Through Collaboration With Suzuken

In April 2005, Kobashou Co., Ltd. acquired the OTC drug wholesaling business of Suzuken Co., Ltd., a major drug wholesaler in Japan. Simultaneously, Suzuken Co., Ltd. acquired an equity interest in Kobashou Co., Ltd. Alongside this move, Kobashou Co., Ltd. established KS Hokkaido Co., Ltd. and KS Tokai Co., Ltd. to make the most of regional characteristics and efficiently service the Hokkaido and Chubu regions, which were previously not covered.

Kobashou Co., Ltd. has thus taken another step in building a framework for improving its comprehensive sales capabilities and product strength to cement a position as a core wholesaler in the health and beauty care market in Japan. This leaves only Tohoku and Kyushu as areas not covered by the company. With Kobashou's recent moves, the Wholesale Operation is a step closer to realizing the goals of nationwide operations and annual sales of ¥300 billion.

Medical Devices Operation

Our management principle of providing comfort to individuals and society is a central tenet of the Medical Devices Operation. This operation comprises the Kobayashi Medical Division (an operating division), equity-method affiliate Medicon, Inc. in Japan, and three Shield Healthcare Centers, subsidiaries in the U.S.

Aiming to Create Strong Business Domains With a Strategy of Being No.1

Medicon, Inc., a joint venture with C.R. Bard, Inc. of the U.S. established in 1972, specializes in urological, gastrointestinal and cardiovascular devices and supplies developed by C.R. Bard. In the urological field in particular, Medicon has contributed to advances in medical treatment as the market leader. The Kobayashi Medical Division was established in 1992 to import and sell advanced medical devices in areas in which Medicon was not involved. The division sells cutting-edge medical devices and supplies for the orthopedics, surgery room, anesthesiology, neurosurgery, and otorhinolaryngology domains. The Kobayashi Medical Division has built an excellent track record in the sale of a range of products in the orthopedics domain, including compression screws made by U.S.-based Acumed, Inc., and bone prostheses-related products made by NGK Spark Plug Co., Ltd. In the fiscal year under review, we signed an exclusive agency agreement with U.S. corporation Orthofix Inc. and started sales of an orthopedic external fixator.

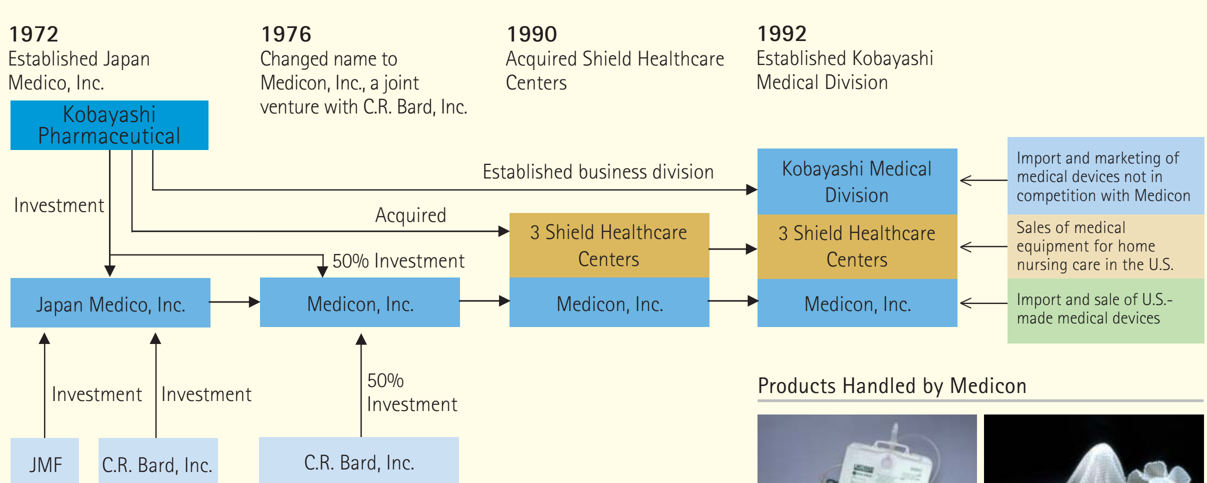
Medicon Inc. and the Kobayashi Medical Division have thus carved out specialty niche areas and are working to build No.1 positions and further expand their businesses in a drastically changing health industry, guided by a mission of providing "safety and reassurance" at the frontline of healthcare.

Advanced Specialization and Customer Trust

The medical instruments field is defined by rapid technological change. For that reason it is imperative to efficiently gather information on cutting-edge technologies and products from the U.S. and Europe and to supply that information in a timely manner to the medical instruments market in Japan. Kobayashi Pharmaceutical quickly collects the latest information from overseas medical device manufacturers, including companies in Europe and the U.S., and distributes this information to the medical frontline in Japan through sales activities as well as seminars and study sessions held nationwide.

Medical instruments have become increasingly complex due to advanced functions and the trend toward minimally invasive treatment in recent years. Medical professionals are therefore placing more importance on information not just about the instruments but also information on related topics such as how to use them and the clinical benefits. Kobayashi Pharmaceutical supports training in this regard through tie-ups with overseas manufacturers. It also provides specialized training to salespeople in-house while helping them to

Medical Devices Operation



Products Handled by Medicon


Bard *I.C. Silver Foley Tray*


Bard *Perfix Plug*

polish their sales skills. Salespeople are also backed up by a system for sharing the latest information. Kobayashi Pharmaceutical's goal is to build a highly specialized professional team trusted at the frontline of healthcare.

To provide "safety and reassurance" at the medical frontline Kobayashi Pharmaceutical has established a control organization that conforms with the revised Pharmaceutical Affairs Law. Kobayashi Pharmaceutical is also taking other steps to create an internal framework for obtaining ISO13485 certification, the international standard for quality management systems for medical instruments.

High Growth as a Trader and Manufacturer

Since its establishment, the Kobayashi Medical Division has forged sales agreements with domestic and overseas manufacturers to provide cutting-edge products to the medical frontline. At present, it has sales agreements with 21 firms. Medicon and the Kobayashi Medical Division leverage their information networks built up over many years to introduce products focused on specialized domains. They have helped to identify a host of strong-selling products to date and through these activities have contributed to the medical profession. Moving forward, Medicon and the Kobayashi Medical Division will concentrate on growing existing products to capture a larger market share, backed by a high level of specialization and the trust of the medical community.

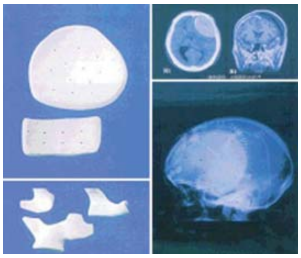
Responding to feedback from customers wanting products that better fit requirements in Japan, we established an in-house product development center in 2003. In the year under review, the Kobayashi Medical Division launched its fourth proprietary product under the *Kobamed* brand, establishing a position as a medical devices manufacturer. We will more actively invest in research and development, including through joint R&D with academia and medical institutions and manufacturers, to speed up in-house development and expand our own product lineup.

By launching our own brand products, we will augment our traditional trading functions with that of a manufacturer, with the aim of achieving higher growth.


Product development meeting

Products Handled by Kobayashi Medical Division

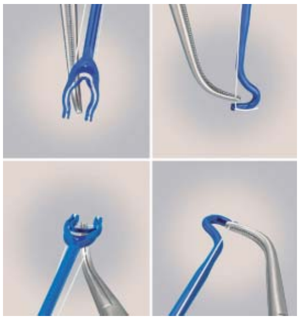

Conmed electric scalpel


NGK Spark Plug *CERATITE* (bone prosthesis)


Acumed ACUTRAK headless compression screw


Orthofix orthopedic external fixator

Proprietary Products — *Kobamed* Brand


Instruments for minimum incision surgery


Trocar Catheter kit

Environmental Protection

Kobayashi Pharmaceutical formulated an environmental action plan based on its Environmental Protection Charter to pursue business activities in a manner that minimizes environmental impact and promotes the efficient use of resources. This plan has guided our environmental protection activities since 1997.

Basic Policy on Environmental Protection

Kobayashi Environmental Declaration

To protect the environment, the Kobayashi Pharmaceutical Group will effectively use finite energy and natural resources, while taking steps to prevent environmental pollution and make regular improvements.

Environmental Action Guidelines

1. Compliance and Numerical Goals
   The Group will ensure compliance with environmental protection-related laws, regulations and agreements in each business domain, while formulating and meeting environmental goals and voluntary standards.
2. Reduce Waste and Improve Recycling
   The Group will reduce waste volumes, taking actions to recycle waste materials that are recyclable or reusable in each stage of operations.
3. Conserve Natural Resources and Energy
   The Group will actively promote the efficient use of energy and recyclable materials to make effective use of finite natural resources.
4. Provide Environmentally Sound Products and Services
   The Group will carefully consider the types of materials and how they are used in all business activities in order to develop products and provide services with a lower environmental impact.
5. Common Action Guidelines and Improved Environmental Awareness
   The Group will make these guidelines known to all Group employees, and hold educational and training programs to raise the environmental awareness of each and every employee.

Overall Environmental Load and Our Response

Kobayashi Pharmaceutical uses chemical substances and consumes resources and energy derived from fossil fuels in its manufacturing operations. As a result, we produce waste and release carbon dioxide into the atmosphere, thus affecting the environment. However, we are implementing energy-saving and recycling measures designed to effectively use fossil fuels, a finite natural resource, as well as appropriately controlling and reducing waste and carbon dioxide emissions from our business activities. We have set concrete numerical goals for annual reductions in carbon dioxide emissions and waste and for raising the recycling ratio, all of which are carefully monitored.

Actions for Preventing Global Warming

We are actively involved in preventing global warming. In 1997, we started measuring our carbon dioxide emissions and since fiscal 2000, ended March 31, 2001, we have been monitoring such emissions per production unit.

In the fiscal year ended March 31, 2005, by transporting more products by railway, we reduced CO_2 emissions by roughly 1,198.91 tons, representing 9.32% of total CO_2 emissions from manufacturing processes at the Kobayashi Pharmaceutical Group. We plan to continue to choose low-emission transportation methods.

