

Something **New**, Something Different

ANNUAL REPORT 2006

Year Ended March 31, 2006

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, Hong Kong and Germany.

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.

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

Forward-looking Statements

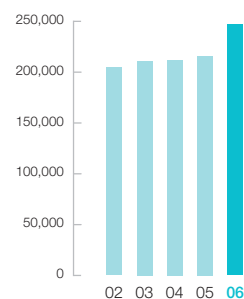
Plans, strategies, beliefs and other statements concerning future business operations of Kobayashi Pharmaceutical Co., Ltd. included in this annual report are forward-looking statements based not on historical facts but on management's assumptions and beliefs in light of information currently available. These forward-looking statements include risks, known and unknown, and uncertainties. Actual management achievements and business results may therefore differ significantly from forecasts in this annual report.

Consolidated Financial Highlights Years ended March 31

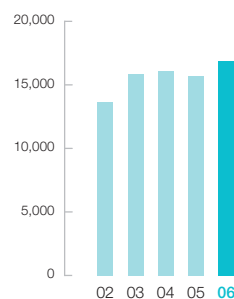
	2004	2005	(Millions of yen) 2006	(% Change)
For the Year				
Net Sales	¥ 211,670	¥ 215,708	¥ 246,853	14.4
Operating Income	16,123	15,699	16,880	7.5
Net Income	6,677	6,731	7,475	11.1
Per Share Data (Yen)				
Net Income	157.25	160.64	179.17	11.5
Shareholders' Equity	1,307.16	1,443.30	1,617.10	12.0
Cash Dividends	21.00	33.00	38.00	15.2
At Year-end				
Total Assets	128,326	134,629	151,945	12.9
Shareholders' Equity	54,454	60,116	66,812	11.1
Ratios (%)				Change
ROA	5.3	5.0	5.2	(0.2)
ROE	12.9	11.7	11.8	0.1
Shareholders' Equity	42.4	44.7	44.0	(0.7)

Note: 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.

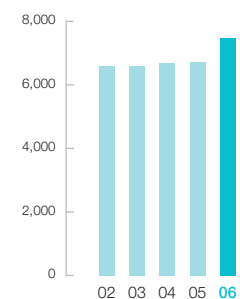
Net Sales
(¥ million)



Operating Income
(¥ million)



Net Income
(¥ million)



Eight Consecutive Years of Sales and Earnings Growth

In the fiscal year ended March 31, 2006, the Kobayashi Pharmaceutical Group once again achieved strong operating results. Consolidated sales and earnings rose for the eighth consecutive fiscal year since we started reporting consolidated business results. These impressive results were supported by growth across all of our businesses, including the mainstay Consumer Products Operation. Following the reorganization of our management structure in 2004, which involved the separation of supervision and business execution, we have been concentrating on creating a corporate culture that emphasizes execution. Emphasis has been put not only on embracing new challenges, but also on the importance of working with a firm resolve to the very end to achieve targets. These efforts are finally starting to deliver results.

Essence of Corporate Brand Strategy: Remain Truly Customer-Oriented

In April 2003, the Kobayashi Pharmaceutical Group adopted the brand slogan, “You make a wish and we make it real.” Guided by this slogan, we have been implementing corporate brand strategies to continuously enhance our corporate value. Stakeholders use a range of parameters to measure corporate value,

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.

but the essential one, in my view, is the perception of a company by its customers. Bringing satisfaction to customers leads to higher profits, ultimately enabling us to satisfy all stakeholders, including shareholders and employees. Aware of this, I believe that the essence of corporate brand management is to remain truly customer-oriented.

When we began corporate brand management initiatives, we created a brand charter through in-depth discussions with business headquarters and group companies. The brand charter reflects the beliefs of all group employees regarding the Kobayashi Pharmaceutical Group’s defining characteristics, our relationships of trust with society

and customers, our aspirations and corporate stance. Each frontline operation now formulates action plans as part of ongoing efforts to foster a change in the mindset of employees such that each and every employee feels encouraged to take action to raise the Group’s corporate value.

Corporate Brand Office – The Source of CSR Initiatives

In April 2006, Kobayashi Pharmaceutical established a Corporate Brand Office. Long before CSR (Corporate Social Responsibility) became a household word, Kobayashi Pharmaceutical had been working to define clear ethical standards, raise product quality, and reorganize operations from the standpoint of the global environment and local communities. We made tireless efforts in all of these areas, convinced that this was the best way to raise corporate value. In respect of compliance, for example, the president oversees all compliance issues as chairman of the Compliance Committee, in light of its importance. To ensure active debate and appropriate measures, important issues are delegated to the Experts Committee comprising external professionals such as lawyers. If deemed necessary, the Experts Committee reports its findings and recommendations to the Board of Directors. The Corporate Brand Office was established partly because we believe that such initiatives must be reported widely both within the Company and to the public.

Developing Human Resources Who Can Learn and Grow on Their Own

Human resources are another invaluable intangible asset alongside the corporate brand. Kobayashi Pharmaceutical has traditionally emphasized human resources development. However, we declared the current year to be the inaugural year of a major drive to nurture human resources, reaffirming our commitment to the importance we give to personnel. In a major shift in our approach to employee education and training, we are seeking to transform passive human resource development programs into systematic educational programs that encourage personnel to learn and grow on their own. For instance, our class for carefully selected next-generation management leaders uses Group-wide case studies to enhance their management capabilities. Each business headquarters has developed an easy-to-join, participation-oriented curriculum of programs designed to transfer technologies to the next generation.

Corporate Brand Management – An Unending Theme

Kobayashi Pharmaceutical's management policy defines the Company's mission as providing people and society with unsurpassed comfort through "Creativity and Innovation." Our brand charter and brand slogan serve as guidelines for continuously increasing corporate value by realizing our management policy. Therefore, as with our management philosophy, corporate brand management is a never-ending theme.

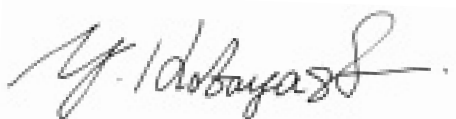
Fortunately, the Kobayashi Group has achieved sustained growth despite a challenging operating environment. It is easy to lose sight of budding problems when things are going well. We will therefore make sure that we do not fall into this trap. I will work tirelessly to maximize our corporate value and to ensure that we remain a company that contributes to society while satisfying shareholders and all other stakeholders.

I look forward to your continuing support in the years ahead.

July 2006



Kazumasa Kobayashi
Chairman and Chief Executive Officer



Yutaka Kobayashi
President and Chief Operating Officer



Kazumasa Kobayashi
Chairman and
Chief Executive Officer

Yutaka Kobayashi
President and
Chief Operating Officer



President and Chief Operating Officer **Yutaka Kobayashi**

Q.1

How did Kobayashi Pharmaceutical perform in the fiscal year ended March 31, 2006?

A. We have been able to sustain sales and earnings growth every year since we went public, including the fiscal year ended March 31, 2006. Earnings growth has also accelerated. I take that as proof that we have achieved our initial goals.

Manufacturing and sales operations have a decisive impact on the Group's operating results, particularly earnings, so I am happy to note that this segment performed well this year. Higher sales of our core product, deodorizing air fresheners, were a particularly important factor. We launched *Gin No Shoshugen*, a new deodorizing air freshener, and invested additional resources in marketing *Muko Kukan* and *Biko Kukan*, both of which are already established brands. We believe that these steps increased overall deodorizing air freshener sales.

Another factor was sales growth of 8% in priority pharmaceuticals categories, driven by the strong performance of *Inochi No Haha A*, a general-use medication for women's health launched in June 2005. Furthermore, last year's cold winter in Japan lifted sales at subsidiary Kiribai Chemical Co., Ltd., which is engaged in the production and sale of body warmers, to a record high. Last year, we also launched *Hananoa*, a nasal cleaning fluid that can be likened to the new concept of a "nose gargle." This product garnered a strong response from customers. It can be used to rinse pollen from the nose and regular rinsing will also help to prevent common colds. Promotions of both uses of this product proved highly successful during the past fiscal year.

On the other hand, we have several issues to deal with, the most important of which is creating a corporate culture that emphasizes execution. Kobayashi Pharmaceutical has traditionally been willing to embrace new challenges. However, the spirit of working with a firm resolve to the very end to achieve targets, the essence of an execution-driven culture, has yet to take sufficient root. In an extremely chal-

lenging and competitive operating environment where it is difficult to get ahead in terms of IT, business tactics or strategies, a company that can see through to the end what it starts emerges as the winner. This may sound a bit extreme, but I sometimes tell the company that 5% planning will suffice, as long as you ensure that the execution part, the remaining 95%, is implemented to the full.



Q.2

My second question is about concrete strategies for each operating segment. What benefits have you reaped from the new R&D framework for the Consumer Products Operation, which has been in place for about a year now?

A. In April 2005, we introduced a new R&D framework called Category Development, switching to a system of six product development categories. These categories cover pharmaceuticals, oral care, foods, sanitary products, deodorizing air fresheners, detergents and sundries. Key product development managers, including brand, product, R&D, and technology development managers, have been allocated to all six categories, bringing all key brand development and incubation functions to each category. In parallel with introducing the new R&D framework, senior management will now attend monthly presentations of ideas for new products. This means I will attend presentations given by the heads of each of the six product categories every month. Around three ideas in each product category will be presented at each meeting. I will approve decisions to proceed with commercialization on the spot to expedite product development.

One particularly noteworthy benefit has been that the new system has fueled stronger competition between categories. People working in one category are motivated if they see that more ideas from other categories are being accepted for development than their own. The system is thus a positive stimulus for a healthy inter-category rivalry. Another important development is regular idea presentations. These have become not only a source of new products but have also spawned new ideas. For example, suggestions may be made on how to renew a product in a particular way or how to extend a brand in a new direction to capture a new market. In these and other ways, Kobayashi Pharmaceutical is already benefiting from the new Category Development system.

Q.3

How will your Web marketing and M&A strategies unfold?

A. The number of people using the Web in their daily life is increasing at a much faster rate than we expected. In Japan, Web-based annual sales already exceed ¥5.5 trillion, a figure rivaling the performance of the convenience store sector. Unfortunately, we have remained at a distance from this huge Web-based market, even though we are a consumer products company.

With this in mind, we have appointed a Web marketing manager. When I tried out a blog site, I was surprised to find a lot of meaningful content about our products. The Web really is a treasure trove for any marketing professional. It has made me acutely aware that Kobayashi Pharmaceutical must use a diverse array of new media formats to get closer to consumers.

M&A is an effective means of implementing our growth strategy. Rather than conducting M&As blindly, our M&A strategy will be guided by two fundamental policies. First, any M&A initiative must generate returns commensurate with investments. To accomplish this, we will employ internal benchmarks for valuing potential acquisition targets against the cost of capital. We will not invest in any company that does not satisfy these benchmarks. Second, we will not invest in businesses that will not capture syner-

gies with our established businesses. By synergies, I mean the ability to make use of the Company's sales channels or having the same customers. These are the two basic criteria we will use to actively acquire companies and brands.

With respect to equity-based alliances, we acquired a 33.4% equity interest in Ito Pharmaceutical Co., Ltd., which is engaged in the production and sale of pharmaceuticals and health foods. Kobayashi Pharmaceutical and Ito Pharmaceutical are both engaged in the production and sale of nutritional supplements. However, Ito Pharmaceutical has two excellent production facilities in China. This could bring significant benefits if we could outsource production of our nutritional supplements to China at a lower cost than we could achieve through in-house production or through our existing OEM suppliers. Since we intend to actively develop businesses in China, we could have products for the Chinese market manufactured at Ito Pharmaceuticals' plants in China.

With respect to joint ventures, we concluded an agreement to form a joint venture with Toyo Shinyaku Co., Ltd. in March 2006. This company expanded its operations by focusing on the development of health foods and by obtaining approval of its products as designated health foods. With 44 products certified as designated health foods as of June 2006, Toyo Shinyaku is the largest producer of such foods in Japan. The main consideration of this joint venture is to combine Toyo Shinyaku's competitive position with our marketing and sales prowess.

Q.4

Tell us about Kobayashi Pharmaceutical's plans for overseas expansion.

A. Our overseas strategy centers on three regions: China, the U.S. and Europe, where the U.K. is our core market. We are putting the highest priority on China, for good reason. China has a large population and strong prospects for continued growth in consumer spending. Affluent consumers in China, representing about 10% of the total population of 1.3 billion, have living standards higher than those of the Japanese. That ten percent alone is equivalent to Japan's population. In other words, we can hardly ignore the fact that there is a market as big as Japan just across the sea from us.

In the UK, Boots, a major retail chain with a 40% share of the retail sector, has been one of our customers for the past three or four years. The relationship has developed to a point where this chain now actively handles our products, leading to steady growth in our business.

In the U.S., we have refocused our marketing strategy by, for example, shifting advertising from TV commercials to newspapers and magazines to improve the visibility of our brands. Now we are looking at M&As as an option for establishing a foothold for further expansion.

Q.5

Regarding nationwide expansion of the Wholesale Operation, what are your plans for regions where Kobayashi Pharmaceutical does not have a presence at this point?