Actions to Reduce Industrial Waste

Kobayashi Pharmaceutical disposed of 22 tons of waste at landfills during the fiscal year ended March 31, 2005, representing a reduction of approximately 91.0% from 244 tons in the prior fiscal year, and a roughly 98.7% reduction compared with 1,644 tons in the fiscal year ended March 31, 1998. These reductions reflect efforts to rigorously sort a variety of waste from plants, including cardboard, paper, glass, plastics, metals and solvents, and promote recycling. Moreover, efforts were made to reduce not only landfill waste but also the volume of waste we generate. In the fiscal year ended March 31, 2005, waste volumes were reduced by 18% year on year to 2,609 tons. Centered on the reuse of waste materials, we keep lowering waste volumes by compacting and sorting waste.

Actions to Promote Recycling

In the fiscal year ended March 31, 2005, the recycling rate was roughly 99.2%, representing an improvement of 7 percentage points from the previous fiscal year. The Company uses both thermal recycling, which reuses waste as thermal energy, and conventional recycling, which mainly involves sorting waste materials. During the fiscal year under review, zero emissions were achieved at four business sites, including the Osaka Plant. Going forward, we will promote activities to further raise the recycling rate.

Environmental Considerations in Product Development

Measures to Develop Environmentally Friendly Products

Kobayashi Pharmaceutical is working to reduce the weight of product containers by changing materials used for existing product containers and taking other steps. During the fiscal year ended March 31, 2005, simpler packaging for *Sarasarty* and *Shoshu Garden* was introduced. Furthermore, since the 1977 launch of refillable *Bluelet* products, we have rolled out products that can be refilled, enhancing the reuse of the original container and parts. As of April 2005, there were 54 of these products spanning 24 product types. With regard to product packaging, we have been examining the use of recycled paper and recycled PET, to the extent that the utilization of these and other materials does not affect product function or application.

Environmental Goals and Results for the Fiscal Year Ended March 31, 2005

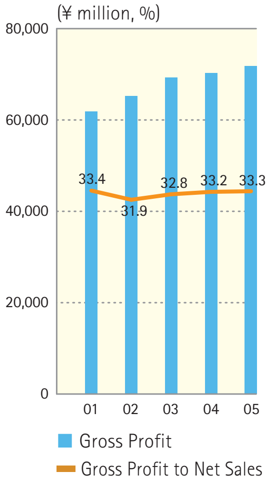
Goals for FY2005	Results for FY2005
1. Actions for Conserving Energy Reduce CO_2 emissions per production unit by 10% from the previous fiscal year.	CO_2 emissions per production unit in the fiscal year ended March 31, 2005 decreased by 16% year on year and total emissions were lowered by 2%.
2. Actions to Reduce Industrial Waste Reduce the volume of waste by 10% from the previous fiscal year.	Landfill waste volume was lowered by 91.0% year on year in the fiscal year ended March 31, 2005.
3. Actions to Promote Recycling Achieve zero emissions at three plants. For those not achieving zero emissions during FY2005, raise the recycling rate by three percentage points.	Zero emissions were achieved at four plants (Osaka, Toyama, Sendai and Ehime). Other locations that could not achieve zero emissions increased the recycling rate by 21 percentage points.
4. Safety Management of Chemical Substances Reduce emissions of PRTR substances at each plant to 100kg or less.	Goals were achieved at all plants.

Financial Section

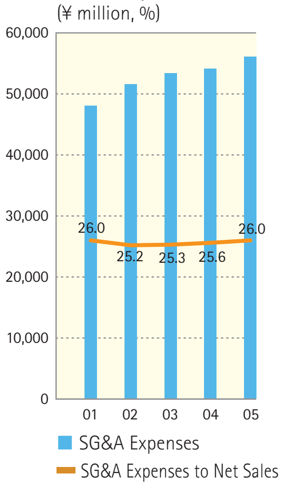
Contents

Management's Discussion and Analysis

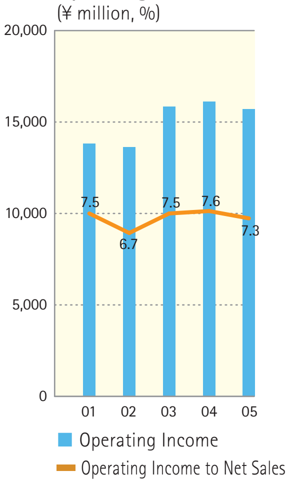
Gross Profit &
Gross Profit to Net Sales
(¥ million, %)



SG&A Expenses &
SG&A Expenses to Net Sales
(¥ million, %)



Operating Income &
Operating Income to Net Sales
(¥ million, %)



Scope of Consolidation and Application of the Equity Method

Kobayashi Pharmaceutical has 22 consolidated subsidiaries, 13 in Japan and 9 overseas, and one affiliate in Japan accounted for by the equity method. The Company classifies its business activities into four segments: Consumer Products Operation (eight consolidated subsidiaries), Wholesale Operation (two consolidated subsidiaries), Medical Devices Operation (seven consolidated subsidiaries and one equity-method affiliate) and Other Operations (five consolidated subsidiaries).

Overview

During the fiscal year under review, although Japan's economy showed signs of revival, recovery in consumer spending remained uncertain on concerns about the future, such as possible increases in social security premiums. The business environment was volatile, characterized by record high summer temperatures and frequent typhoons that directly hit the country, mild winter weather, combined with the outbreak of influenza and abnormally high levels of airborne pollen.

In challenging circumstances, Kobayashi Pharmaceutical unleashed the spirit expressed by its management philosophy of "Creativity and Innovation." The Group cultivated latent customer needs by introducing new products and services to seed new markets while invigorating existing markets by offering products and services with new added value. Alongside these measures, Kobayashi Pharmaceutical also made proactive efforts to buy brands, form business partnerships and pursue overseas business expansion.

However, operating income declined due to heavy advertising expenses to raise the visibility of our brands and other factors, despite cost savings achieved through manufacturing cost reductions and reviews of sales promotion budgets.

Effective from the fiscal year ended March 31, 2005, we included four additional subsidiaries into the scope of consolidation: Shanghai Kobayashi Daily Chemicals Co., Ltd., Kobayashi Pharmaceutical (Hong Kong) Co., Ltd., Kobayashi Pharmaceutical Life Service Co., Ltd. and Kobayashi Com Co., Ltd.

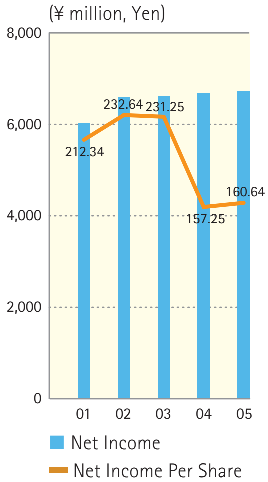
Net Sales

Consolidated net sales for the year under review were ¥215,708 million, 1.9% higher than in the previous year. The Consumer Products Operation saw sales rise on the launch of new products, deregulation in the pharmaceuticals industry and higher-than-normal airborne pollen counts. The Wholesale Operation benefited from the outbreak of influenza and sales of allergy medicines, among other factors. However, the operating environment was severe, affected by the introduction of a new pricing system of tax-inclusive prices, an extremely hot summer and a relatively mild winter. Sales rose in the Medical Devices Operation as the Kobayashi Medical Division concentrated on products in selected areas and focused on strengthening its position as a pharmaceuticals manufacturer. Overseas sales declined due to changes in the medical insurance system in California and the impact of the yen's appreciation.

Gross Profit and Operating Income

The cost of sales increased ¥2,524 million, or 1.8%, from the previous year. Gross profit rose 2.2% to ¥71,796 million. Selling, general and administrative (SG&A) expenses increased ¥1,938 million, or 3.6%, due to stepped up advertising. As a result, operating income declined 2.6% from the previous fiscal year to ¥15,699 million. The ratio of gross profit to net sales improved from 33.2% to 33.3%. The ratio of operating income to net sales changed from 7.6% to 7.3%.

Net Income & Net Income Per Share
(¥ million, Yen)



Income Before Income Taxes and Net Income

Income before income taxes and minority interests increased 8.0% to ¥12,770 million, mainly due to a substantial year-on-year decline of ¥1,875 million in loss on disposal of property, plant and equipment, and a ¥1,073 million year-on-year increase in other, net to ¥404 million.

Consolidated net income increased 0.8% to ¥6,731 million. Net income per share was ¥160.64, up 2.2% from the ¥157.25 recorded in the previous fiscal year.

Note: Kobayashi Pharmaceutical conducted a 1.5-for-1 stock split on November 20, 2003. Net income per share for the previous fiscal year is calculated based on the average number of shares outstanding during the period, assuming the stock split was conducted at the beginning of the fiscal year.

Segment Information

Kobayashi Pharmaceutical's business is classified into four segments: Consumer Products Operation, Wholesale Operation, Medical Devices Operation, and Other Operations. As more than 90% of consolidated net sales are recorded in Japan, geographic segment information is not presented.

Inter-group sales and transfers are included in segment sales. These amounted to ¥28,933 million in the previous year and ¥30,183 million in the year under review.

Net Sales and Operating Income by Segment

Net Sales (¥ million)

Consumer Products Operation	2001	2002	2003	2004	**2005**
Sales to third parties	¥59,696	¥64,977	¥66,027	¥66,523	**¥67,525**
Inter-group sales and transfers	17,238	19,029	19,532	20,532	**21,749**
	76,934	84,006	85,559	87,055	**89,274**
Wholesale Operation					
Sales to third parties	107,485	117,214	125,858	126,080	**128,356**
Inter-group sales and transfers	–	4	0	–	–
	107,485	117,218	125,858	126,080	**128,356**
Medical Devices Operation					
Sales to third parties	15,490	19,932	16,113	15,609	**16,056**
Other Operations					
Sales to third parties	2,330	2,524	2,923	3,458	**3,771**
Inter-group sales and transfers	10,323	10,108	8,783	8,401	**8,434**
	12,653	12,632	11,706	11,859	**12,205**

Operating Income (¥ million)

	2001	2002	2003	2004	**2005**
Consumer Products Operation	¥12,764	¥13,397	¥14,438	¥14,631	**¥14,493**
Wholesale Operation	499	(59)	256	535	**799**
Medical Devices Operation	259	441	829	645	**190**
Other Operations	82	(14)	265	153	**140**

■Consumer Products Operation

In this segment, 16 new products were launched (excluding nutritional supplement food products) in an effort to create new markets and further expand on existing markets. Among these products (non-pharmaceuticals) those that contributed to growth were *Keshimin Cream*, a skin care cream with vitamin effectiveness for discoloration and freckles from sun exposure; *Ofloat*, a pleasant aromatic bathing product that floats on the surface of bathwater; and *Nodonuru*, an oral antiseptic spray that went on sale following deregulation of pharmaceutical products. In addition, nutritional supplement food products, sold through the twin channels of mail order and drug store outlets, also benefited from increased health consciousness and continued to post favorable results. Compared to last year, this year's marked increase in airborne pollen counts resulted in dramatically higher sales of allergy medicines, such as the eyewash product *Eyebon*.

Net Sales and Operating Income

As a result, sales increased 2.5% over the previous fiscal year to ¥89,274 million but the segment's contribution to consolidated net sales decreased from 31.4% to 31.3%.

Sales of pharmaceuticals rose 1.4% and sales of deodorizing air fresheners were up 2.9%. But, household sundry sales fell 8.2%. Sales of oral hygiene products and sanitary products were up 2.0% and 5.3% respectively. Sales of food products continued to record strong growth, rising 12.4%.

Despite cost-cutting through sweeping reductions of manufacturing costs, an aggressive commitment to advertising aimed at raising the profile of the Company's brands, both domestically and internationally, saw operating income decrease 0.9% year on year to ¥14,493 million.

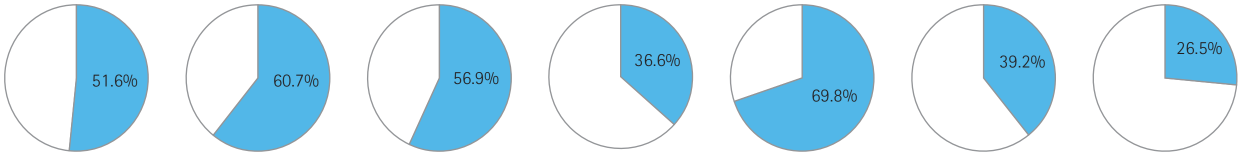
Sales by Category

(¥ million)

	2004		**2005**		Changes	
	Sales	% of total sales (%)	Sales	% of total sales (%)	Amount	Change (%)
Pharmaceuticals	14,957	17.2	**15,164**	**17.0**	**207**	**1.4**
Oral hygiene products	9,891	11.4	**10,091**	**11.3**	**200**	**2.0**
Sanitary products	11,879	13.7	**12,506**	**14.0**	**627**	**5.3**
Deodorizing air fresheners	27,258	31.3	**28,037**	**31.4**	**779**	**2.9**
Household sundries	5,008	5.7	**4,598**	**5.2**	**(410)**	**(8.2)**
Food products	9,958	11.4	**11,196**	**12.5**	**1,238**	**12.4**
Body warmers	8,104	9.3	**7,682**	**8.6**	**(422)**	**(5.2)**
Total	87,055	100.0	**89,274**	**100.0**	**2,219**	**2.5**

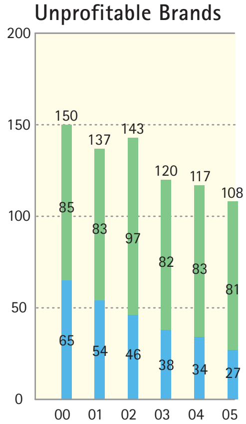
Market Share of Principal Brands (Pie Chart)

Eye Wash | Oral Hygiene Products | Cooling Gel Sheets for Forehead | Sanitary Sheets | Deodorizing Toilet Bowl Cleansers | Deodorizing Air Fresheners | Body Warmers



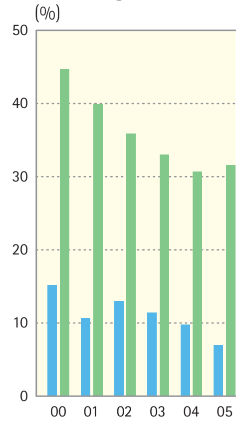
Eyebon | *Breath Care* | *Netsusama Sheet* | *Sarasarty* | *Bluelet* | *Sawaday*, *Shoshugen*, etc. | *Kiribai Haru*

Number of Profitable and Unprofitable Brands



■ Profitable brands
■ Unprofitable brands

New Products as a Percentage of Sales
(%)



■ First year
■ First four years

Number of Profitable and Unprofitable Brands

	2000	2001	2002	2003	2004	**2005**
Profitable brands	85	83	97	82	83	**81**
Unprofitable brands	65	54	46	38	34	**27**

New Products as a Percentage of Sales

(%)

	2000	2001	2002	2003	2004	**2005**
First year	15.2	10.7	13.0	11.4	9.8	**7.0**
First four years	44.7	39.9	35.9	33.0	30.7	**31.6**

Issues to Be Addressed in the Current Fiscal Year

Although we expect the operating environment to continue to be severe, we launched seven new products in spring 2005 to meet latent consumer needs. These include *Shoyo Ekiyaku*, a highly effective treatment for gum boils with four effective ingredients that penetrate the affected area for a complete cure, *Fan de Rich*, a deodorizing air freshener with a fan to spread aroma and deodorize every corner of a room and *Sarasarty Yawaraka Silk Touch*, a comfortable sanitary sheet with a soft and smooth touch. Effective from June 2005, Kobayashi Pharmaceutical acquired exclusive marketing rights to *Inochi no Haha A*, a general purpose women's health medication for treatment of menopausal disorders. These and other products are projected to boost sales 4.2% to ¥93,000 million in the fiscal year ending March 31, 2006.

Regarding earnings, operating income is forecast to increase 3.5% to ¥15,000 million as we reduce cost of sales as part of ongoing cost-cutting measures, while continuing to advertise aggressively to raise the visibility of the Company's brands.

■Wholesale Operation

The Wholesale Operation segment faced a challenging operating environment mainly due to the introduction of a new pricing system of tax-inclusive prices at drugstores, our leading customer base, and the scorching summer heat followed by a mild winter. However, sales of the Wholesale Operation significantly benefited from improved sales of products from the beginning of the year to treat the outbreak of influenza and pollen-related allergies, together with contributions of new sales from our wholesaler in the Shikoku region.

Net Sales and Operating Income

Sales of the Wholesale Operation increased 1.8% from the previous fiscal year to ¥128,356 million but the segment's contribution to consolidated net sales declined from 59.6% to 59.5%.

By product, in the drugs category, sales of products increased 9.8% but sales of merchandise were down 2.6%. Higher sales of health foods and contact lens care products, both expanding markets, underpinned sales in the sundries and foods category, driving up product sales by 9.5% and merchandise by 2.1%.

On the profit front, operating income, which climbed 49.3% year on year to ¥799 million, benefited from bulk purchases from manufacturers leveraging economies of scale accompanying the expansion of business operations, and thorough cost reductions such as lower delivery charges.

Sales by Category

(¥ million)

		2004		**2005**		Changes	
		Sales	% of total sales (%)	Sales	% of total sales (%)	Amount	Change (%)
Drugs	Products	7,606	6.0	**8,352**	**6.5**	**746**	**9.8**
	Merchandise	43,165	34.2	**42,025**	**32.7**	**(1,140)**	**(2.6)**
Sundries and food	Products	14,594	11.6	**15,976**	**12.5**	**1,382**	**9.5**
	Merchandise	60,715	48.2	**62,003**	**48.3**	**1,288**	**2.1**
Total		126,080	100.0	**128,356**	**100.0**	**2,276**	**1.8**

Issues to Be Addressed in the Current Fiscal Year

In the fiscal year ending March 31, 2006, the Wholesale Operation will promote more alliances in order to respond to the expanding geographic coverage of drugstores, our principal customers, strengthen our product offering by more clearly differentiating our health foods and contact lens care products, both expanding markets, and launch new lines in baby care and products for the elderly. As a result of these and other initiatives, sales are projected to increase 25.4% to ¥161,000 million, with operating income rising 0.1% to ¥800 million. Effective April 2005, Kobashou Co., Ltd. and two newly consolidated subsidiaries, KS Hokkaido Co., Ltd. and KS Tokai Co., Ltd., took over Suzuken Co., Ltd.'s OTC drug wholesale business.

■Medical Devices Operation

In Japan, the Kobayashi Pharmaceutical Group concentrated on expanding its lineup of products related to specific selected fields, such as orthopedics, operating theaters, neurosurgery and otorhinolaryngology. Particular emphasis has been placed on expanding the product lineup and capturing orders in the orthopedics field. A greater effort has also been given to making the transition from a company engaging solely in sales to one that also engages in manufacturing, with the result that four products developed in-house have been marketed.

Overseas, although the three Shield Health Centers were able to increase their customer base by purchasing customer lists, earnings were heavily impacted by changes in the California State insurance system (cutbacks in insurance refunds and other measures) and the stronger yen.

Net Sales and Operating Income

Sales of the Medical Devices Operation posted a 2.9% increase compared to the previous fiscal year to ¥16,056 million. The segment's contribution to consolidated net sales was unchanged at 7.4%.

By category, sales of Kobayashi Medical Division, known for its special strengths in products for orthopedics, operating theaters, neurosurgery and otorhinolaryngology, increased 11.1%. Overseas, due to a negative impact from changes in California's insurance system and the strong yen, the three Shield Healthcare Centers saw significant declines, with sales falling 4.6% to ¥8,245 million.

As a result, operating income fell 70.5% from the previous fiscal year to ¥190 million yen. Equity in earnings of Medicon, Inc., an equity-method affiliate, was ¥330 million.