A. The Wholesale Operation must squarely face ongoing industry realignment in the distribution sector.



We remain committed to expanding the scale of our operations through mergers and alliances. As a first step, we focused on peer companies in the wholesale sector. Next, we plan to seek opportunities for alliances with wholesalers in different business sectors. In fact, we have already seen mergers between wholesalers handling ethical drugs and wholesalers specializing in cosmetics and daily necessities. Our wholesale subsidiary, Kobashou Co., Ltd., will continue to seek out opportunities for mergers and alliances.

Q.6

What is your approach to manufacturing in the Medical Devices Operation?

A. Our operations are currently focused on trading, primarily the import of pharmaceutical products from the U.S. and Europe for marketing and sales to hospitals in Japan. This strategy has risks. If a supplier in the U.S. or Europe merges with or is acquired by another company, the new owner may decide not to market the products through our channel. We want to hedge against this risk by transforming ourselves into a manufacturer.

We started to develop products in-house two years ago. In the fiscal year ended March 31, 2006, we launched 2 products under our proprietary *Kobamed* brand, compared with 4 products in the previous fiscal year. A three-year plan is currently being implemented to raise the share of Kobayashi Pharmaceutical brand products relative to total sales to between 20% and 25% by the fiscal year ending March 31, 2008, the final year of the plan.



Q.7

What are your policies on returning profits to shareholders, including dividend payments and other means of profit sharing?

A. The dividend payout ratio in the sector in which we operate is in the range from 20% to 40%. We intend to keep our dividend payout ratio in this range, while making aggressive investments to spur growth.

Recently, the founding family of Kobayashi Pharmaceutical sold some of their holdings in the company. This move was intended to increase the free float, since it is still small. Another goal was to increase the number of individual shareholders. As of the end of March 2006, we had only around 6,900 individual shareholders. I want to see this number rise to at least 10,000, or up to 12,000 if possible.

Q.8

What is your outlook for the fiscal year ending March 31, 2007?

A. We have set slightly ambitious targets for the fiscal year ending March 31, 2007, based on progress with growth strategies set forth by management policies and projections of steady sales of products launched this spring.

We only bring to market products that we believe will make consumers' wishes come true. Our confidence in these products has not been misguided. Rather, it has been rewarded by strong customer acceptance, which has supported our sales.

We remain committed to maximizing corporate value by creating unique products and services, as we make a group-wide effort to satisfy the expectations of all stakeholders. I look forward to the continued support and guidance of stakeholders as we work to achieve our goals.

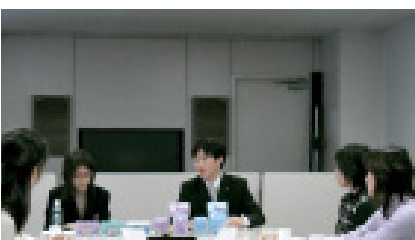
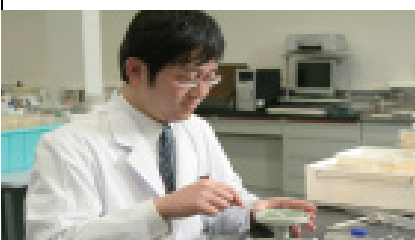


Horizontal Cooperation Essential to Developing Products That Win Customer Acceptance

Timely product development backed by marketing prowess is Kobayashi Pharmaceutical's prime competitive strength and its lifeline. Our unwavering commitment to sustaining and honing this strength has convinced many customers that we are a company that continually brings unique products to market.

Developing products that are well received by customers begins with the refinement of the product concept and progresses to defining a clear product concept, commercialization through R&D, cost and quality control at the production stage, and sales based on a marketing plan. Successful implementation requires full use of the expertise of each process manager, and close cooperation among one another.

Kobayashi Pharmaceutical redefined its product development system in April 2005 to further strengthen the above framework. The updated approach is based on "Category Development," in which marketing, product development, research, and technology development divisions are incorporated into a single unit to develop new products in each category. Product development lacks effectiveness if each division involved in the development process works independently of the others, and leads to issues such as poor communication or different approaches taken toward products by various divisions. Instead of a vertical hierarchy, a framework that brings together divisional heads horizontally at the product category level ensures that views are shared at all stages of development, from product planning to sales.



Integrated Category-based Product Development Encompassing Development to Brand Incubation

In April 2005, we switched to a system of six product categories for developing products. These cover pharmaceuticals, oral care, foods (nutritional supplements), sanitary products, deodorizing air fresheners, detergents and sundries. A team of brand managers, product development managers, researchers and technology development managers is put together to develop new products in each product category and to strengthen existing brands in their respective categories. A product category manager is appointed for each product category.

Product category teams are responsible for developing new products while keeping a watchful eye over market conditions and developments in each category. These teams also conduct product line extensions for existing brands and product renewals in their respective categories. This system enables each and every member of the team to know exactly how products are positioned relative to the category as a whole. By developing new products and nurturing existing ones under an integrated system, Kobayashi Pharmaceutical aims to further enhance its brands.

New Product Development System

Integrated organizational structure by category

Drugs/Sanitary Department			Daily Goods Department		
Pharmaceuticals	Oral Care	Foods	Sanitary Products	Deodorizing Air Fresheners	Detergents and Sundries
Brand Manager	Brand Manager	Brand Manager	Brand Manager	Brand Manager	Brand Manager
Product Development Manager	Product Development Manager	Product Development Manager	Product Development Manager	Product Development Manager	Product Development Manager
R&D	R&D	R&D	R&D	R&D	R&D
Technology Development	Technology Development	Technology Development	Technology Development	Technology Development	Technology Development

Category-based Product Development System Enhances Employee Capabilities

When an integrated team takes responsibility for nurturing a product from its gestation period through start-up, launch and growth, it naturally feels greater enthusiasm for the product. Exchanges of opinions between the R&D manager and the marketing manager often bring to light customer perceptions that had gone unnoticed or inspire a new product development idea. Thus, an active involvement in areas other than one's specialization deepens expertise and cultivates a broader outlook. We are also considering exchanging personnel across categories as a means of broadening their specialization.

By taking the significance of the marketing viewpoint into consideration, our new product development system will further boost our core capabilities in developing strong-selling products that reflect customer preferences, giving form to our brand slogan "You make a wish and we make it real." In only its first year, the new system has reinvigorated the product development process and promoted a healthy rivalry between categories. In these and other ways, we believe that the new system is steadily starting to yield results.

Participation of Top Management in Idea Presentations Speeds Up Product Development

In parallel with the introduction of the Category Development system, we have begun holding monthly presentations of new ideas for products. New ideas from each category are presented to five top executives: the president, Research and Development Company president, Product Sales Company president, Manufacturing Company president and Marketing Office manager. Decisions on whether to approve or reject an idea for development or to further investigate its technical feasibility are made immediately at these meetings.

Management participation in decision-making at such an early stage allows Kobayashi Pharmaceutical to realize the speedy product development essential for launching products that meet market needs. Because decisions are made on the spot at these presentations, the category team members work very hard to come up with good ideas. At category team-level meetings, marketing managers, product development managers, researchers and technology development managers propose ideas for developing new products that reflect their respective backgrounds. Through extensive discussions at these meetings, ideas are refined until they finally give rise to highly innovative, unique products.



Idea presentation

Idea Presentations

The following 18 products were launched in spring 2006. Targeted net sales for these new products in their first fiscal year are ¥9.3 billion.



Nicitol 85



Faiti



Fukidia



Anmercin Plaster DX



Partialdent Disinfecting and Cleansing solution



Dental Dr. Micro-flossing brush



Speed Breathcare



Easy Collagen



Chitosan Ashitaba Aojiru



Small and Unnoticeable Underarm Pad



Hot Clear



Sarasarty Ultra-breathable Sheets



Netsusama Cooling Belt for the Neck



Push-pon



Odor Removing Fan de Rich



Deodorizing Byubyutto Drain Cleaner



Clear



Bluelet Toilet Bleach

Feature 2 Overseas Marketing Strategy (in China)



Shanghai Kobayashi
Daily Chemicals Co., Ltd.
Fujito Owaki
General Manager

Targeted Marketing and Quality Are Crucial in China

Kobayashi Pharmaceutical's overseas strategy centers on East Asia, the U.S. and Europe. Of these regions, East Asia, where China in particular is experiencing remarkable economic growth, has been positioned as the overseas market with the highest priority. Shanghai, where our local Chinese subsidiary is headquartered, is a large, modern metropolis with a population of 17 million. As a central driving force of the development of the Chinese economy, the city sets the pace for the rest of China in various fields. Meanwhile, looking across China, overall economic growth of around 10% is once again projected for the fiscal year ending March 31, 2007. However, growing disparity in income levels between high- and low-income earners, among other factors, presents us with challenges in terms of expanding our business locally.



Deodorizing air fresheners



Body warmers



Cooling gel
sheets



Breath care
products

That's why we have increasingly focused our marketing strategies on affluent and middle-income consumers. Chinese consumers have very discriminating spending habits. They have a strong preference for, and are willing to spend money on, high-quality products. Inexpensive, low-quality products is not the way to go. For example, *Sawaday* (sold as *Shang Fa Rei* in China), which is currently priced at 14 yuan, would have to be sold at around 5 yuan to appreciably expand our business. But such a large price reduction is close to impossible, and it is doubtful whether it would stimulate commensurate growth in market demand anyway. Therefore, I believe it is crucial that we bring to market high-quality Japanese products even if they are slightly more expensive.

Steady Sales Area Expansion With an Eye on Cost Performance

Established in 1998, Shanghai Kobayashi Daily Chemicals Co., Ltd. currently has 45 salespeople throughout China, including 15 in Shanghai. China has four directly administered cities: Shanghai, Beijing, Chongqing and Tianjin; two Special Administrative Regions: Hong Kong and Macao; four autonomous regions; and 24 provinces. Shanghai Kobayashi Daily Chemicals covers the four directly administered cities, one autonomous region and 14 provinces. (Kobayashi Pharmaceutical (Hong Kong) Co., Ltd is responsible for the two Special Administrative Regions; provincial capitals serve as hubs for existing operations in the 14 provinces.)

The immediate goal of Shanghai Kobayashi Daily Chemicals is to achieve profitability in 2008 on a full-year basis. To this end, as we drive further sales growth, we plan to expand our presence to 16 provinces, in parallel with extending operations from provincial capitals to neighboring cities and increasing our sales force from 45 to around 80 individuals. However, with the large disparity in economic development and income levels across various regions in China, it is crucial that we scrutinize cost performance. Our basic policy is to move into regions before competitors and capture the No. 1 market share in each product category. By keeping a watchful eye on advertising returns and carefully studying sales patterns at retail outlets by offering products on a trial basis, we will invest in expanding our operations while minimizing risks.



Shanghai Kobayashi Daily Chemicals Co., Ltd.



Production line

Regarding sales channels in China, we are putting the highest priority on hypermarkets, as they have the power to attract the most customers and the greatest sales. Furthermore, Shanghai and neighboring areas have more than 5,000 convenience stores, promising further growth as a channel for sales of daily goods and other products. With respect to pharmacies, because personal face-to-face sales are still common, we are hoping for deregulation to promote the emergence of drugstore-type outlets and OTC pharmaceutical sales.

Deodorizing Air Fresheners Positioned as Core Product Category; Rapid Growth Projected for Body Warmers

The Chinese market is entering a stage where full-fledged demand is set to emerge for deodorizing air fresheners, body warmers and cooling gel sheets, all of which have excellent growth potential. Of these products, deodorizing air fresheners currently represent the largest proportion of sales in China. However, in this product category, we need to offer four fragrances for each brand, for a total of eight products when refills are included. While we have continued to release new brands every year to expand our product lineup, we have decided to shift our emphasis from volume to quality to achieve profitability as shelf space at stores in China is very expensive. Our current policy therefore emphasizes strengthening three of our existing brands.

Sales of body warmers in China increased at least twofold in the fiscal year ended March 31, 2006, the third year these products have been on the market. Because the Chinese have traditionally used hot water bottles as body warmers, only 1% of consumers were aware of the availability of disposable body warmers when these products initially went on sale. However, the recognition rate in Shanghai shot up to 80% in just two years after sales began. This growth has triggered increasing competition, with new players entering the market. To retain our position as the No. 1 manufacturer in this product category, we must bring to market new products that are distinct from those of rivals.

Cooling gel sheets are still at a stage where we need to work on winning more market recogni-



Products displayed in a store

tion. To accomplish this, we are working hard on various initiatives, including securing prominent shelf space in stores, effectively distributing trial samples, and formulating sales strategies for the summer. Furthermore, in May 2006, we began sales of a breath care product in Shanghai. We are looking forward to seeing how this new product will be received by the Chinese market. We are making company-wide efforts to expand sales of this breath care product, with the goal of making it a resounding success.

Building a Strong Presence in China

The Chinese economy is growing at what some call “quadruple speed”—at a pace four times faster than any other industrialized country where economic growth is much slower. Ideally, this means that Shanghai Kobayashi Daily Chemicals should conduct business operations, including initiatives to grow sales and decision-making, four times faster than in Japan to keep up with economic growth. The watchwords “Simple, Clear and Speed,” which are enshrined in the Group’s Code of Conduct, embody a crucial tenet transcending national boundaries. Shanghai Kobayashi Daily Chemicals has adopted these watchwords as a key policy in China. We expect Chinese economic growth to accelerate, stimulated by upcoming major events such as the Beijing 2008 Olympic Games and the Shanghai World Expo in 2010. Determined to outpace this growth, Shanghai Kobayashi Daily Chemicals will continue to spur expansion in step with the development of China.