Sales by Category

(¥ million)

	2004		**2005**		Changes	
	Sales	% of total sales (%)	Sales	% of total sales (%)	Amount	Change (%)
Kobayashi Medical Division	5,937	38.0	**6,594**	**41.1**	**657**	**11.1**
Shield Healthcare Centers (3 firms)	8,639	55.3	**8,245**	**51.3**	**(394)**	**(4.6)**
Others	1,033	6.7	**1,217**	**7.6**	**184**	**17.8**
Total	15,609	100.0	**16,056**	**100.0**	**447**	**2.9**

Issues to Be Addressed in the Current Fiscal Year

Kobayashi Medical Division will expand the lineup of products it imports and distributes for orthopedics and other areas, while stepping up the development of *Kobamed*, a proprietary brand of pharmaceutical products developed in-house. Overseas, the three Shield Healthcare Centers will concentrate on increasing customers by purchasing customer lists and other initiatives, and far-reaching cost-cutting measures. As a result of these and other initiatives, we expect net sales to increase 5.9% to ¥17,000 million and operating income to rise 110.5% to ¥400 million.

■Other Operations

Other Operations are conducted by Kobayashi Pharmaceutical's subsidiaries in support of the Company's three principal businesses and to contribute to the profits of those businesses. The Group reviewed the transfer values of the materials and services these subsidiaries and affiliates provide.

As a result, sales of Other Operations decreased 2.9% from the previous fiscal year to ¥12,205 million. Operating income was down 8.5% at ¥140 million.

Analysis of Financial Position

Assets

Total assets were ¥134,629 million as of March 31, 2005, 4.9% higher than at the end of the previous fiscal year. This increase was primarily attributable to increases in current assets.

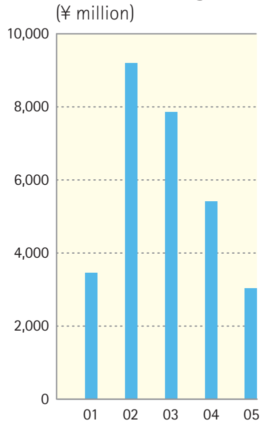
Current assets increased to ¥86,705 million, 8.3% more than at the end of the previous fiscal year. Trade notes and accounts receivable rose 5.7%, or ¥2,366 million, and inventories rose 12.0%, or ¥1,689 million, mainly reflecting the impact of bulk purchasing by the Wholesale Operation.

Property, plant and equipment rose 1.8% to ¥25,003 million due mainly to increases in buildings and structures.

Investments and other assets were ¥22,921 million as of March 31, 2005, down 3.4% from a year ago, reflecting mainly a decrease in investments in securities due to the decline of ¥942 million in unconsolidated subsidiaries and affiliates.

Interest-bearing Debt

(¥ million)



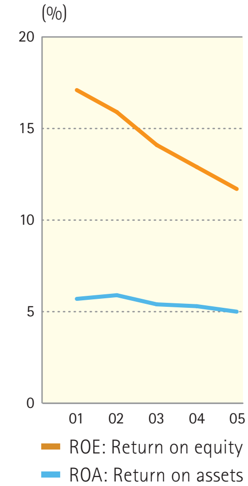
Liabilities

Total liabilities were ¥73,967 million at March 31, 2005, up 0.8% from the previous fiscal year-end. Current liabilities increased only 1.1% to ¥65,007 million. This was mainly because of a decrease in short-term loans accompanying the repayment of funds used for the acquisition of Kiribai Chemical Co., Ltd. Short-term loans declined 40.3% to ¥2,692 million. As a result, the current ratio improved 8.9 percentage points from a year ago to 133.4%.

Long-term liabilities decreased 1.5% to ¥8,960 million. Mirroring the decline in current liabilities, the decline in long-term liabilities reflects repayment of the long-term debt used for the acquisition of Kiribai Chemical. As a result, long-term debt at the end of the fiscal year under review was ¥342 million, a decrease of 62.2% from a year earlier.

ROE & ROA

(%)



Shareholders' Equity

Shareholders' equity was ¥60,116 million at March 31, 2005, 10.4% higher than a year ago. The principal factor was an increase in retained earnings of ¥5,399 million. Owing to the buyback of shares, treasury stock increased ¥15 million to ¥2,332 million. As a result, the shareholders' equity ratio improved 2.3 percentage points from 42.4% to 44.7% at the end of the fiscal year under review. The return on shareholders' equity (ROE) decreased 1.2 percentage points from 12.9% to 11.7%. The ratio of ordinary income to total assets (ROA) decreased 0.6 of a percentage point from 11.1% to 10.5%.

Cash Flow Analysis

Cash Flows from Operating Activities

Net cash provided by operating activities was ¥8,364 million, ¥1,393 million higher than in the previous fiscal year. The main contributing factors were an increase of ¥945 million in income before income taxes and minority interests, improved working capital, and lower income taxes paid due to an increase in the special deduction for testing and research expenses.

Cash Flows from Investing Activities

Net cash used in investing activities was ¥3,936 million, an increase of ¥1,578 million over the previous fiscal year, attributable to the procurement of metal molds for new product development, purchases of customer lists by U.S. subsidiaries, and acquiring marketing licenses and trademarks in Japan.

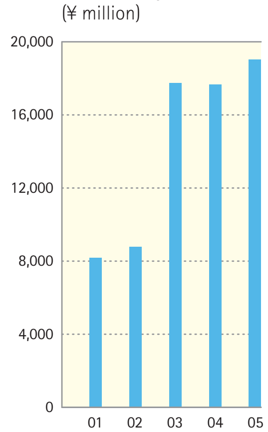
As a result, free cash flow was ¥4,428 million, a decrease of ¥185 million compared to the previous fiscal year.

Cash Flows From Financing Activities

Net cash used in financing activities was ¥3,369 million, ¥1,205 million less than in the previous fiscal year. Although there was an increase of ¥283 million in dividends paid, there were no Board of Directors-approved treasury stock purchases in the year under review.

As a result of the above, cash and cash equivalents at the end of the year were ¥19,036 million, an increase of ¥1,373 million over the previous fiscal year.

Cash and cash equivalents at end of year
(¥ million)



Cash Flows

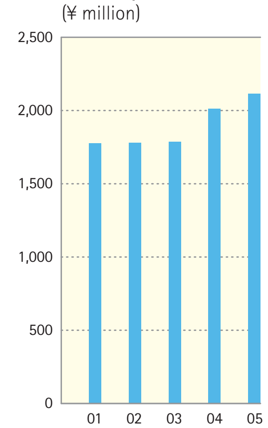
(¥ million)

	2004	**2005**	Change	
	Amount	Amount	Amount	Change (%)
Cash flows from operating activities	6,971	**8,364**	**1,393**	**20.0**
Cash flows from investing activities	(2,358)	**(3,936)**	**(1,578)**	–
Free cash flows	4,613	**4,428**	**(185)**	**(4.0)**
Cash flows from financing activities	(4,574)	**(3,369)**	**1,205**	–
Cash and cash equivalents at end of year	17,663	**19,036**	**1,373**	**7.8**

R&D Expenses

R&D underpins new product development, Kobayashi Pharmaceutical Group's core strength. R&D expenses, included in selling, general and administrative expenses, increased ¥105 million, or 5.2%, from the previous year to ¥2,115 million.

R&D Expenses
(¥ million)



Risk Factors

Kobayashi Pharmaceutical's Management Policies

Ever since Kobayashi Pharmaceutical was founded, management policy has been to provide people and society with comfort through "Creativity and Innovation." Our brand slogan, "You make a wish and we make it real," defines our mission of providing health, peace of mind and convenience to all our stakeholders.

At this time of intensifying competition and volatility, the Kobayashi Pharmaceutical Group's growth hinges on continuously providing new products and services to meet customer needs through our policy of "Something New, Something Different." Through this approach, we aim to raise enterprise value and meet the expectations of all our stakeholders.

Significant Changes in Financial Position and Operating Results

In the fiscal year under review, the Kobayashi Pharmaceutical Group incurred a ¥277 million loss related to liquidation of an overseas subsidiary and provided a ¥188 million allowance for losses on investment to cover possible losses at a domestic subsidiary, in addition to a ¥277 million loss on sale of Kicks Co., Ltd., a domestic subsidiary. The subsidiary was sold to another firm in our industry in order to assure sustained growth at this company.

Furthermore, the Company incurred a ¥162 million impairment loss on securities without market quotations.

Significant Changes in Cash Flows

The Company acquired intangible assets, including trademarks, to improve KOVA (Kobayashi Value Added), its proprietary management index, paying ¥2,322 million for the investment.

High Dependence on Certain Customers With Whom Continuity of Business is Uncertain

Kobayashi Pharmaceutical is not overly dependent on any particular customer with whom there is uncertainty of business continuity. Nevertheless, the Company may have to provide for doubtful receivables owing to bankruptcies of customers and uncertainties about their financial positions.

High Dependence on Products and Technologies With an Uncertain Future

The Company is not highly dependent on specific products and technologies with an uncertain future.

Legal Constraints

Our Consumer Products Operation and Medical Devices Operation are subject to the Pharmaceutical Affairs Law.

Major Lawsuits

There are no pending major lawsuits that are likely to have a significant impact on operations.