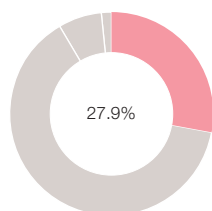


Products displayed in a store

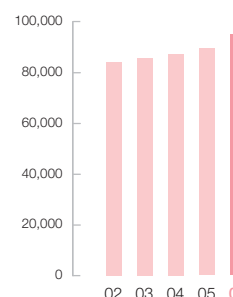
Business Segments at a Glance

Consumer Products Operation

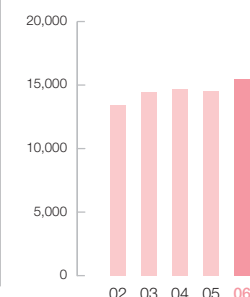
Share of Sales (%)



Sales (¥ million)



Operating Income (¥ million)



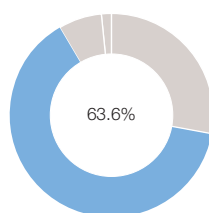
Main Group Companies

- Kobayashi Pharmaceutical Co., Ltd.
- Sendai Kobayashi Pharmaceutical Co., Ltd.
- Toyama Kobayashi Pharmaceutical Co., Ltd.
- Ehime Kobayashi Pharmaceutical Co., Ltd.
- Kiribai Chemical Co., Ltd.
- Kobayashi Healthcare LLC.
- Kobayashi Healthcare Europe, Ltd.
- Kobayashi Healthcare Germany GmbH
- Shanghai Kobayashi Daily Chemicals Co., Ltd.
- Kobayashi Pharmaceutical (Hong Kong) Co., Ltd.
- Itoh Kanpo Pharmaceutical Co., Ltd.

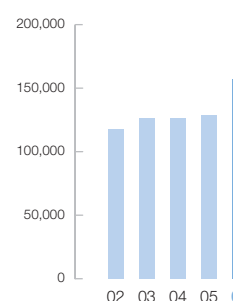
Kobayashi Pharmaceutical is working to speed up product development in its mainstay Consumer Products Operation. To this end, an integrated product development and incubation system called the Category System was launched in April 2005. In parallel, top management is now involved in Idea Meetings from the earliest stages of product development. We aim to continually unveil innovative products that have a strong impact on consumer markets, as we strive to raise the contribution of new products to sales. Notably, 18 new products were rolled out in spring 2006, an all-time high for us. We are currently putting emphasis on the healthcare categories of pharmaceuticals, oral hygiene products, and foods in particular. Efforts are also focused on M&As, including acquisitions of brands and companies. Overseas, we will strive to strengthen sales centered on body warmers in China, our top priority market.

Wholesale Operation

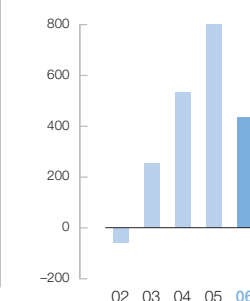
Share of Sales (%)



Sales (¥ million)



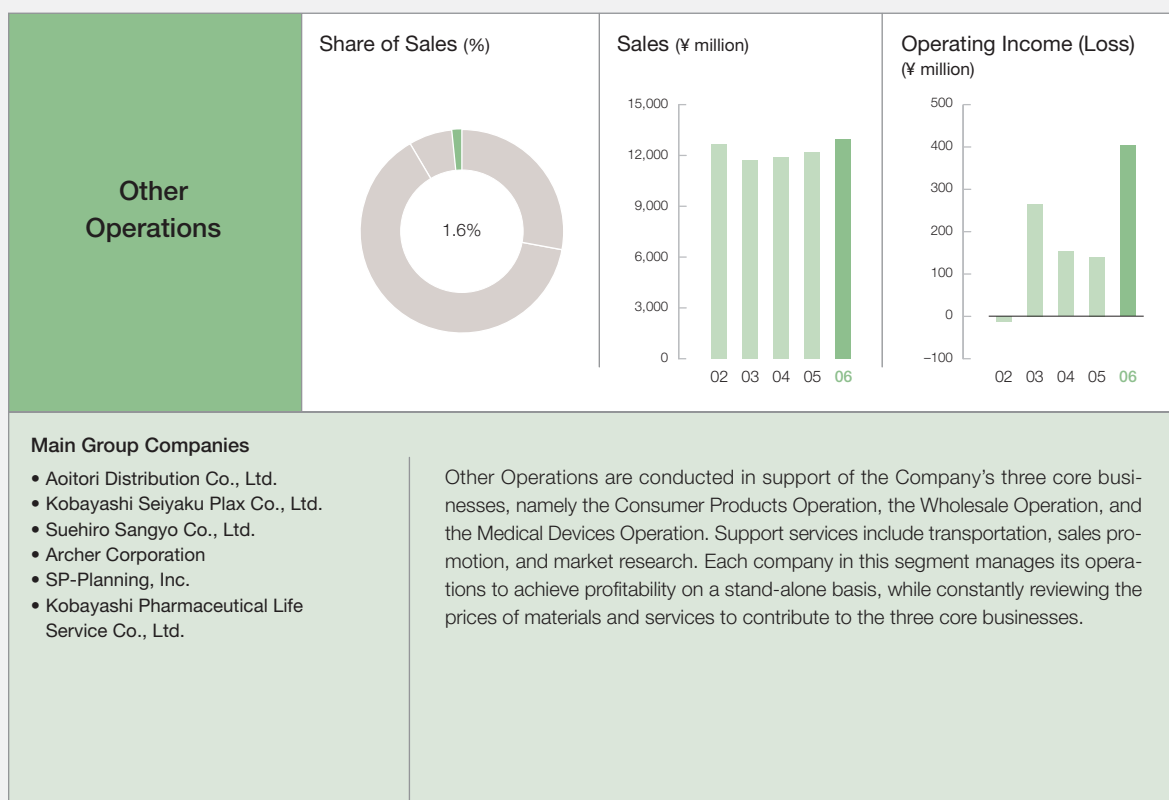
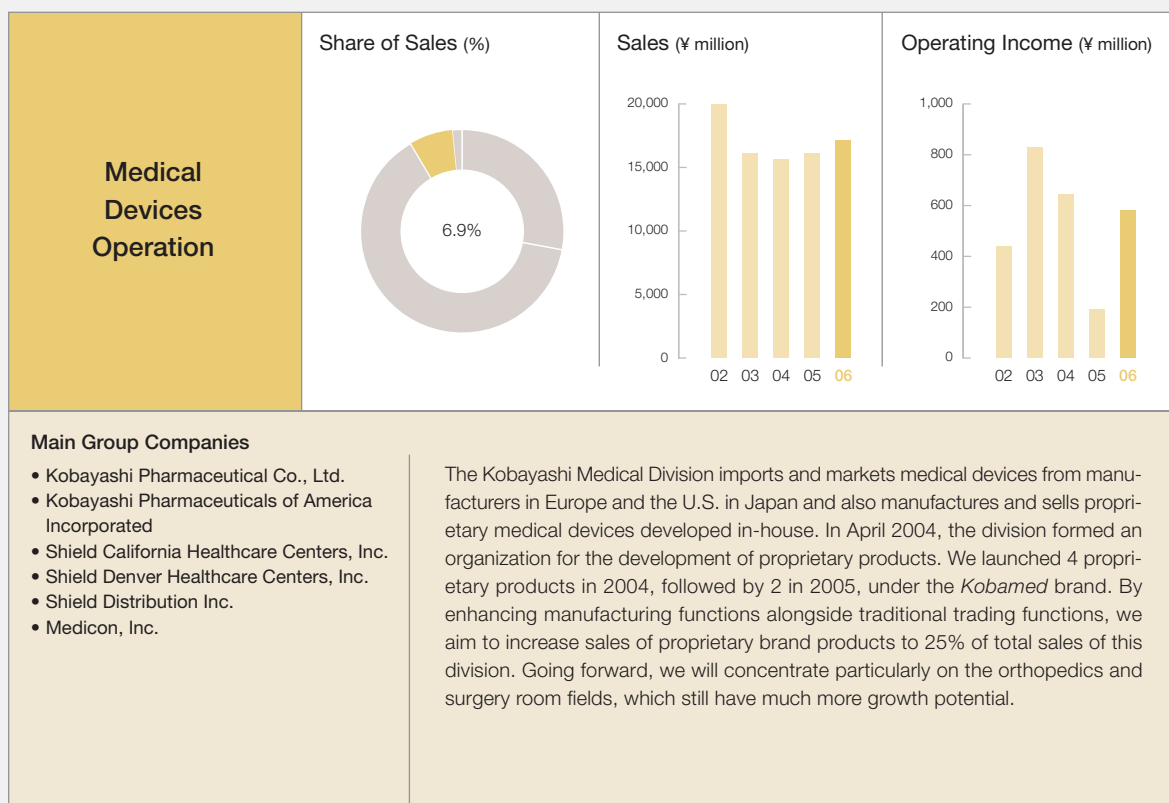
Operating Income (Loss) (¥ million)



Main Group Companies

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

In 2001, Kobayashi Pharmaceutical spun off its wholesale operation to form Kobashou Co., Ltd. In 2005, Kobashou formed an equity-based business alliance with Suzuken Co., Ltd. This move established Kobashou as the largest OTC drug wholesaler in Japan and expanded its sales area to Hokkaido and Chubu, regions not formerly covered by the company. Since April 2006, we have made progress with assembling a nationwide sales network, with the establishment of a new operating base in the Tohoku region. With the view to actively forming alliances with companies within and outside its industry, Kobayashi Pharmaceutical will continue to pursue integration and greater efficiency in systems and logistics. The overriding goal is to increase annual sales from the Wholesale Operation to ¥300 billion.



Note: The share of sales for each segment is calculated based on sales to external customers.

Ensuring That Products are Easily Understood by Consumers

The Consumer Products Operation, Kobayashi Pharmaceutical's mainstay business, has cemented a strong position in consumer product markets through the development and sales of highly unique products. Our strategy seeks to capture the No. 1 share of growing markets by carving out niche markets at the earliest stage. In essence, this entails creating new markets for products that fulfill overlooked or unsatisfied customer needs.

Our marketing strategy, the other side of our niche-market strategy, focuses on making it easy for consumers to understand our products. One highly praised aspect of Kobayashi Pharmaceutical is the fact that we create memorable product names that enable consumers to immediately identify products with their applications and functions. Our packaging, naming and advertising strategies give top priority to making it easy for consumers to understand our products.

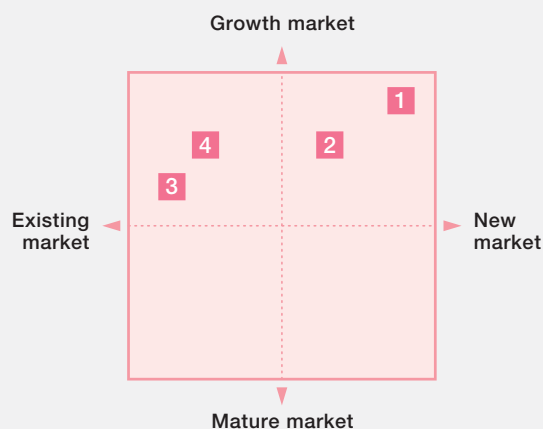
Brand Management with a Streamlined Portfolio

Our products fall into four types:

- 1 Products for Creating New Demand: Development of entirely new products, never before seen in the market, and creation of new markets in the process.
- 2 Products for Expanding Existing Demand: Powerful products brought to emerging markets to promote fast expansion.
- 3 Products for Taking on Competitors: Products that protect existing offerings from those of rival companies when new players enter cultivated markets.
- 4 Products for Brand-based Line Extension: The addition of value to existing products under a single brand in a way that expands the lineup and further reinforces the brand.

Representative products include *Hananoa*, a nasal cleaning fluid that can be likened to a “nose gargle” that removes contamination and pollen from deep inside the nose. This is a category (1) product that has created an entirely new market. *Gin No Shoshugen*, a deodorizing air freshener with enhanced anti-bacterial and deodorant properties, is a category (3) product introduced to take on new products from competitors. *Eyebon Torori Meyaku Dry Eye*, a viscous eye-drop to moisten dry eyes, is a category (4) product that extends and strengthens the established *Eyebon* brand.

Strategy Portfolio



In these and other ways, we raise the return on invested capital and execute concentrated sales promotion activities through strategies that carefully position each brand. Brand managers are entirely responsible for overall brand management, including brand development and sales promotion, and for ensuring sales and profit through the timely withdrawal or renewal of unprofitable products.

“Mother Concept” Development

The “Mother Concept” approach to development helps us to deliver attractive brands. The idea is to analyze major social trends over the medium and long terms, anticipate consumers’ future needs, and then establish themes called “Mother Concepts” that define areas where products should be placed. One such “Mother Concept” is the treatment of menopause-related problems, where we are carrying out product development incorporating a range of perspectives, from treatment to prevention, beauty care and mental care. The acquisition of exclusive sales agency rights to *Inochi No Haha A*, a general-use medication for women’s health issues, is positioned as part of this strategy. The “Mother Concept” approach to development meshes well with our policies geared to niche marketing.