Consolidated Balance Sheets

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
ASSETS			
Current assets:			
Cash and time deposits (Note 4)	¥ 19,036	¥ 17,663	$ 177,260
Trade notes and accounts receivable (Note 7)	44,138	41,772	411,007
Inventories (Note 6)	15,783	14,094	146,969
Deferred income taxes (Note 13)	2,418	2,453	22,516
Other current assets	5,977	4,578	55,657
Allowance for doubtful accounts	(647)	(529)	(6,025)
Total current assets	86,705	80,031	807,384
Property, plant and equipment:			
Land (Note 7)	9,928	9,949	92,448
Buildings and structures (Note 7)	23,913	23,570	222,674
Machinery and equipment	4,390	4,063	40,879
Construction in progress	284	361	2,645
Other	4,962	4,511	46,205
	43,477	42,454	404,851
Accumulated depreciation	(18,474)	(17,887)	(172,027)
Property, plant and equipment, net	25,003	24,567	232,824
Investments and other assets			
Investments in securities (Notes 5 and 7):			
Unconsolidated subsidiaries and affiliates	2,375	3,317	22,116
Other	6,384	6,554	59,447
Allowance for loss on devaluation of securities	(188)	(332)	(1,751)
	8,571	9,539	79,812
Excess of cost over net assets acquired	3,100	3,759	28,867
Deferred income taxes (Note 13)	2,330	2,460	21,697
Other assets	10,677	10,080	99,423
Allowance for doubtful accounts	(1,757)	(2,110)	(16,361)
Total investments and other assets	22,921	23,728	213,438
	¥134,629	¥128,326	$1,253,646

See accompanying notes to the consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term loans (Note 7)	¥ 2,692	¥ 4,512	$ 25,068
Trade notes and accounts payable (Note 7)	43,499	41,069	405,056
Accrued income taxes (Note 13)	3,631	3,479	33,811
Accrued expenses	2,617	2,705	24,369
Other current liabilities	12,568	12,533	117,032
Total current liabilities	65,007	64,298	605,336
Long-term liabilities:			
Long-term debt (Note 7)	342	905	3,185
Accrued retirement benefits for employees (Note 8)	6,474	6,320	60,285
Accrued retirement benefits for directors and statutory auditors	1,264	1,158	11,770
Other liabilities	880	711	8,194
Total long-term liabilities	8,960	9,094	83,434
Total liabilities	73,967	73,392	688,770
Minority interests	546	480	5,084
Shareholders' equity (Note 11)**:**			
Common stock			
Authorized – 170,100,000 shares			
Issued – 42,525,000 shares in 2005 and 2004	3,450	3,450	32,126
Additional paid-in capital	4,184	4,183	38,961
Retained earnings	53,585	48,186	498,976
Unrealized holding gain on securities	1,851	1,640	17,236
Foreign currency translation adjustments	(622)	(688)	(5,792)
Treasury stock, at cost	(2,332)	(2,317)	(21,715)
Total shareholders' equity	60,116	54,454	559,792
	¥134,629	¥128,326	$1,253,646

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Income

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Net sales	¥215,708	¥211,670	$2,008,641
Cost of sales	143,912	141,388	1,340,087
Gross profit	71,796	70,282	668,554
Selling, general and administrative expenses (Note 12)	56,097	54,159	522,367
Operating income	15,699	16,123	146,187
Other income (expenses):			
Interest and dividend income	131	115	1,220
Equity in earnings of affiliates	391	280	3,641
Interest expense	(86)	(72)	(801)
Sales discounts	(1,027)	(1,025)	(9,563)
Exchange gain (loss)	79	(47)	736
Loss on disposal or write-offs of inventories	(2,709)	(2,197)	(25,226)
Gain on sales of property, plant and equipment	6	1,310	56
Loss on disposal of property, plant and equipment	(118)	(1,993)	(1,099)
Other, net	404	(669)	3,761
Income before income taxes and minority interests	12,770	11,825	118,912
Income taxes (Note 13)**:**			
Current	6,024	5,993	56,094
Deferred	(56)	(779)	(521)
	5,968	5,214	55,573
Minority interests	(71)	66	(661)
Net income	¥ 6,731	¥ 6,677	$ 62,678

	Yen		U.S. dollars (Note 1)
Amounts per share:	2005	2004	2005
Net income	¥ 160.64	¥ 157.25	$ 1.50
Cash dividends	33.00	21.00	0.31

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2005 and 2004

		Millions of yen					
	Number of shares issued (Thousands)	Common stock	Additional paid-in capital	Retained earnings	Unrealized holding gain on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2003	28,350	¥ 3,450	¥ 4,183	¥ 42,142	¥ 843	¥ (574)	¥ (777)
Net income for the year				6,677			
Stock split	14,175						
Unrealized holding gain on securities					797		
Foreign currency translation adjustments						(114)	
Cash dividends				(591)			
Bonuses to directors and statutory auditors				(42)			
Net change in treasury stock							(1,540)
Balance at March 31, 2004	42,525	¥ 3,450	¥ 4,183	¥ 48,186	¥ 1,640	¥ (688)	¥ (2,317)
Net income for the year				**6,731**			
Unrealized holding gain on securities					**211**		
Foreign currency translation adjustments						**66**	
Cash dividends				**(874)**			
Bonuses to directors and statutory auditors				**(39)**			
Gain on sales of treasury stock			**1**				
Decrease in retained earnings resulting from inclusion and exclusion of consolidated subsidiaries				**(419)**			
Net change in treasury stock							**(15)**
Balance at March 31, 2005	**42,525**	**¥ 3,450**	**¥ 4,184**	**¥ 53,585**	**¥ 1,851**	**¥ (622)**	**¥ (2,332)**

	Thousands of U.S. dollars (Note 1)					
	Common stock	Additional paid-in capital	Retained earnings	Unrealized holding gain on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2004	$ 32,126	$ 38,951	$ 448,701	$ 15,271	$ (6,407)	$ (21,576)
Net income for the year			**62,678**			
Unrealized holding gain on securities				**1,965**		
Foreign currency translation adjustments					**615**	
Cash dividends			**(8,139)**			
Bonuses to directors and statutory auditors			**(363)**			
Gain on sales of treasury stock		**10**				
Decrease in retained earnings resulting from inclusion and exclusion of consolidated subsidiaries			**(3,901)**			
Net change in treasury stock						**(139)**
Balance at March 31, 2005	**$32,126**	**$38,961**	**$498,976**	**$17,236**	**$(5,792)**	**$(21,715)**

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2005 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
Cash flows from operating activities:			
Income before income taxes and minority interests	¥12,770	¥11,825	$118,912
Adjustments for:			
Depreciation and amortization	3,239	3,350	30,161
(Decrease) increase in allowance for doubtful accounts	(232)	1,159	(2,160)
Increase (decrease) in accrued retirement benefits	149	(59)	1,387
Interest and dividend income	(131)	(115)	(1,220)
Interest expense	86	72	801
Equity in earnings of affiliates	(391)	(280)	(3,641)
Loss on disposal or write-offs of inventories	2,709	2,197	25,226
Gain on sale of goodwill	(736)	(714)	(6,853)
Loss on sales or disposal of property, plant and equipment	118	2,458	1,099
Allowance for loss on devaluation of securities	188	332	1,751
Changes in operating assets and liabilities:			
Increase in trade notes and accounts receivable	(1,503)	(3,254)	(13,996)
Increase in inventories	(4,174)	(2,355)	(38,868)
Increase in trade notes and accounts payable	2,044	54	19,033
(Decrease) increase in consumption tax payable	(332)	129	(3,092)
Other	238	(1,492)	2,217
Subtotal	14,042	13,307	130,757
Interest and dividends received	131	118	1,220
Interest paid	(86)	(77)	(801)
Income taxes paid	(5,723)	(6,377)	(53,292)
Net cash provided by operating activities	8,364	6,971	77,884
Cash flows from investing activities:			
Payments for purchases of property, plant and equipment	(2,256)	(1,288)	(21,008)
Proceeds from sales of property, plant and equipment	26	2,391	242
Payments for purchases of intangible assets	(2,323)	(574)	(21,631)
Increase in investments in securities	(177)	(3,542)	(1,648)
Increase in other assets	(226)	(232)	(2,104)
Decrease in short-term loans receivable	62	274	577
Proceeds from sale of goodwill	736	714	6,854
Other	222	(101)	2,067
Net cash used in investing activities	(3,936)	(2,358)	(36,651)
Cash flows from financing activities:			
Decrease in short-term loans, net	(1,337)	(145)	(12,450)
Proceeds from long-term debt	–	212	–
Repayment of long-term debt	(1,144)	(2,508)	(10,653)
Dividends paid	(874)	(591)	(8,139)
Increase in treasury stock	(17)	(1,539)	(158)
Other	3	(3)	28
Net cash used in financing activities	(3,369)	(4,574)	(31,372)
Effect of exchange rate changes on cash and cash equivalents	41	(128)	382
Net increase (decrease) in cash and cash equivalents	1,100	(89)	10,243
Cash and cash equivalents at beginning of year	17,663	17,752	164,475
Increase in cash and cash equivalents resulting from change in number of consolidated subsidiaries	273	–	2,542
Cash and cash equivalents at end of year (Note 4)	¥19,036	¥17,663	$177,260

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries

1. Basis of Presentation of 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 generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards. The Company's overseas subsidiaries maintain their accounts and records in conformity with generally accepted accounting principles prevailing in their respective countries of domicile.

The accompanying consolidated financial statements have been prepared based on the consolidated financial statements of the Company and its subsidiaries (the "Group") 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 format which is more familiar to readers outside Japan. In addition, certain notes included herein are not required under accounting principles generally accepted in Japan but are presented as additional information.

The U.S. dollar amounts included herein are presented solely for convenience and are translated, as a matter of arithmetic computation only, at ¥107.39 = U.S.$1.00, the approximate exchange rate in effect on March 31, 2005. This translation should not be construed as a representation that Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at the above or any other 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. All significant intercompany transactions and accounts have been eliminated in consolidation. Investments in affiliates (companies over which the Company has the ability to exercise significant influence) are, with certain minor exceptions, accounted for by the equity method.

The difference between the cost and the underlying net equity in investments in consolidated subsidiaries and affiliates accounted for on an equity basis is allocated to identifiable assets based on their fair value at the respective dates of acquisition. Unallocated costs are deferred and amortized by the straight-line method over a five-year period, except for the difference related to Kiribai Chemical Co., Ltd. which is being amortized over a ten-year period.

The balance sheet date of certain consolidated subsidiaries is December 31. Any significant differences in intercompany accounts and transactions arising from intervening intercompany transactions during the period from January 1 through March 31 have been adjusted, if necessary.

In addition, the balance sheet date of one domestic consolidated subsidiary is September 30. For consolidation purposes, the financial statements of the subsidiary are prepared as of March 31 and for the year ended.

(b) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The actual results could differ from these estimates.

(c) Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits with banks withdrawable on demand, and short-term investments which are readily convertible to cash subject to an insignificant risk of any change in their value and which were purchased with an original maturity of three months or less.

(d) Foreign currency translation

Income and expenses denominated in foreign currencies are translated into Japanese yen at the exchange rates prevailing at the transaction dates. All monetary assets and liabilities denominated in foreign currencies are translated into Japanese yen at the rate of exchange in effect at the balance sheet date except for those items covered by forward foreign exchange contracts including currency swaps.