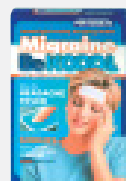
Mother Concept Development (Menopause Care)



Overseas Operations

Kobayashi Pharmaceutical has positioned the development of overseas markets as a priority issue. Accordingly, we established local marketing subsidiaries in China, Hong Kong, the U.S. and U.K. In April 2006, a subsidiary was established in Germany to expand geographic coverage in the European market. In Europe, we have started marketing *Netsusama Sheets*, cooling gel sheets for children and grown-ups, under the BeCOOL brand.

Overseas operations currently make only a small contribution to operating results. However, as Japan’s population has begun to decline, a key strategy will be to enter and expand operations in overseas markets to achieve higher growth.



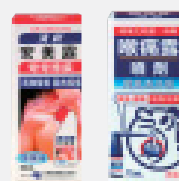
U.S.



U.K.



Germany



Hong Kong

Aggressively Pursuing M&As

The Kobayashi Pharmaceutical Group views M&As as an effective means of achieving sustained growth. In March 2004, the Company established a Growth Strategy Office directly under the president that is dedicated to pursuing M&As, with the aim of having a single unit conduct M&A-related negotiations.

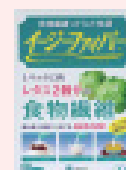
M&As involve acquisitions of companies or brands. In both cases, two criteria must be satisfied. The first is that the acquisition must be expected to yield a return on investment at least equal to our internal benchmarks. The second is that the acquisition target must be able to generate synergies with existing businesses, by, for example, being able to make use of the Group's sales channels or having the same customers.

One prime example of a successful acquisition satisfying these criteria was that of the *Inochi No Haha* A brand from Sasaoka Yakuhin Corporation. In only 10 months after relaunching sales in June 2005, we were able to grow annual sales of this brand fivefold. Building on this success, Kobayashi Pharmaceutical aims to promote further development of brands focused on menopause-related problems. In addition, we have seen a steady stream of other M&A successes, including the acquisition of Suzuken Co., Ltd.'s OTC pharmaceutical operations, the formation of a capital tie-up with Itoh Pharmaceutical Co., Ltd. and the signing of a share transfer agreement with Aloe Pharmaceutical Co., Ltd. These developments have spurred expansion in business domains and sales areas, as well as the pace of growth.

Going forward, we will continue to aggressively pursue M&As in each business operation to drive further growth.

M&As

1998 ➤ Acquisition of goodwill for *Easy Fiber*, a dietary fiber supplement



2001 ➤ Acquisition of White Hall Japan



2001 ➤ Acquisition of Kiribai Chemical Co., Ltd.



2002 ➤ Acquisition of goodwill for *Tochucha*



2005 ➤ Acquisition of exclusive sales agency rights to *Inochi No Haha A*, a general-use medication for women's health issues



2005 ➤ Acquisition of goodwill for *Ashi No Hienai Fushigi Na Kutsushita*



2006 ➤ Acquisition of Aloe Pharmaceutical Co., Ltd.



The Starting Point for the Kobayashi Pharmaceutical Group

Kobayashi Pharmaceutical started out as a wholesaler of pharmaceutical products. Today, the Wholesale Operation represents at least 60% of Group sales. Approximately 19% of the products we market are developed and manufactured in-house. By type of product, pharmaceuticals account for 40% of Group sales, foods and daily necessities for 20% each, contact lens products for 10%, and other products for the remaining 10%.

In 2001, the Company spun off its wholesale operations to form Kobashou Co., Ltd., a move that strengthened our competitive position in the face of rapid changes in the distribution sector. As an independent wholesaler, Kobashou is expanding its wholesale network through alliances with other wholesalers. In the past, its service area was largely limited to the Kanto and Kansai regions, but it now extends to the Chugoku and Shikoku areas too.

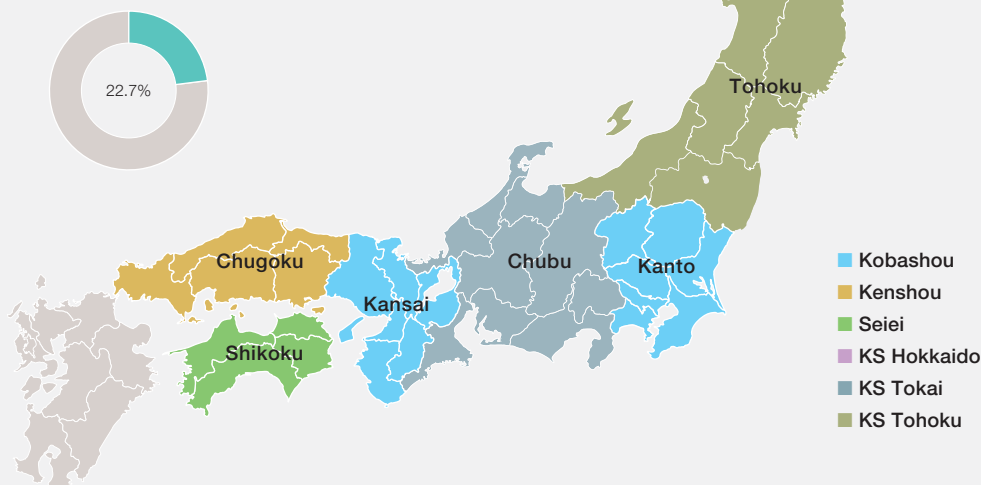
Primary Goals: Annual Sales of ¥300 Billion and a Nationwide Network

In 2005, Kobayashi Pharmaceutical acquired the OTC pharmaceutical wholesaling business of Suzuken Co., Ltd. The company also accepted capital participation by this major pharmaceutical wholesaler. This move established Kobayashi Pharmaceutical as Japan's largest OTC drug wholesaler and expanded its sales areas to Hokkaido and Chubu.

In April 2006, Kobayashi Pharmaceutical purchased all issued shares of Sowa Co., Ltd., an OTC drug wholesaler headquartered in Sendai, Miyagi Prefecture. This move marked the entry of Kobayashi Pharmaceutical into the Tohoku region, and increased sales by roughly ¥12.0 billion. Kobayashi Pharmaceutical renamed this company KS Tohoku Co., Ltd. following its conversion into a subsidiary.

Through these and other initiatives, Kobayashi Pharmaceutical is making steady progress toward building a nationwide wholesaling network. Expansion into the Kyushu region, the only area in Japan not covered by the Company at present, and boosting sales to ¥300 billion, are our primary goals. Kobayashi Pharmaceutical continues to look at new opportunities for business expansion through alliances and partnerships that go well beyond the bounds of its current business, including wholesalers from other sectors.

Wholesale Operation—Market Reach Kobayashi Pharmaceutical's market share (As of March 31, 2005)



Japan's Increasingly Attractive Medical Devices Market

Japan's medical devices market has been a relatively small, niche sector that has not received as much attention as the country's pharmaceutical market. However, over the past decade, along with breathtaking advances, medical devices have been playing an increasingly significant role in many areas, such as in the provision of minimally invasive medical care*, improving patient Quality of Life (QoL), and contributing to curbing national medical expenditures and enhancing public health.

The Medical Devices Operation is positioned as one of three business pillars alongside the Consumer Products Operation and the Wholesale Operation. The Medical Devices Operation in Japan is conducted by Medicon, Inc., a joint venture with C.R. Bard, Inc. of the U.S., and the Kobayashi Medical Division, which was established in 1992 as an operating division of Kobayashi Pharmaceutical. Overseas, three Shield Healthcare Centers sell medical equipment for home nursing-care patients in the U.S. In an industry defined by rapid technological change, research capabilities are crucial. In 1996, Kobayashi Pharmaceutical established a research firm in the U.S. to gather information on cutting-edge medical technologies and products from the U.S. and Europe. Having established such an information network at an early stage, Kobayashi Pharmaceutical today uses its industry-leading research capabilities to bring cutting-edge medical equipment to the Japanese market.

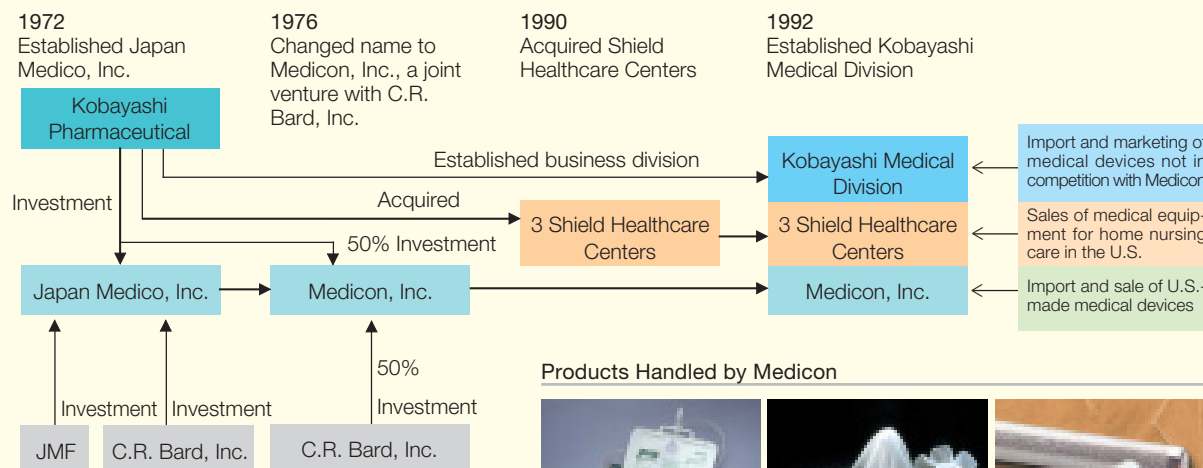
* Diagnosis and treatment using extremely minimally invasive medical instruments, such as endoscopes and catheters, as opposed to traditional invasive surgical procedures involving major incisions as part of diagnosis or treatment.

Two Divisions, One Goal: Be the No. 1 in Targeted Fields

Over more than thirty years, Medicon has marketed cutting-edge medical instruments developed by U.S.-based C.R. Bard, focusing on the urological and gastrointestinal fields. In the urological field in particular, Medicon has established a position as the market leader.

The Kobayashi Medical Division launches and sells advanced medical devices from around the world in Japan based on sales agreements with 20 domestic and overseas manufacturers. The division specializes in medical devices and supplies for the orthopedics, surgical product, anesthesiology, surgery room, neurosurgery, and otorhinolaryngology domains.

Medical Devices Operation



Bard I.C. Silver Foley Tray



Bard Perfix Plug



Bard Brachysource

Medicon and the Kobayashi Medical Division have launched numerous strong-selling products, aiming to become No. 1 in their respective fields of specialization. Leveraging their information networks, which have been built up over many years, and the trust of their customers, the two divisions will continue to provide “safety and reassurance” at the medical front line.

Proprietary Brand *Kobamed*

Since its inception in 1992, the Kobayashi Medical Division has won many accolades by introducing cutting-edge medical devices primarily from Europe and the U.S. to Japan. In parallel, we have received a large amount of feedback from customers in the form of inquiries about products and suggestions for improvements. For this reason, we began using this feedback as the basis for developing products that better fit the requirements of frontline medical professionals in Japan, leading to the launch of proprietary products under the *Kobamed* brand since 2004.

The first *Kobamed*-brand product was a lineup of instruments for minimum incision surgery in the urological field. Incorporating the traditional advantages of both laparotomy and laparoscopy, this groundbreaking set of surgical instruments garnered a strong response from urological surgeons for enabling them to more safely perform difficult procedures.

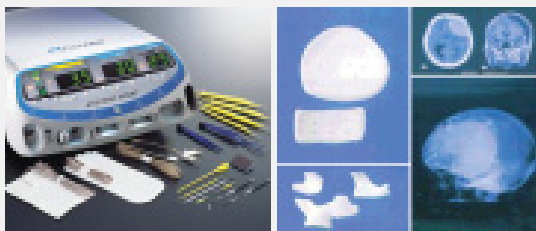
In January 2006, Kobayashi Medical Division launched the KIAPEX hip bone prosthesis system featuring an artificial femoral head to treat fractures of the inner side of the femoral neck, which are common among the elderly. One defining feature of this product is that it offers a much-improved range of mobility compared with existing products.

By continuing to augment our trading and manufacturing functions, we aim to further enhance the overall growth potential of our medical operations.

ISO 13485 Certification Acquired in Pursuit of Safety and Reliability

To provide “safety and reassurance” to the medical front line, we have established a management system in conformity with Japan’s revised Pharmaceutical Affairs Law in conjunction with obtaining ISO 13485 certification, the international standard for quality management systems for medical instruments in December 2005.

Products Handled by Kobayashi Medical Division



Conmed electric scalpel

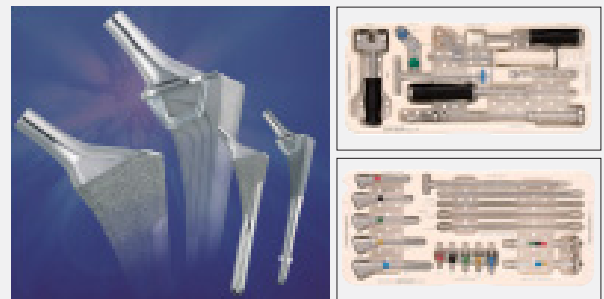
NGK Spark Plug *CERATITE*
(bone prosthesis)



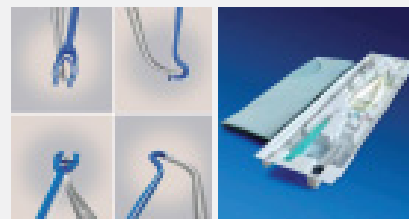
Acumed ACUTRAK
headless compression
screw

Orthofix orthopedic
external fixator

Proprietary Products — *Kobamed* Brand



KIAPEX bipolar hip prosthesis



Instruments for
minimum incision
surgery

Trocar Catheter kit

■ Approach to CSR

The Kobayashi Pharmaceutical Group implements corporate brand management to enhance corporate value under the slogan, “You make a wish and we make it real.” In this process, the Group recognizes that one of its top management priorities is to not only provide products and services that meet customer expectations, but also to earn the respect of society by fulfilling its social responsibilities. These responsibilities include creating a compliance system that encompasses corporate ethics, taking initiatives to protect the environment, and ensuring product quality and safety.

Kobayashi Pharmaceutical manufactures and markets products for large numbers of people, many of which can have a direct bearing on the well-being and health of consumers. We therefore pay close attention at all times to ensuring that our products are free of defects, as we do our utmost to prove worthy of the trust that our customers place in us and our products.

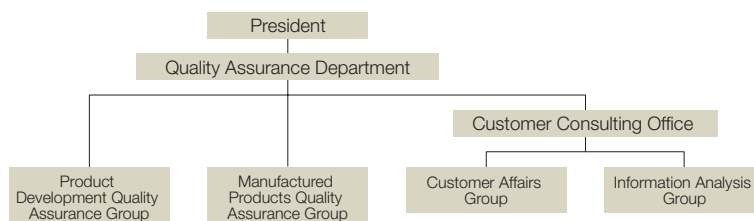
In order to reinforce our commitment to corporate social responsibility and its related activities, and to fulfill our social responsibilities, we established the Corporate Brand Office in April 2006. Through these and other initiatives, we strive to raise our corporate value.

I Product Quality and Safety Assurance Activities

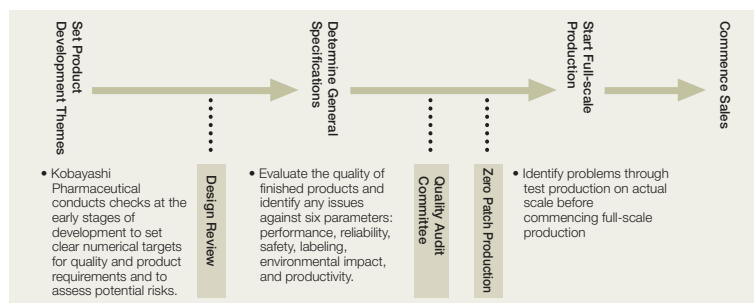
As a manufacturer with a management policy of “providing people and society with comfort” through the products it delivers to customers, Kobayashi Pharmaceutical positions ensuring product quality and safety as one of its top management priorities. To these ends, the Company has put in place a robust management system that establishes numerous stringent standards for a multifaceted critical review and evaluation of product quality and safety from the initial stage of product development through various intermediate stages to commercialization.

Product Quality and Safety Assurance System

Kobayashi Pharmaceutical has a Quality Assurance Department, an independent organization that reports



directly to the president and that is responsible for establishing and supervising the quality and safety of our products. The Department comprises the Product Development Quality Assurance Group, responsible for quality issues at the development stage; the Manufactured Products Quality Assurance Group, responsible for quality-related issues at the manufacturing stage; and the Customer Affairs Group, responsible for follow-up after products have been delivered to customers.



Product Development Quality Assurance System

The Kobayashi Group ensures that only products meeting the highest quality standards are brought to market through a strict three-step screening system comprising the Design Review, Quality Audit Committee and Zero Patch Production stages.

II Human Resources Development Policy and Training Programs

Human resources development is a crucial priority for implementing our brand slogan. It is essential that all of our employees enjoy their work and are able to develop their personal capabilities to the full. To this end, we have established a performance-linked personnel system that is highly transparent, impartial and fair. This system is grounded on participation by all employees and on the belief that every employee is a “leading player” in an organization that champions “equality.”

Furthermore, Kobayashi Pharmaceutical has revamped its employee training programs. First, we introduced a program for nurturing handpicked candidates for management positions from an early stage under the leadership of the chairman. Second, aiming to enhance the capabilities of all employees, we have launched a two-tier training program, with first tier targeting younger employees up to their fifth year with the company, who hold the key to realizing strong frontline operations, and the second tier targeting group managers responsible for training these employees.

III Environmental Policy

One of the most urgent issues faced by the Group is to provide superior quality products and services that offer high added value, but also to minimize the environmental impact of its business operations. Following the ratification of the Kyoto Protocol, substantial reductions in emissions of greenhouse gases have become an immediate priority for both businesses and individuals.

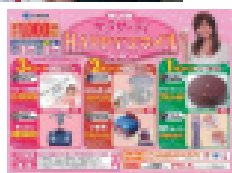
In the fiscal year ended March 31, 2006, Kobayashi Pharmaceutical achieved a 2.5% reduction in carbon dioxide emissions, despite a 16.6% increase in production volume. The Group is also promoting extensive sorting and recycling of waste at all five of its plants, thus reducing the final volume of waste sent to landfills to 0.3% of total waste.

Initiatives extend from the product manufacturing to the distribution stages. In the latter, Kobayashi Pharmaceutical is using streamlined product containers and switching to simpler packaging without compromising product functionality. The Company is also switching to simpler packaging for transportation and storage. Other measures include promotion of green procurement of office supplies, a transition to low-pollution vehicles, reducing emissions of Pollutant Release and Transfer Register (PRTR) substances and using alternative substances, and participation in local clean-up and environmental protection activities.

IV Social Contribution Activities

Donation to UNICEF

The Company established the Kobayashi Pharmaceutical UNICEF Fund in November 1993. As part of this initiative, the Company conducts summer and winter sales campaigns and donates five yen for every postcard received from each participating customer to the Japan Committee for UNICEF. With donations directly proportional to participation, this program is supported by the goodwill and cooperation of participants. Kobayashi Pharmaceutical is committed to continuing this program, with the aim of using the donations to support the underprivileged through UNICEF.



Participation in the Pink Ribbon Campaign to Increase Awareness of Breast Cancer

Kobayashi Pharmaceutical supports the Pink Ribbon Campaign to promote the awareness of the importance of early detection and treatment of breast cancer, an ailment with a high incidence rate among women. The company donates ten yen for every response received in the Sarasarty sanitary sheet campaign. The money is donated to the Japan Society of Breast Health, an NPO supporting the Pink Ribbon Campaign.

Kobayashi Pharmaceutical recognizes raising shareholder value as a key priority for achieving its fundamental management policy of maximizing corporate value. For this reason, we have implemented various measures to enhance corporate governance, including providing timely and accurate disclosure and improving management transparency.

Following approval by the general shareholders' meeting in June 2000, several measures were implemented to reshape the management structure so as to promote the separation of management and business execution functions. These included the adoption of an executive officer system and an in-house company system. Furthermore, in April 2004, the Kobayashi Pharmaceutical Group was reorganized into four business headquarters: the 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. In addition, the number of directors has been reduced to an optimal level to revitalize the Board of Directors.

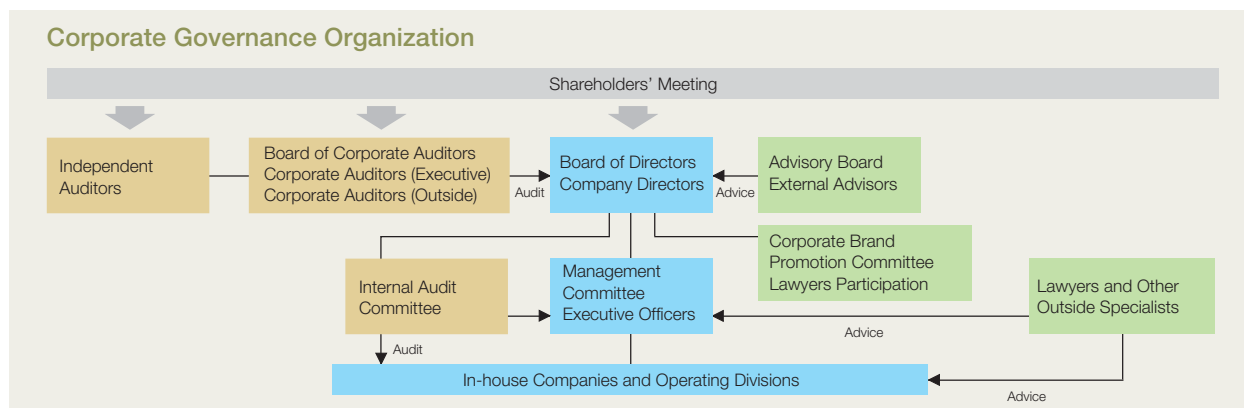
The Board of Directors holds regular monthly meetings and special meetings as necessary. The Board decides on important matters relating to management and other issues required by law and regulations, and regularly monitors the execution of operations.

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 the Company's 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. In addition, the number of internal auditing staff has been increased as part of efforts to reinforce audit functions.

The Company exchanges views on improving its operations with its independent auditor, Ernst & Young Shin Nihon, 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 (renamed the Corporate Brand Promotion Committee in May 2006) 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, as part of efforts to enhance awareness of compliance. In January 2003, Employee Consulting Centers were established both inside and outside the Company to facilitate internal reporting and ensure that the Company promptly gathers and responds to the latest information.

In addition, the Kobayashi Pharmaceutical Group is actively promoting opportunities for the views of on-site employees to be heard by top management, in order to create a favorable corporate climate where opinions can be freely exchanged. The Company believes that maintaining and developing this corporate climate is an effective means of ensuring strong corporate governance.



Directors



Chairman and Chief
Executive Officer
Kazumasa Kobayashi



President and Chief
Operating Officer
Yutaka Kobayashi



Senior Executive Director
Akira Horiguchi
*Senior General Manager,
Medical Device Business
Headquarters*



Executive Director
Masaaki Tanaka
*President, Manufacturing
Company*



Executive Director
Jyoji Miki
*President, Product Sales
Company*



Executive Director
Takashi Tsujino
*President, Research and
Development Company*



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



Director
Satoshi Yamane
*Senior General Manager,
Group Corporate Business
Headquarters*

Corporate Auditors



Statutory Auditor
Toshiyuki Morii



Statutory Auditor
Masahiro Hiraoka



Auditor
Hiroshi Hayashi



Auditor
Ryuji Sakai

Executive Officers

Hiroshi Nomoto
President, Kiribai Chemical Co., Ltd.

Takafumi Sakaguchi
President, Kobayashi Medical Division

Hidetsugu Yamamoto
President, Business System Company

Tomoharu Nagahara
*Currently on loan to Itoh Kanpo
Pharmaceutical Co., Ltd.*

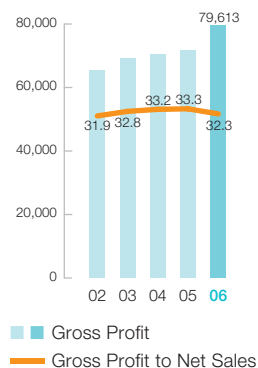
Haruyoshi Kosaka
*Officer-in-charge, Wholesale Business
Headquarters and President, Kobashou Co., Ltd.*

Kunio Moritani
*Manager, Wide Area Chain Store, Product Sales
Company*

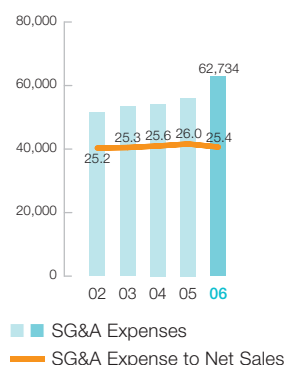
Shin Horiuchi
Manager, Product Sales Company

* Yutaka Kobayashi, Akira Horiguchi, Masaaki Tanaka,
Jyoji Miki, Takashi Tsujino, Akihiro Kobayashi and Satoshi
Yamane concurrently serve as executive officers.

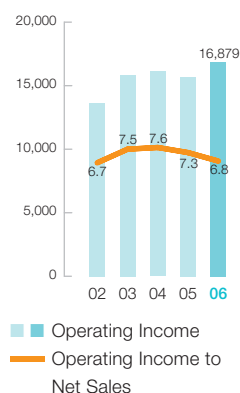
Gross Profit and Gross Profit to Net Sales
(¥ million/%)



SG&A Expenses and SG&A Expense to Net Sales
(¥ million/%)



Operating Income and Operating Income to Net Sales
(¥ million/%)



“You make a wish and we make it real”

The Kobayashi Pharmaceutical Group follows a management policy that defines the Company's mission as providing people and society with comfort through continuous “Creativity and Innovation.” We will continue to work toward realizing the concept of our brand slogan “You make a wish and we make it real”—that is, provide products and services for the health, comfort and happiness of all stakeholders.