The balance sheet accounts of the overseas subsidiaries are translated into Japanese yen at the rate of exchange in effect at the balance sheet date except that the components of shareholders' equity are translated at their historical exchange rates. Income and expense accounts are translated at the average rate of exchange in effect during the year. Differences resulting from translating the financial statements of the overseas subsidiaries have not been included in the determination of net income, but are presented as foreign currency translation adjustments in the consolidated balance sheets.

(e) Investments in securities

Securities are classified into three categories; trading securities, held-to-maturity debt securities, or other securities. Trading securities, consisting of debt and marketable equity securities, are stated at fair value. Gain or loss, both realized or unrealized, is charged to income. Held-to-maturity debt securities are stated at their amortized cost. Marketable securities classified as other securities are carried at fair value with any changes in unrealized holding gain or loss, net of the applicable income taxes, reported as a separate component of shareholders' equity. Non-marketable securities classified as other securities are carried at cost.

If the fair value of other securities has declined significantly and the impairment in value is not deemed temporary, these securities are written down to fair value and the resulting loss is charged to income as incurred.

(f) Inventories

Commodities and raw materials are stated principally 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.

(g) Property, plant and equipment

Property, plant and equipment is stated at cost. The Company and its domestic subsidiaries calculate depreciation by the declining-balance method except for buildings (other than structures attached to the buildings) acquired after March 31, 1998, to which the straight-line method is applied. The overseas subsidiaries calculate depreciation by the straight-line method.

(h) Allowance for doubtful accounts

The Company and its domestic subsidiaries provide for doubtful accounts principally at an amount based on the historical bad debt ratio. In addition, an estimate of uncollectible amounts from certain specific doubtful receivables is provided.

(i) Reserve for sales returns

The Company and its domestic subsidiaries provide for sales returns based on the historical sales return ratio. The reserve for sales returns is included in other current liabilities.

(j) Accrued retirement benefits

The Company and two domestic consolidated subsidiaries have an unfunded defined retirement benefit plan and a non-contributory funded pension plan. Domestic consolidated subsidiaries other than the above two domestic consolidated subsidiaries also have unfunded defined retirement benefit plans for their employees. The unfunded defined retirement benefit plans provide for lump-sum payments to eligible employees who terminate their services which are determined by reference to their current rate of pay, length of service and the conditions under which termination occurs.

Certain overseas subsidiaries have funded defined contribution plans for their employees.

Accrued retirement benefits for employees of the Company and two domestic consolidated subsidiaries represent the estimated present value of the projected benefit obligation in excess of the fair value of the pension plan assets.

Domestic consolidated subsidiaries other than the above two domestic consolidated subsidiaries have adopted a simplified method of calculation. Under this simplified method, accrued retirement benefits for employees are stated at 100% of the amount which would be required to be paid if all eligible employees voluntarily retired at the balance sheet date.

Prior service cost is being amortized by the straight-line method over ten years which is a shorter period than the average remaining years of service of the participants.

Actuarial differences are amortized in the year following the year in which the difference is recognized by the straight-line method over ten years which is a shorter period than the average remaining years of service of the participants.

Directors and statutory auditors ("officers") are customarily entitled, subject to the shareholders' approval, to lump-sum payments under the unfunded retirement allowances plan. The provision for retirement allowances for these officers has been made at an estimated amount based on the Company's and consolidated subsidiaries' internal regulations.

(k) Allowance for loss on devaluation of securities

An allowance for loss on devaluation of securities is provided to cover possible future losses on investments in securities at a level determined by considering the financial position of the individual unconsolidated subsidiaries.

(l) Income taxes

Accrued income taxes are provided at the amount currently payable.

The Company and its consolidated subsidiaries have adopted interperiod income tax allocation by the assets and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences attributable to the differences between the tax bases of the assets and liabilities and the amounts reported in the consolidated financial statements.

(m) Leases

The Company and its subsidiaries lease offices and other facilities. Finance leases, except for those which transfer the legal title of the underlying property from the lessor to the lessee at the end of the lease term, are accounted for as operating leases.

(n) Research and development and computer software

Research and development costs are charged to income when incurred.

Expenditures relating to computer software developed for internal use are charged to income when incurred, except if they contribute to the generation of income or to future cost savings. Such expenditures are capitalized as assets and are amortized over their estimated useful life, customarily 5 years.

(o) Net income and cash dividends per share

Net income per share is calculated based on the net income available for distribution to shareholders of common stock and the weighted-average number of shares of common stock outstanding during the year.

On November 20, 2003, the Company made a three-for-two stock split by way of a free share distribution. If the stock split had been made at the beginning of the year ended March 31, 2004, the per share amount of net income for the year ended March 31, 2004 would have been ¥154.17.

Cash dividends per share reflected in the accompanying consolidated statements of income are the amounts applicable to each respective fiscal year.

(p) Appropriation of retained earnings

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by resolution of the shareholders at a general meeting held subsequent to the close of such financial period. The accounts for that period do not, therefore, reflect such appropriations (see Note 15 (2)).

(q) Derivatives and hedging activities

Derivative financial instruments, which include forward foreign exchange contracts, currency options, and interest-rate swaps, are used to offset the Group's risk of exposure to fluctuation in interest and currency exchange rates.

Derivatives are carried at fair value with any changes in unrealized gain or loss charged or credited to income, except for those which meet the criteria for deferral hedge accounting under which the unrealized gain or loss is deferred as an asset or a liability. When a forward foreign exchange contract meets certain criteria, receivables and payables covered by these contracts are translated at the contracted rates. When an interest-rate swap meets certain criteria, the net amount to be paid or received under the contract is added or deducted from the interest on the underlying hedged item.

The Company evaluates the effectiveness of its hedging activities by reference to the accumulated gain or loss on each hedging instrument and on the related hedged item from the commencement of the hedge.

(r) New Accounting Pronouncement

A Japanese accounting standard called "Impairment of Fixed Assets" was issued in August 2002, which went into effect for fiscal years beginning on or after April 1, 2005. Early adoption was allowed from fiscal years beginning on or after April 1, 2004 and application from fiscal years ending from March 31, 2004 through March 30, 2005 was also permitted.

This standard requires that tangible and intangible fixed assets be carried at cost less depreciation, and be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. A company is required to recognize an impairment loss in its statement of income if certain indicators of asset impairment exist and if the book value of an asset exceeds the undiscounted sum of its future cash flows.

3. Termination of Joint Business

Revenue from sale of distribution rights:

In March 2002, the Company and Medtronic Sofamor Danek Inc. terminated their joint business in Japan. As a consequence, the Company has received and will receive by installments the proceeds from the sale of the distribution rights in Japan. These revenues have been and will be recorded in the Company's books of accounts on a cash basis as follows:

	Thousands of U.S. dollars
In April 2005	$10,000
In April 2006	10,000
In April 2007	11,000
In April 2008	11,000

4. Cash and Cash Equivalents

A reconciliation of cash and time deposits in the consolidated balance sheets to cash and cash equivalents in the consolidated statements of cash flows is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Cash and time deposits	¥19,036	¥17,663	$177,260
Time deposits with original maturity of more than three months	–	–	–
Cash and cash equivalents	¥19,036	¥17,663	$177,260

5. Investments in Securities

Securities classified as "other securities" are summarized as follows:

(a) Securities whose carrying value exceeds their acquisition cost

	Millions of yen					
	2005			2004		
	Acquisition cost	Carrying value	Unrealized gain	Acquisition cost	Carrying value	Unrealized gain
Equities	¥ 684	¥3,805	¥3,121	¥591	¥3,415	¥2,824
Debt securities	2,503	2,509	6	–	–	–
	¥3,187	¥6,314	¥3,127	¥591	¥3,415	¥2,824

	Thousands of U.S. dollars		
	2005		
	Acquisition cost	Carrying value	Unrealized gain
Equities	$ 6,369	$35,432	$29,063
Debt securities	23,308	23,363	55
	$29,677	$58,795	$29,118

(b) Securities whose acquisition cost exceeds their carrying value

	Millions of yen					
	2005			2004		
	Acquisition cost	Carrying value	Unrealized loss	Acquisition cost	Carrying value	Unrealized loss
Equities	¥ 74	¥ 63	¥ (11)	¥ 79	¥ 70	¥ (9)
Debt securities	500	500	0	3,309	3,305	(4)
	¥ 574	¥ 563	¥ (11)	¥3,388	¥3,375	¥(13)

	Thousands of U.S. dollars		
	2005		
	Acquisition cost	Carrying value	Unrealized loss
Equities	$ 689	$ 587	$(102)
Debt securities	4,656	4,656	0
	$5,345	$5,243	$(102)

(c) Securities whose market value is not determinable

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Unlisted stock other than those traded on the over-counter market	¥285	¥595	$2,654
Investment trusts	222	174	2,067

(d) Redemption schedule for other securities with maturities

	Millions of yen		Thousands of U.S. dollars
Due	2005	2004	2005
Within one year	¥1,001	¥ 999	$ 9,321
After one year but within five years	2,008	2,307	18,698
	¥3,009	¥3,306	$28,019

6. Inventories

Inventories at March 31, 2005 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Commodities	¥ 9,164	¥ 7,628	$ 85,334
Finished goods	5,003	5,191	46,587
Raw materials, work in process and supplies	1,616	1,275	15,048
	¥15,783	¥14,094	$146,969

7. Short-Term Loans and Long-Term Debt

The average interest rates on short-term bank loans for the years ended March 31, 2005 and 2004 were 2.00% and 1.03%, respectively.

Long-term debt at March 31, 2005 and 2004 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Loans from banks with average interest rates of 1.29% for 2005 and 0.81% for 2004	¥ 972	¥ 2,114	$ 9,051
Less amounts due within one year	(630)	(1,209)	(5,866)
	¥ 342	¥ 905	$ 3,185

The aggregate annual maturities of long-term debt subsequent to March 31, 2005 are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2006	¥630	$5,866
2007	94	876
2008	80	745
2009	107	996
2010 and thereafter	61	568
	¥972	$9,051

Assets pledged as collateral at March 31, 2005 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Trade notes	¥ 137	$ 1,276
Land	2,123	19,769
Buildings and structures	1,080	10,057
Investments in securities	125	1,164
	¥3,465	$32,266

Secured liabilities at March 31, 2005 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Trade notes and accounts payable	¥8,312	$77,400
Short-term loans	180	1,676
Long-term loans	32	298
	¥8,524	$79,374

In order to achieve more efficient and flexible financing, the Company and its consolidated subsidiaries have concluded line-of-credit agreements with certain financial institutions and insurance companies. The status of these at March 31, 2005 was as follows:

	Millions of yen	Thousands of U.S. dollars
Lines of credit	¥33,103	$308,250
Credit used	450	4,190
Available credit	¥32,653	$304,060

8. Accrued Retirement Benefits

The following table sets forth the funded and accrued status of the plans, and the amounts recognized in the consolidated balance sheets at March 31, 2005 and 2004 for the Group's defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Projected benefit obligation	¥(11,701)	¥(10,602)	$(108,958)
Fair value of pension plan assets	3,769	2,861	35,096
Unfunded retirement benefit obligation	(7,932)	(7,741)	(73,862)
Unrecognized prior service cost	830	933	7,729
Unrecognized actuarial differences	1,094	599	10,187
Net retirement benefit obligation	(6,008)	(6,209)	(55,946)
Prepaid pension cost	(466)	(111)	(4,339)
Accrued retirement benefits for employees	¥ (6,474)	¥ (6,320)	$ (60,285)

The components of net pension cost for the years ended March 31, 2005 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Service cost	¥ 681	¥617	$6,341
Interest cost	201	224	1,872
Expected return on pension plan assets	(57)	(43)	(531)
Amortization of prior service cost	104	103	969
Amortization of actuarial differences	75	74	698
Pension cost	¥1,004	¥975	$9,349

The assumptions used in determining the actuarial present value of the projected benefit obligation at March 31, 2005 and 2004 were as follows:

	2005	2004
Discount rates	2.0%	2.0%
Expected rates of return on plan assets	2.0%	2.0%

9. Leases

The following *pro forma* amounts present the acquisition cost and accumulated depreciation of property leased to the Group at March 31, 2005 and 2004, which would have been reflected in the consolidated balance sheets if finance leases other than those which transfer the ownership of the leased property (currently accounted for as operating leases) were capitalized:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Machinery and equipment:			
Acquisition cost	¥ 8,185	¥ 8,300	$ 76,217
Accumulated depreciation	(4,878)	(4,312)	(45,423)
	¥ 3,307	¥ 3,988	$ 30,794
Furniture and fixtures:			
Acquisition cost	¥ 2,301	¥ 2,413	$ 21,426
Accumulated depreciation	(1,325)	(1,408)	(12,338)
	¥ 976	¥ 1,005	$ 9,088
Others:			
Acquisition cost	¥ 2,541	¥ 2,561	$ 23,661
Accumulated depreciation	(1,846)	(1,580)	(17,189)
	¥ 695	¥ 981	$ 6,472
Total	¥ 4,978	¥ 5,974	$ 46,354

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2005 for finance leases other than those which transfer the ownership of the leased property to the lessees are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2006	¥2,552	$23,764
2007 and thereafter	2,543	23,680
Total	¥5,095	$47,444

Lease payments related to finance leases accounted for as operating leases and depreciation and interest expense, which have not been reflected in the consolidated statements of income for the years ended March 31, 2005 and 2004 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Lease expenses	¥2,381	¥2,556	$22,172
Estimated depreciation expense	2,253	2,315	20,980
Estimated interest expense	105	129	978

10. Derivatives and Hedging Activities

The Company utilizes forward foreign exchange contracts, currency options and interest-rate swaps to reduce the risk of fluctuation in interest rates and foreign exchange rates. The Company has established a control environment which includes policies and procedures for risk assessment and for the approval, reporting and monitoring of transactions involving derivatives. The Company does not hold or issue derivatives for speculative trading purposes.

11. Shareholders' Equity

The Commercial Code of Japan (the "Code") provides that an amount equivalent to at least 10% of all cash appropriations of retained earnings be appropriated to the legal reserve until the sum of the legal reserve and additional paid-in capital equals 25% of common stock. The legal reserve is not available for dividends but may be used to eliminate or reduce a deficit by approval of the shareholders or may be transferred to common stock by resolution of the Board of Directors. The Code also stipulates that, to the extent that the sum of additional paid-in capital and the legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for appropriation by resolution of the shareholders. Retained earnings include the legal reserve provided in accordance with the provisions of the Code.

The legal reserve of the Company, included in retained earnings at March 31, 2005 and 2004, amounted to ¥330 million ($3,073 thousand).

In accordance with the Code, a stock option plan for directors, certain employees of the Company and certain subsidiaries was approved at the annual general meeting of the shareholders held on June 27, 2003. Under the terms of this plan, the issuance of 197,000 shares of common stock has been authorized. The eligible participants may purchase these stock options at 1.05 times the exercise price calculated as the average of the closing market price of the Company's shares on the Tokyo Stock Exchange for all trading for the month immediately preceding the month of the date of the grant. However, if the exercise price referred to above is less than the closing market price of the Company's shares on the Tokyo Stock Exchange on the day preceding the date on which the rights are granted, the closing market price is to be used as the exercise price. The lower limit of the exercise price has been determined at ¥2,620. The options become exercisable on July 1, 2005 and are scheduled to expire on June 30, 2008.

12. Selling, General and Administrative Expenses

The major components of selling, general and administrative expenses for the years ended March 31, 2005 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars
Account	2005	2004	2005
Sales promotion activities	¥ 4,715	¥ 4,395	$ 43,905
Freight and storage	8,059	7,741	75,044
Advertising	11,494	10,820	107,030
Salaries and bonuses	11,571	11,474	107,747
Office rent and other rental charges	2,705	2,717	25,189
External services	3,572	3,505	33,262
Research and development costs	2,115	2,010	19,695

13. Income Taxes

The Company and its domestic subsidiaries are subject to several taxes based on income which, in the aggregate, resulted in a statutory tax rate of approximately 40.6% and 42.0% for the years ended March 31, 2005 and 2004. The overseas subsidiaries are subject to the income taxes of their countries of domicile.

A reconciliation of the difference between the statutory tax rate and the effective tax rates in the accompanying consolidated statements of income is as follows:

	2005	2004
Statutory tax rates	40.6%	42.0%
Tax loss carryforwards of consolidated subsidiaries	3.2	5.2
Utilization of tax loss carryforward	—	(3.4)
Tax credits on research and development costs	(2.0)	(2.2)
Amortization of excess of cost over net assets acquired	2.1	2.0
Nontaxable dividend income	—	(1.6)
Expenses not deductible for tax purposes	1.6	1.5
Effect of changes in statutory tax rate	—	0.9
Equity in earnings of affiliates	(1.3)	(0.6)
Other	2.5	0.2
Effective tax rates	46.7%	44.0%

The tax effects of the temporary differences which gave rise to a significant portion of the deferred tax assets and liabilities at March 31, 2005 and 2004 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2005	2004	2005
Deferred tax assets:			
Accrued retirement benefit for employees	¥ 2,242	¥ 2,231	$ 20,877
Net operating loss carryforwards	1,750	1,166	16,296
Reserve for employees' bonuses	755	743	7,030
Accrued retirement benefits for directors and statutory auditors	527	544	4,907
Allowance for doubtful accounts	392	501	3,650
Accrued expenses	667	498	6,211
Accrued enterprise tax	262	326	2,440
Unrealized intercompany profits	276	272	2,570
Other	624	863	5,811
Gross deferred tax assets	7,495	7,144	69,792
Valuation allowance	(1,730)	(1,032)	(16,109)
Total deferred tax assets	5,765	6,112	53,683
Deferred tax liabilities:			
Unrealized holding gain on securities	1,017	1,142	9,470
Other	—	57	—
Total deferred tax liabilities	1,017	1,199	9,470
Net deferred tax assets	¥ 4,748	¥ 4,913	$ 44,213

14. Segment Information

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

The business segment information of the Company and its consolidated subsidiaries for the years ended March 31, 2005 and 2004 is outlined as follows:

	Millions of yen						
	2005						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations	Consolidated
I Sales and operating income							
Sales to third parties	¥67,525	¥128,356	¥16,056	¥ 3,771	¥215,708	¥ —	¥215,708
Inter-group sales and transfers	21,749	—	—	8,434	30,183	(30,183)	—
Total sales	89,274	128,356	16,056	12,205	245,891	(30,183)	215,708
Operating expenses	74,781	127,557	15,866	12,065	230,269	(30,260)	200,009
Operating income	¥14,493	¥ 799	¥ 190	¥ 140	¥ 15,622	¥ 77	¥ 15,699
II Assets, depreciation and capital expenditures							
Total assets	¥53,687	¥ 46,150	¥ 8,688	¥ 8,085	¥116,610	¥ 18,019	¥134,629
Depreciation	1,828	162	466	159	2,615	121	2,736
Capital expenditures	3,305	177	782	728	4,992	29	5,021

	Millions of yen						
	2004						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations	Consolidated
I Sales and operating income							
Sales to third parties	¥66,523	¥126,080	¥15,609	¥ 3,458	¥211,670	¥ —	¥211,670
Inter-group sales and transfers	20,532	—	—	8,401	28,933	(28,933)	—
Total sales	87,055	126,080	15,609	11,859	240,603	(28,933)	211,670
Operating expenses	72,424	125,545	14,964	11,706	224,639	(29,092)	195,547
Operating income	¥14,631	¥ 535	¥ 645	¥ 153	¥ 15,964	¥ 159	¥ 16,123
II Assets, depreciation and capital expenditures							
Total assets	¥51,968	¥ 43,320	¥ 9,082	¥ 7,334	¥111,704	¥ 16,622	¥128,326
Depreciation	1,765	208	408	149	2,530	132	2,662
Capital expenditures	1,648	500	173	83	2,404	37	2,441

	Thousands of U.S. dollars						
	2005						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations	Consolidated
I Sales and operating income							
Sales to third parties	$628,783	$1,195,232	$149,511	$ 35,115	$2,008,641	$ —	$2,008,641
Inter-group sales and transfers	202,524	—	—	78,536	281,060	(281,060)	—
Total sales	831,307	1,195,232	149,511	113,651	2,289,701	(281,060)	2,008,641
Operating expenses	696,350	1,187,792	147,742	112,347	2,144,231	(281,777)	1,862,454
Operating income	$134,957	$ 7,440	$ 1,769	$ 1,304	$ 145,470	$ 717	$ 146,187
II Assets, depreciation and capital expenditures							
Total assets	$499,926	$ 429,742	$ 80,901	$ 75,286	$1,085,855	$ 167,790	$1,253,646
Depreciation	17,022	1,509	4,339	1,480	24,350	1,127	25,477
Capital expenditures	30,776	1,648	7,282	6,779	46,485	270	46,755

Geographic Segment Information

Geographic segment information has been omitted because more than 90% of the consolidated sales were recorded in Japan and more than 90% of the assets are located in Japan.