Kobayashi Pharmaceutical is committed to the pursuit of “Something New, Something Different” through the development of products and services that meet consumer needs in this age of rapid changes and intensifying competition. We believe that this process is the driving force behind growth. Through this pursuit, our overriding goal is raise stakeholder satisfaction by increasing the Group's corporate value.

Scope of Consolidation and Application of the Equity Method

Kobayashi Pharmaceutical has 26 consolidated subsidiaries, 15 in Japan and 11 overseas, and two affiliates in Japan accounted for by the equity method. The Company classifies its business activities into four segments: the Consumer Products Operation (ten consolidated subsidiaries and one equity-method affiliate); Wholesale Operation (five consolidated subsidiaries); Medical Devices Operation (five consolidated subsidiaries and one equity-method affiliate); and Other Operations (six consolidated subsidiaries).

Overview

During the fiscal year under review, despite an uncertain outlook characterized by factors such as rising crude oil prices, Japan's economy staged a gradual recovery, showing signs of improvement such as higher private-sector capital investment fueled by improved corporate earnings, and an upturn in consumer spending.

In this environment, the Kobayashi Pharmaceutical Group 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.

Meanwhile, the Company reported higher earnings as it aggressively reduced manufacturing costs and reviewed sales promotion expenses, while promoting its brands through aggressive advertising both in Japan and overseas.

Net Sales

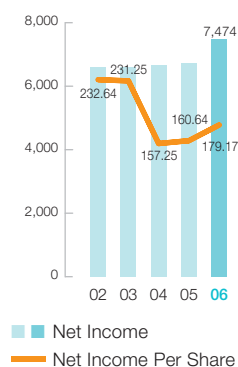
Consolidated net sales for the year under review were ¥246,853 million, 14.4% higher than in the previous year. The Consumer Products Operation saw sales rise on the launch of new products, development of existing brands, and a severe winter. Sales rose in the Wholesale Operation, due mainly to the acquisition of the OTC drug wholesale business from Suzuken. Sales rose in the Medical Devices Operation, as the Company focused on sales in orthopedics, a field with strong growth potential, and directed resources to developing its own products.

Gross Profit and Operating Income

The cost of sales (after provisions for returned products) increased ¥23,326 million, or 16.2%, from the previous year. This included a ¥265 million increase resulting from higher crude oil prices. Gross profit (after provisions for returned products) rose 10.9% to ¥79,614 million. Selling, general and administrative (SG&A) expenses increased ¥6,637 million, or 11.8%, as the Company continued to record heavy advertising expenses. As a result, operating income rose 7.5% to ¥16,880 million.

The ratio of gross profit to net sales declined from 33.3% to 32.3%. The ratio of operating income to net sales decreased from 7.3% to 6.8%. Both these declines primarily reflected the fact that the low-margin Wholesale Operation represented a higher proportion of total sales.

**Net Income and
Net Income Per Share**
(¥ million/yen)



Note: Kobayashi Pharmaceutical conducted a 1.5-for-1 stock split on November 20, 2003.

Income Before Income Taxes and Net Income

Income before income taxes and minority interests increased 9.7% to ¥14,010 million. Net income rose 11.1% to ¥7,475 million. Net income per share increased 11.5% to ¥179.17, compared to ¥160.64 in the previous fiscal year.

Segment Information

The Kobayashi Pharmaceutical Group'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 ¥30,183 million in the previous year and ¥34,962 million in the year under review.

Net Sales and Operating Income by Segment

Net Sales						(¥ million)
	2002	2003	2004	2005	2006	
Consumer Products Operation						
Sales to third parties	64,977	66,027	66,523	67,525	68,869	
Inter-group sales and transfers	19,029	19,532	20,532	21,749	25,908	
	84,006	85,559	87,055	89,274	94,777	
Wholesale Operation						
Sales to third parties	117,214	125,858	126,080	128,356	156,934	
Inter-group sales and transfers	4	0	–	–	1	
	117,218	125,858	126,080	128,356	156,935	
Medical Devices Operation						
Sales to third parties	19,932	16,113	15,609	16,056	17,127	
Other Operations						
Sales to third parties	2,524	2,923	3,458	3,771	3,923	
Inter-group sales and transfers	10,108	8,783	8,401	8,434	9,053	
	12,632	11,706	11,859	12,205	12,976	
Operating Income (Loss)						(¥ million)
	2002	2003	2004	2005	2006	
Consumer Products Operation	13,397	14,438	14,631	14,493	15,447	
Wholesale Operation	(59)	256	535	799	436	
Medical Devices Operation	441	829	645	190	583	
Other Operations	(14)	265	153	140	402	

■ Consumer Products Operation

In this segment, 14 new products were launched (excluding nutritional food supplements) as part of efforts to create new markets and further expand existing markets. The Company concentrated on promoting the *Shoshugen* brand of deodorizing air fresheners and the *Namaba* brand of oral hygiene products, in addition to launching *Inochi No Haha A*, a general purpose women's health medication in June 2005. Sales of body warmers also rose due to a record-setting severe winter.

Net Sales and Operating Income

As a result, sales increased 6.2% over the previous fiscal year to ¥94,777 million, but the segment's contribution to consolidated net sales decreased from 31.3% to 27.9%.

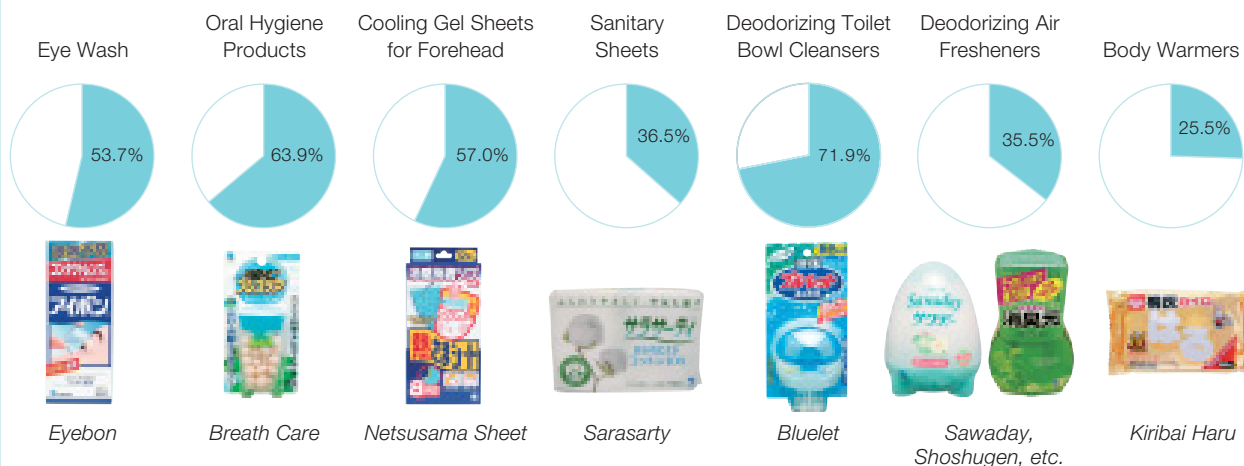
Sales of body warmers rose substantially, rising 31.5% because of below-normal winter temperatures, sales of pharmaceuticals rose 8.4%, and sales of deodorizing air fresheners were up 1.0%. Sales of oral hygiene products and sanitary products were up 6.5% and 6.0% respectively. Sales of food products continued to rise, climbing 2.0% from the previous year. But household sundries sales fell 1.8%.

Sales by Category

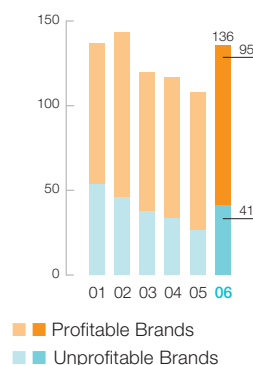
	2005		2006		Changes	
	Sales	% of Total Sales	Sales	% of Total Sales	Amount	Change (%)
Pharmaceuticals	15,164	17.0	16,434	17.3	1,270	8.4
Oral hygiene products	10,091	11.3	10,742	11.3	651	6.5
Sanitary products	12,506	14.0	13,257	14.0	751	6.0
Deodorizing air fresheners	28,037	31.4	28,307	29.9	271	1.0
Household sundries	4,598	5.2	4,517	4.8	(81)	(1.8)
Food products	11,196	12.5	11,421	12.0	225	2.0
Body warmers	7,682	8.6	10,099	10.7	2,417	31.5
Total	89,274	100.0	94,777	100.0	5,503	6.2

Operating income rose 6.6% from the previous year to ¥15,447 million, as the Company cut costs through sweeping reductions in manufacturing costs at a time of growing sales.

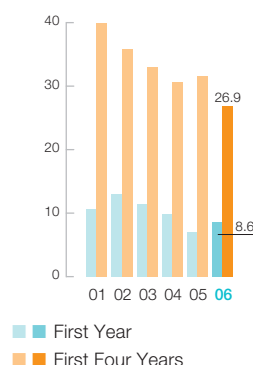
Market Share of Principal Brands (Pie Chart)



Number of Profitable and Unprofitable Brands



New Products as a Percentage of Sales (%)



Number of Profitable and Unprofitable Brands

	2001	2002	2003	2004	2005	2006
Profitable brands	83	97	82	83	81	95
Unprofitable brands	54	46	38	34	27	41

*The number of unprofitable brands includes certain new products.

New Products as a Percentage of Sales

	2001	2002	2003	2004	2005	2006
First year	10.7	13.0	11.4	9.8	7.0	8.6
First four years	39.9	35.9	33.0	30.7	31.6	26.9

Issues to be Addressed in the Fiscal Year Ending March 31, 2007

To increase sales in an environment where product prices have generally stabilized, we launched a record-high 18 new products in spring 2006 targeting latent customer needs. These include *Nicotol 85*, a diet pill for reducing abdominal fat; *Fychie*, an anemia treatment; *Cleair*, an air freshener that eliminates unpleasant household odors by releasing ions; and *Hot Clear*, a cleansing gel for removing blackheads from the nose. Regarding existing brands, the Company will aggressively promote sales in line with the marketing plans drawn up for each brand. These and other measures are expected to boost net sales 7.1% to ¥101,500 million.

Regarding earnings, operating income is forecast to increase 6.8% to ¥16,500 million, as we reduce the 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

Acquisition of the OTC wholesale operations of Suzuken on April 1, 2005 significantly boosted segment sales.

Net Sales and Operating Income

Sales of the Wholesale Operation increased 22.3% from the previous fiscal year to ¥156,935 million, and the segment's contribution to consolidated net sales increased from 59.5% to 63.6%.

By product, sales of products in the drugs category increased 25.2% and sales of merchandise rose 33.8%. With the market expansion triggered by the launch of *Coenzyme Q10* last year running its course, sales of products in sundries and food rose only 22.0%, and merchandise sales were up only 14.1%.

On the profit front, operating income declined 45.6% year on year to ¥436 million, despite improved profit margins resulting from bulk purchases from manufacturers, leveraging economies of scale accompanying expansion of business operations. These gains were offset as the benefits of the acquisition of Suzuken's OTC drug wholesale operations have yet to start contributing to business results.

Sales by Category

(¥ million)

		2005		2006		Changes	
		Sales	% of Total Sales	Sales	% of Total Sales	Amount	Change (%)
Drugs	Products	8,352	6.5	10,459	6.7	2,107	25.2
	Merchandise	42,025	32.7	56,210	35.8	14,185	33.8
Sundries and food	Products	15,976	12.5	19,494	12.4	3,518	22.0
	Merchandise	62,003	48.3	70,772	45.1	8,769	14.1
Total		128,356	100.0	156,935	100.0	28,579	22.3

Issues to be Addressed in the Fiscal Year Ending March 31, 2007

In the fiscal year ending March 31, 2007, the Wholesale Operation will promote more alliances to respond to the expanding geographic coverage of drugstores, its principal customers, and raise efficiency; strengthen product offerings by more clearly differentiating its health foods and contact lens care products, both expanding markets; and launch new product lineups for the elderly and other customer segments. As a result of these and other initiatives, sales are projected to increase 10.2% to ¥173,000 million, with operating income rising 37.9% to ¥600 million. In April 2006, Sowa Co., Ltd. a company with an operating base in the Tohoku region, became a consolidated subsidiary, following the acquisition of all outstanding shares of the company in April 2006.

■ Medical Devices Operation

In medical devices, Kobayashi Medical Division concentrated sales efforts in the orthopedic area, where demand is expected to increase, and surgery room products, such as electric scalpels. In in-house product development, a priority area, the Company launched a femoral head prosthesis in January. Overseas, the three Shield Healthcare Centers were able to increase their customer base by purchasing customer lists. The companies also focused on raising profit margins by introducing new customer management systems and reducing back-office costs.

Net Sales and Operating Income

Sales of the Medical Devices Operation rose 6.7% to ¥17,127 million. The segment's contribution to consolidated net sales declined from 7.4% to 6.9%.

By category, sales of Kobayashi Medical Division, known for its special strengths in products for orthopedics, surgery room, neurosurgery and otorhinolaryngology, increased 14.4%. Overseas, combined sales of the three Shield Healthcare Centers rose 4.1% to ¥8,587 million.

As a result, operating income increased 207.9% to ¥583 million. Equity in earnings of Medicon, Inc., an equity-method affiliate, was ¥263 million.