Overseas Sales Information

Overseas sales information has been omitted because overseas sales, consisting of export sales of the Company and its domestic consolidated subsidiaries and sales of overseas consolidated subsidiaries, constituted less than 10% of the total consolidated sales.

15. Subsequent Event

(1) On April 1, 2005, a consolidated subsidiary, Kobashou Co., Ltd. (the "subsidiary"), acquired the OTC pharmaceutical wholesale business of Suzuken Co., Ltd. ("Suzuken") in exchange for new shares of common stock issued by the subsidiary.

The business divestitures are summarized as follows:

With respect to the business divestitures in the Kanto and Kinki areas, the subsidiary acquired the businesses in exchange for new shares of common stock issued by the subsidiary. With respect to the business divestitures in the Hokkaido and Tokai areas, Suzuken split into newly established companies, KS Hokkaido Co., Ltd. ("KS Hokkaido") and KS Tokai Co., Ltd. ("KS Tokai"), by spinning off the business. In connection with the spin-offs, KS Hokkaido and KS Tokai both issued new shares to Suzuken. The subsidiary exchanged its own shares of common stock for all shares of KS Hokkaido and KS Tokai owned by Suzuken.

The issuance of the new shares and the share exchanges referred to above are summarized as follows:

(i) In connection with the business divestitures in the Kanto and Kinki areas, the subsidiary issued 1,756 new shares of common stock to Suzuken as outlined above.

(ii) In connection with the business divestiture in the Hokkaido area, KS Hokkaido issued 200 new shares of common stock to Suzuken. In addition, the subsidiary exchanged 4.53 shares of its own common stock for one newly issued share of common stock of KS Hokkaido which is owned by Suzuken.

(iii) In connection with the business divestiture in the Tokai area, KS Tokai issued 200 new shares of common stock to Suzuken. In addition, the subsidiary exchanged 0.16 shares of its own common stock for one newly issued share of common stock of KS Tokai which is also owned by Suzuken.

As a result of the business divestitures outlined above, the subsidiary issued 2,694 shares of common stock to Suzuken and Suzuken currently owns 20% of the common stock of the subsidiary.

(2) The following appropriations of retained earnings of the Company, which have not been reflected in the consolidated financial statements for the year ended March 31, 2005, were approved at a general meeting of the shareholders held on June 29, 2005:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥33.00 = U.S.$0.2 per share)	¥1,374	$12,794
Bonuses to directors and statutory auditors	39	363

Report of Independent Auditors

ERNST & YOUNG SHINNIHON

■ Certified Public Accountants
Osaka Kokusai Bldg., 29th Floor
3-13, Azuchi-machi, 2-chome
Chuo-ku, Osaka, Japan 541-0052

■ Tel : 06 4964 6669
Fax : 06 6263 5170

The Board of Directors
Kobayashi Pharmaceutical Co., Ltd.

We have audited the accompanying consolidated balance sheets of Kobayashi Pharmaceutical Co., Ltd. and consolidated subsidiaries as of March 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kobayashi Pharmaceutical Co., Ltd. and consolidated subsidiaries at March 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

Supplemental Information

As described in Note 15(1), on April 1, 2005, a consolidated subsidiary, Kobashou Co., Ltd. acquired the OTC pharmaceutical wholesale business of Suzuken Co., Ltd. in exchange for new shares of common stock issued by the consolidated subsidiary.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2005 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1.

June 29, 2005

Ernst & Young Shin Nihon

Six-year Consolidated Financial Summary

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

	Millions of yen					
	2005	2004	2003	2002	2001	2000
For the Year						
Net Sales	¥215,708	¥211,670	¥210,922	¥204,647	¥185,001	¥180,731
Cost of Sales	143,912	141,388	141,675	139,404	123,140	121,739
Gross Profit	71,796	70,282	69,247	65,243	61,861	58,992
Selling, General and Administrative Expenses	56,097	54,159	53,394	51,613	48,054	46,121
Operating Income	15,699	16,123	15,853	13,630	13,807	12,871
Income before Income Taxes and Minority Interests	12,770	11,825	12,840	10,924	11,453	9,389
Net Income	6,731	6,677	6,606	6,595	6,020	4,822
Per Share Data (Yen)						
Net Income	160.64	157.25	231.25	232.64	212.34	170.8
Cash Dividends	33	21	21	18.5	17.5	15
Cash Flows from Operating Activities	8,364	6,971	12,046	4,039	3,961	7,306
Free Cash Flows	4,428	4,613	11,770	(2,892)	(817)	2,662
Depreciation and Amortization Expenses	3,239	3,350	3,480	2,598	2,157	1,921
Capital Expenditures*1	5,021	2,441	2,631	4,329	4,926	3,667
R&D Expenses	2,115	2,010	1,785	1,778	1,774	1,292
At Year-End						
Current Assets	86,705	80,031	77,315	72,759	64,849	69,248
Property, Plant and Equipment, Net	25,003	24,567	27,758	28,301	26,000	23,513
Current Liabilities	65,007	64,298	65,926	62,645	57,871	62,977
Long-term Liabilities	8,960	9,094	99,367	13,218	10,068	9,197
Shareholders' Equity	60,116	54,454	49,267	44,428	38,436	32,142
Total Assets	134,629	128,326	125,680	120,855	106,391	104,331
Working Capital	21,698	15,733	11,389	10,114	6,978	6,721
Interest-bearing Debt	3,034	5,417	7,859	9,196	3,461	8,432
Financial Ratios (%)						
As a percent of net sales:						
Gross Profit	33.3%	33.2%	32.8%	31.9%	33.4%	32.7%
Operating Income	7.3	7.6	7.5	6.7	7.5	7.1
Net Income	3.1	3.2	3.1	3.2	3.3	2.7
Current Ratio	133.4	124.5	117.3	116.1	112.1	110
ROE	11.7	12.9	14.1	15.9	17.1	19.2
ROA	5.0	5.3	5.4	5.8	5.7	5.1
Shareholders' Equity Ratio	44.7	42.4	39.2	36.8	36.1	30.8
Debt-equity Ratio (times)*2	0.05	0.10	0.16	0.21	0.09	0.26

*1 Capital expenditures as shown in Segment Information in the Notes to Consolidated Financial Statements.
*2 Debt-equity ratio: Interest-bearing debt at the fiscal year-end divided by Shareholders' equity.

Corporate Data / Investor Information

Corporate Data

(As of March 31, 2005)

- Corporate Name: KOBAYASHI PHARMACEUTICAL CO., LTD.
- Foundation: August 22, 1919
- Head Office: 3-6, Doshomachi 4-chome, Chuo-ku, Osaka 541-0045, Japan
- Representative Director: Yutaka Kobayashi, President (Appointed president on June 29, 2004)
- Number of Employees: 2,398 (Consolidated)
- Consolidated Subsidiaries: 22
- Non-consolidated Subsidiaries: 5
- Affiliates Accounted for by the Equity Method: 1

Investor Information

(As of March 31, 2005)

- Common Stock: ¥3,450 million
- Number of Shares Authorized: 170,100,000 (As of June 29, 2004)
- Number of Shares Issued: 42,525,000
- Number of Shareholders: 7,696
- Stock Exchange Listing: Tokyo Stock Exchange 1st Section, Osaka Securities Exchange 1st Section
- Transfer Agent: UFJ Trust Bank Limited
- Annual Shareholders' Meeting: June
- Investor Relations: KOBAYASHI PHARMACEUTICAL CO., LTD.
  Finance & Accounting Department
  Tel. 81-6-6222-0089
  Fax. 81-6-6222-0114
  E-mail: info@kobayashi.co.jp
  URL: http://www.kobayashi.co.jp/

Directors, Corporate Auditors and Officers


Chairman and Chief Executive Officer
Kazumasa Kobayashi


President and Chief Operating Officer
Yutaka Kobayashi


Senior Executive Director
Yoshiharu Shimatani


Senior Executive Director
Akira Horiguchi


Executive Director
Masaaki Tanaka


Director
Akihiro Kobayashi

Directors

Chairman and Chief Executive Officer
Kazumasa Kobayashi

President and Chief Operating Officer
Yutaka Kobayashi
(Senior General Manager, Product Business Headquarters)

Senior Executive Directors
Yoshiharu Shimatani
(Officer In-charge, Product Business Headquarters)

Akira Horiguchi
(Senior General Manager, Medical Device Business Headquarters)

Executive Director
Masaaki Tanaka
(Senior General Manager, Group Corporate Business Headquarters)

Director
Akihiro Kobayashi
(President, International Sales Company and Manager, Marketing Office)

Corporate Auditors

Statutory Auditors
Toshiyuki Morii

Tetsuo Nakata

Auditors
Hiroshi Hayashi

Ryuji Sakai

Executive Officers

Senior Executive Officers
Takashi Tsujino
(President, Research and Development Company)

Jyoji Miki
(President, Product Sales Company)

Executive Officers
Hiroshi Nomoto
(President, Kiribai Chemical Co., Ltd.)

Takafumi Sakaguchi
(President, Kobayashi Medical Division)

Hidetsugu Yamamoto
(President, Business System Company)

Satoshi Yamane
(Manager, Business Development Office; and Manager, Board Office)

Tomoharu Nagahara
(President, Manufacturing Company)

Haruyoshi Kosaka
(Officer In-charge, Wholesale Business Headquarters)

* Yutaka Kobayashi, Yoshiharu Shimatani, Akira Horiguchi, Masaaki Tanaka and Akihiro Kobayashi concurrently serve as executive officers.

(As of June 29, 2005)

KOBAYASHI PHARMACEUTICAL CO., LTD.

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