Sales by Category

(¥ million)

		2005		2006		Changes	
		Sales	% of Total Sales	Sales	% of Total Sales	Amount	Change (%)
Kobayashi Medical Division		6,594	41.1	7,544	44.1	950	14.4
Shield Healthcare							
Centers (3 firms)		8,245	51.3	8,587	50.1	342	4.1
Others		1,217	7.6	996	5.8	(221)	(18.2)
Total		16,056	100.0	17,127	100.0	1,071	6.7

Issues to be Addressed in the Fiscal Year Ending March 31, 2007

Kobayashi Medical Division will expand its lineup of products for existing fields, such as orthopedics and operating theaters, while stepping up the in-house development of products. Overseas, the three Shield Healthcare Centers in the U.S. will concentrate on increasing customers by purchasing customer lists and taking other initiatives, and implement far-reaching cost-cutting measures. As a result of these and other initiatives, we expect net sales to increase 0.4% to ¥17,200 million. Due partly to the impact of the reduction in official drug prices on Kobayashi Medical Division, operating income is projected to decline 48.5% to ¥300 million.

■ Other Operations

Other Operations (transportation, sales promotion, market research, etc.) are conducted on a financially independent basis 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 increased 6.3% from the previous fiscal year to ¥12,976 million. Operating income was up 187.1% at ¥402 million, due in part to cost reductions.

Analysis of Financial Position

Assets

Total assets were ¥151,945 million as of March 31, 2006, 12.9% higher than at the end of the previous fiscal year. This increase was primarily attributable to increases in current assets and investments and other assets.

Current assets rose to ¥98,906 million, 14.1% higher than a year earlier, mainly reflecting an increase of ¥5,401 million, or 28.4%, in cash and time deposits. In addition, trade notes and accounts receivable increased ¥3,564 million, or 8.1% and inventories rose ¥1,740 million, or 11.0%, reflecting the inclusion of new subsidiaries into the scope of consolidation.

Property, plant and equipment declined 8.9% to ¥22,788 million due mainly to loss on impairment of land, machinery and equipment.

Investments and other assets were ¥30,251 million, up 32.0% from a year ago. The main contributing factor was an increase of ¥5,495 million, or 231.4%, in investments in securities chiefly reflecting the formation of equity-based alliances.

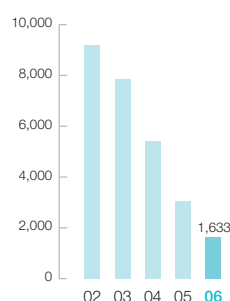
Liabilities

Total liabilities were ¥82,215 million at March 31, 2006, up 11.2% from the previous fiscal year-end.

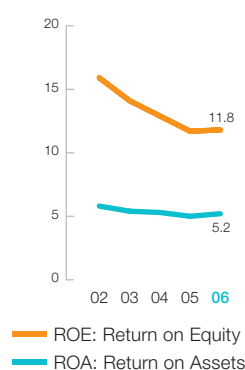
Current liabilities increased 10.8% to ¥72,040 million. This was mainly due to an increase of ¥5,688 million, or 13.1%, in trade notes and accounts payable resulting from the consolidation of subsidiaries. Short-term loans declined 49.0% to ¥1,372 million. As a result, the current ratio improved 3.9 percentage points from a year ago to 137.3%.

Long-term liabilities increased 13.6% to ¥10,175 million. This was due mainly to an increase of ¥591 million, or 9.1%, in accrued retirement benefits for employees. Long-term debt at the end of the fiscal year under review was ¥261 million, a decrease of 23.5% from a year earlier.

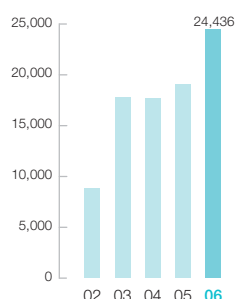
Interest-bearing Debt
(¥ million)



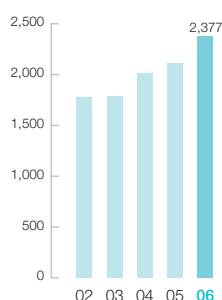
ROE and ROA
(%)



Cash and Cash Equivalents
at End of Year
(¥ million)



R&D Expenses
(¥ million)



Shareholders' Equity

Shareholders' equity was ¥66,812 million at March 31, 2006, 11.1% higher than a year ago. The principal factor was an increase in retained earnings of ¥6,501 million. Treasury stock rose ¥1,148 million to ¥3,480 million due to treasury stock purchases. As a result, the shareholders' equity ratio declined 0.7 of a percentage point from 44.7% to 44.0% at the end of the fiscal year under review. The return on shareholders' equity (ROE) increased 0.1 of a percentage point from 11.7% to 11.8%. The ratio of ordinary income to total assets (ROA) decreased 0.2 of a percentage point from 10.8% to 10.6%.

Cash Flow Analysis

Cash Flows From Operating Activities

Net cash provided by operating activities was ¥13,159 million, ¥4,795 million higher than in the previous fiscal year. The main contributing factors were an increase of ¥1,240 million in income before income taxes and minority interests, and improvement in net working capital.

Cash Flows From Investing Activities

Net cash used in investing activities was ¥6,415 million, ¥2,478 million more than in the previous fiscal year. This was mainly attributable to the procurement of dies for new product development, and investments in securities accompanying new capital alliances.

As a result, free cash flow* was ¥6,744 million, an increase of ¥2,316 million compared with the previous fiscal year.

Cash Flows From Financing Activities

Net cash used in financing activities was ¥1,420 million, ¥1,950 million less than in the previous fiscal year. The main components were dividends paid and the purchase of treasury stock, partly offset by cash inflows from investments in subsidiary Kobashou Co., Ltd.

As a result, cash and cash equivalents at the fiscal year-end were ¥24,437 million, an increase of ¥5,401 million from a year earlier.

* Free cash flow is calculated according to the following formula:

Free cash flow = (Cash flows from operating activities) + (Cash flows from investing activities)

Cash Flows

	2005		2006		Change	
	Amount		Amount		Amount	Change (%)
Cash flows from operating activities	8,364		13,159		4,795	57.3
Cash flows from investing activities	(3,936)		(6,415)		(2,478)	63.0
Free cash flows	4,428		6,744		2,316	52.3
Cash flows from financing activities	(3,369)		(1,420)		1,950	(57.9)
Cash and cash equivalents at end of year	19,036		24,437		5,401	28.4

R&D Expenses

R&D underpins new product development, the Kobayashi Pharmaceutical Group's core strength.

In the fiscal year ended March 31, 2006, the Consumer Products Operation developed 27 products in the following 5 categories: pharmaceuticals, oral hygiene, sanitary products, deodorizing air fresheners, and foods. The goal was to supply products that help consumers lead healthy and comfortable lives.

In the fiscal year ended March 31, 2006, the Medical Devices Operation developed a product to treat fractures of the inner side of the femoral neck, which are common among the elderly. This was part of efforts to actively bring proprietary products to market.

Consequently, R&D expenses, included in selling, general and administrative expenses, increased ¥262 million from the previous year to ¥2,377 million.

Risk Factors

(1) Highly Competitive Business Environment

The Kobayashi Pharmaceutical Group aims to differentiate itself from rival companies by developing new products and services that satisfy customer needs. This is crucial as the Group's main products target retail consumers. However, we are susceptible to intensifying price-based competition triggered by the launch of competing products by rivals. In response, we may have to increase development costs for new products, or advertising and sales promotion expenses to stimulate demand. These and other factors could affect the Group's operating results and financial position.

(2) Highly Susceptible to Sales of New Products

The Group pursues aggressive product development activities as part of its strategy for spurring growth, launching new products every year in the spring and fall. However, delays in developing or bringing new products to market, sales of competing products, and other factors may have an impact on sales of the Group's new products, which could in turn affect the Group's operating results and financial position.

(3) Risk Concerning Inability to Reap Anticipated Benefits of Mergers or Alliances

While enhancing product lineups through M&As and business alliances, the Group is striving to expand sales regions in pursuit of a broader range of new markets both in Japan and overseas. However, these M&As and alliances are subject to uncertainties. The Group may be unable to reap the anticipated benefits of M&As and alliances or may be forced to change its business strategies, due to unforeseen post-merger or alliance events. This could affect the Group's operating results and financial position.

(4) Legal Constraints

The Group's businesses are subject to the Pharmaceutical Affairs Law as well as other relevant laws and regulations. The Medical Devices Operation is particularly susceptible to reductions in NHI reimbursement prices. These and other factors could affect the Group's operating results and financial position.

(5) Changes in Raw Material Prices

The Group's Consumer Products Operation is exposed to the risk of changes in raw material prices. Despite ongoing cost reductions, the Group's operating results and financial condition may be affected by a sharp rise in raw material prices triggered by surging crude oil prices and other factors.

(6) Impact of Inclement Weather

Sales of some of the Group's products, such as body warmers, hay fever-related products, and cold remedies, are highly susceptible to seasonal factors, such as temperatures and airborne pollen counts, which could have a large impact on sales. Trends in sales of these products could therefore affect the Group's operating results and financial position.

(7) Overseas Business Risk

The Group's trading transactions, principally the import of medical devices, are subject to fluctuations in exchange rates. However, the Group reduces their impact on operating results mainly by hedging foreign currency risk through forward exchange transactions. The Group does not engage in derivative transactions for speculative purposes. Line items denominated in foreign currencies, including the sales, expenses, assets and liabilities, of overseas subsidiaries, are converted into yen for the purpose of preparing consolidated financial statements. In the event of a large change in the prevailing exchange rate on the conversion date, there will be a substantial corresponding change in the yen value of such line items. The Group is also exposed to the risk of changes in regulations by foreign governments, as well as economic conditions. These and other factors could affect the Group's operating results and financial position.

(8) Information Management and System Risk

The Group holds large volumes of information mainly as part of its mail-order shopping businesses, including personal information. For this reason, the Group has established an internal information management system in conjunction with enhancing in-house training programs and information management. However, the Group's operating results and financial position could be affected by a loss of public trust caused by a leak of information.

(9) Intellectual Property Risk

Third-party infringement of intellectual property rights, including the Group's brands and related trademarks, may result in large damages to the Group. Furthermore, the inadvertent infringement of the intellectual property rights of a third party by the Group may also have adverse consequences. These and other factors could impact the Group's operating results and financial position.

Consolidated Financial Statements

Consolidated Balance Sheets

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
ASSETS			
Current assets:			
Cash and time deposits (Note 5)	¥ 24,437	¥ 19,036	\$ 208,028
Trade notes and accounts receivable	47,702	44,138	406,078
Securities (Note 6)	1,502	1,000	12,786
Inventories (Note 7)	17,523	15,783	149,170
Deferred income taxes (Note 14)	2,820	2,418	24,006
Other current assets	5,492	4,977	46,752
Allowance for doubtful accounts	(570)	(647)	(4,852)
Total current assets	98,906	86,705	841,968
Property, plant and equipment:			
Land (Notes 8 and 15)	8,487	9,928	72,248
Buildings and structures (Note 8)	23,213	23,913	197,608
Machinery and equipment (Note 15)	4,427	4,390	37,686
Construction in progress	217	284	1,847
Other	5,471	4,962	46,574
	41,815	43,477	355,963
Accumulated depreciation	(19,027)	(18,474)	(161,973)
Property, plant and equipment, net	22,788	25,003	193,990
Investments and other assets:			
Investments in securities (Notes 6 and 8):			
Unconsolidated subsidiaries and affiliates	7,870	2,375	66,996
Other	7,739	6,384	65,881
Allowance for loss on devaluation of securities	(252)	(188)	(2,145)
	15,357	8,571	130,732
Excess of cost over net assets acquired	2,597	3,100	22,108
Deferred income taxes (Note 14)	2,292	2,330	19,511
Software	1,162	911	9,892
Intangible assets	2,760	2,867	23,495
Other assets	7,426	6,899	63,216
Allowance for doubtful accounts	(1,343)	(1,757)	(11,433)
Total investments and other assets	30,251	22,921	257,521
Total assets	¥151,945	¥134,629	\$1,293,479

See accompanying notes to the consolidated financial statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term loans (Note 8)	¥ 1,372	¥ 2,692	\$ 11,680
Trade notes and accounts payable (Note 8)	49,188	43,499	418,728
Accrued income taxes (Note 14)	4,578	3,631	38,972
Accrued expenses	14,984	12,939	127,556
Other current liabilities	1,918	2,246	16,327
Total current liabilities	72,040	65,007	613,263
Long-term liabilities:			
Long-term debt (Note 8)	261	342	2,222
Accrued retirement benefits for employees (Note 9)	7,065	6,474	60,143
Accrued retirement benefits for directors and statutory auditors	1,358	1,264	11,560
Other liabilities	1,491	880	12,693
Total long-term liabilities	10,175	8,960	86,618
Total liabilities	82,215	73,967	699,881
 Minority interests	 2,918	 546	 24,840
 Shareholders' equity (Note 12):			
Common stock			
Authorized – 170,100,000 shares			
Issued – 42,525,000 shares in 2006 and 2005	3,450	3,450	29,369
Additional paid-in capital	4,192	4,184	35,686
Retained earnings	60,087	53,585	511,509
Unrealized holding gain on securities	2,857	1,851	24,321
Foreign currency translation adjustments	(294)	(622)	(2,502)
Treasury stock, at cost	(3,480)	(2,332)	(29,625)
Total shareholders' equity	66,812	60,116	568,758
Total liabilities and shareholders' equity	¥151,945	¥134,629	\$1,293,479

See accompanying notes to the consolidated financial statements.

Consolidated Financial Statements

Consolidated Statements of Income

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Net sales (Note 17)	¥246,853	¥215,708	\$2,101,413
Cost of sales	167,239	143,912	1,423,674
Gross profit	79,614	71,796	677,739
Selling, general and administrative expenses (Note 13)	62,734	56,097	534,043
Operating income (Note 17)	16,880	15,699	143,696
Other income (expenses):			
Interest and dividend income	156	131	1,328
Equity in earnings of affiliates	459	391	3,907
Interest expense	(94)	(86)	(800)
Sales discounts	(1,117)	(1,027)	(9,509)
Exchange (loss) gain	(22)	79	(187)
Loss on disposal or write-offs of inventories	(2,759)	(2,709)	(23,487)
Gain on sales of property, plant and equipment	53	6	451
Royalty income	544	441	4,631
Loss on disposal of property, plant and equipment	(134)	(118)	(1,141)
Loss on impairment of fixed assets (Note 15)	(1,656)	–	(14,097)
Gain on sale of goodwill (Note 4)	1,065	736	9,066
Other, net	635	(773)	5,406
Income before income taxes and minority interests	14,010	12,770	119,264
Income taxes (Note 14):			
Current	7,241	6,024	61,641
Deferred	(960)	(56)	(8,172)
	6,281	5,968	53,469
Minority interests	(254)	(71)	(2,162)
Net income	¥ 7,475	¥ 6,731	\$ 63,633

	Yen		U.S. dollars (Note 1)
Amounts per share:	2006	2005	2006
Net income:			
Basic	¥179.17	¥160.64	\$1.53
Diluted	179.01	–	1.52
Cash dividends	38.00	33.00	0.32

See accompanying notes to the consolidated financial statements.

Consolidated Financial Statements

Consolidated Statements of Shareholders' Equity

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Number of shares issued (Thousands)	Millions of yen					
		Common stock	Additional paid-in capital	Retained earnings	Unrealized holding gain on securities	Foreign currency translation adjustments	Treasury stock
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)	-	-	-
Increase in treasury stock	-	-	-	-	-	-	(15)
Balance at March 31, 2005	42,525	¥ 3,450	¥ 4,184	¥ 53,585	¥ 1,851	¥ (622)	¥ (2,332)
Net income for the year	-	-	-	7,475	-	-	-
Effect of change in ownership ratio of consolidated subsidiaries	-	-	-	498	-	-	-
Unrealized holding gain on securities	-	-	-	-	1,006	-	-
Foreign currency translation adjustments	-	-	-	-	-	328	-
Cash dividends	-	-	-	(1,374)	-	-	-
Bonuses to directors and statutory auditors	-	-	-	(44)	-	-	-
Gain on sales of treasury stock	-	-	8	-	-	-	-
Decrease in retained earnings resulting from inclusion of consolidated subsidiaries	-	-	-	(53)	-	-	-
Increase in treasury stock	-	-	-	-	-	-	(1,148)
Balance at March 31, 2006	42,525	¥ 3,450	¥ 4,192	¥ 60,087	¥ 2,857	¥ (294)	¥ (3,480)

	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, 2005	\$29,369	\$35,618	\$456,159	\$15,757	\$(5,294)	\$(19,852)
Net income for the year	-	-	63,633	-	-	-
Effect of change in ownership ratio of consolidated subsidiaries	-	-	4,239	-	-	-
Unrealized holding gain on securities	-	-	-	8,564	-	-
Foreign currency translation adjustments	-	-	-	-	2,792	-
Cash dividends	-	-	(11,697)	-	-	-
Bonuses to directors and statutory auditors	-	-	(374)	-	-	-
Gain on sales of treasury stock	-	68	-	-	-	-
Decrease in retained earnings resulting from inclusion of consolidated subsidiaries	-	-	(451)	-	-	-
Increase in treasury stock	-	-	-	-	-	(9,773)
Balance at March 31, 2006	\$29,369	\$35,686	\$511,509	\$24,321	\$(2,502)	\$(29,625)

See accompanying notes to the consolidated financial statements.

Consolidated Financial Statements

Consolidated Statements of Cash Flows

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Thousands of U.S. dollars (Note 1)	
	Millions of yen	
	2006	2005
	2006	2006
Cash flows from operating activities:		
Income before income taxes and minority interests	¥14,010	¥12,770
Adjustments for:		
Depreciation and amortization	3,414	3,239
Loss on impairment of fixed assets	1,656	—
Decrease in allowance for doubtful accounts	(532)	(232)
Increase in accrued retirement benefits	591	149
Interest and dividend income	(156)	(131)
Interest expense	94	86
Equity in earnings of affiliates	(459)	(391)
Loss on disposal or write-offs of inventories	2,759	2,709
Gain on sale of goodwill	(1,065)	(736)
Loss on disposal of property, plant and equipment	134	118
Allowance for loss on devaluation of securities	64	188
Changes in operating assets and liabilities:		
Increase in trade notes and accounts receivable	(1,191)	(1,503)
Increase in inventories	(4,417)	(4,174)
Increase in trade notes and accounts payable	3,943	2,044
Increase (decrease) in consumption tax payable	240	(332)
Other	399	238
Subtotal	19,484	14,042
Interest and dividends received	156	131
Interest paid	(93)	(86)
Income taxes paid	(6,388)	(5,723)
Net cash provided by operating activities	13,159	8,364
Cash flows from investing activities:		
Payments for purchases of property, plant and equipment	(1,391)	(2,256)
Proceeds from sales of property, plant and equipment	300	26
Payments for purchases of intangible assets	(895)	(2,323)
Increase in investments in securities	(6,490)	(177)
Proceeds from redemption of investments in securities	1,005	—
Increase in other assets	(223)	(226)
Decrease in short-term loans receivable	140	62
Proceeds from sale of goodwill	1,065	736
Other	74	222
Net cash used in investing activities	(6,415)	(3,936)
Cash flows from financing activities:		
Decrease in short-term loans, net	(931)	(1,337)
Repayment of long-term debt	(630)	(1,144)
Dividends paid	(1,374)	(874)
Increase in treasury stock	(1,219)	(17)
Proceeds from issuance of common stock to minority	2,650	—
Other	84	3
Net cash used in financing activities	(1,420)	(3,369)
Effect of exchange rate changes on cash and cash equivalents	77	41
Net increase in cash and cash equivalents	5,401	1,100
Cash and cash equivalents at beginning of year	19,036	17,663
Increase in cash and cash equivalents resulting from change in number of consolidated subsidiaries	0	273
Cash and cash equivalents at end of year (Note 5)	¥24,437	¥19,036

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
March 31, 2006

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 of Japan 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.

Certain reclassifications of previously reported amounts have been made to conform the consolidated financial statements for the year ended March 31, 2005 to the 2006 presentation. Such reclassifications had no effect on consolidated net income or shareholders' equity.

The U.S. dollar amounts included herein are presented solely for convenience and are translated, as a matter of arithmetic computation only, at ¥117.47 = U.S.\$1.00, the approximate exchange rate in effect on March 31, 2006. 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 their respective dates of acquisition. Unallocated costs are deferred and amortized by the straight-line method over a five-year period, except for the differences related to (1) Kiribai Chemical Co., Ltd. which is being amortized over a ten-year period, (2) Seiei Co., Ltd. which was charged to income in the year of acquisition.

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, 2006. For consolidation purposes, the financial statements of the subsidiary were prepared as of March 31, 2006 and for the year then 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 and currency swaps.

The balance sheet accounts of the overseas subsidiaries are translated into Japanese yen at the rates 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 rates 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 and 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 their historical bad debt ratio. In addition, an additional allowance is provided at estimate of uncollectible amounts from certain specific doubtful receivables.

(i) Reserve for sales returns

The Company and its domestic subsidiaries provide a reserve 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. All other domestic consolidated subsidiaries 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.

All other 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 asset and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences attributable to the temporary 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 lives, customarily 5 years.

(o) Net income and cash dividends per share

Basic 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. Diluted net income per share is computed based on the amount of net income attributable to the shareholders of common stock and the weighted-average number of shares of common stock outstanding during the year after giving effect to the dilutive potential of the shares of common stock to be issued upon the exercise of stock options. No diluted net income per share for the year ended March 31, 2005 has been presented because there were no potentially dilutive shares outstanding as of that date.

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 appropriations of retained earnings with respect to a given financial period are made by resolution of the shareholders at a general meeting held subsequent to the close of the financial period. The accounts for that period do not, therefore, reflect such appropriations (see Note 18).

(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 credited or charged 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 to 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.

3. Change in Method of Accounting

Effective the year ended March 31, 2006, the Company and its domestic consolidated subsidiaries have adopted a new accounting standard for the impairment of fixed assets which 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. Companies are required to recognize an impairment loss in their 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. The standard states that impairment losses are to be measured as the excess of the book value over the higher of (1) the fair market value of the asset, net of disposition costs, and (2) the present value of future cash flows arising from ongoing utilization of the asset and from its disposal after use. The standard covers land, factories, buildings, other forms of property, plant and equipment, and leased assets as well as intangible assets.

As a result of the adoption of this new accounting standard, a loss on impairment of fixed assets including leased assets in the amount of ¥1,619 million (\$13,782 thousand) was recognized and income before income taxes and minority interests decreased by the same amount for the year ended March 31, 2006 from the corresponding amount which would have been recorded under the previous method.

4. 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 account on a cash basis as follows:

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

5. 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
	2006	2005	2006
Cash and time deposits	¥24,437	¥19,036	\$208,028
Time deposits with original maturity of more than three months	—	—	—
Cash and cash equivalents	¥24,437	¥19,036	\$208,028

6. Securities and Investments in Securities

Securities classified as “other securities” are summarized as follows:

(a) Securities whose carrying value exceeds their acquisition cost

	Millions of yen					
	2006			2005		
	Acquisition cost	Carrying value	Unrealized gain	Acquisition cost	Carrying value	Unrealized gain
Equities	¥ 788	¥5,460	¥4,672	¥ 684	¥3,805	¥3,121
Debt securities	501	501	0	2,503	2,509	6
	¥1,289	¥5,961	¥4,672	¥3,187	¥6,314	¥3,127

	Thousands of U.S. dollars		
	2006		
	Acquisition cost	Carrying value	Unrealized gain
Equities	\$ 6,708	\$46,480	\$39,772
Debt securities	4,265	4,265	0
	\$10,973	\$50,745	\$39,772

(b) Securities whose acquisition cost exceeds their carrying value

	Millions of yen					
	2006			2005		
	Acquisition cost	Carrying value	Unrealized loss	Acquisition cost	Carrying value	Unrealized loss
Equities	¥ 190	¥ 185	¥ (5)	¥ 74	¥ 63	¥(11)
Debt securities	2,505	2,493	(12)	500	500	0
	¥2,695	¥2,678	¥(17)	¥574	¥563	¥(11)

	Thousands of U.S. dollars		
	2006		
	Acquisition cost	Carrying value	Unrealized loss
Equities	\$ 1,618	\$ 1,575	\$ (43)
Debt securities	21,324	21,222	(102)
	\$22,942	\$22,797	\$(145)

(c) Securities whose market value is not determinable

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Unlisted stock other than those traded on the over-the-counter market	¥316	¥285	\$2,690
Investment trusts	286	222	2,435

(d) Redemption schedule for other securities with maturities

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Due within one year	¥1,502	¥1,000	\$12,786
Due after one year but within five years	1,491	2,008	12,693
	¥2,993	¥3,008	\$25,479

7. Inventories

Inventories at March 31, 2006 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Commodities	¥ 9,607	¥ 9,164	\$ 81,782
Finished goods	5,875	5,003	50,013
Raw materials, work in process and supplies	2,041	1,616	17,375
	¥17,523	¥15,783	\$149,170

8. Short-term Loans and Long-term Debt

The average interest rates on short-term bank loans for the years ended March 31, 2006 and 2005 were 2.95% and 2.00%, respectively.

Long-term debt at March 31, 2006 and 2005 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Loans from banks with average interest rates of 1.49% for 2006 and 1.29% for 2005	¥342	¥ 972	\$2,911
Less amounts due within one year	(81)	(630)	(689)
	¥261	¥ 342	\$2,222

The aggregate annual maturities of long-term debt subsequent to March 31, 2006 are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2007	¥ 81	\$ 689
2008	106	902
2009	94	800
2010	50	425
2011 and thereafter	11	95
	¥342	\$2,911

Assets pledged as collateral at March 31, 2006 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Land	¥2,123	\$18,073
Buildings and structures	1,022	8,700
Investments in securities	166	1,413
	¥3,311	\$28,186

Secured liabilities at March 31, 2006 are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Trade notes and accounts payable	¥8,740	\$74,402
Long-term loans	25	213
	¥8,765	\$74,615

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. The status of these at March 31, 2006 is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Lines of credit	¥29,124	\$247,927
Credit used	474	4,035
Available credit	¥28,650	\$243,892

9. 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, 2006 and 2005 for the Group's defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation	¥(12,550)	¥(11,701)	\$(106,836)
Fair value of pension plan assets	5,282	3,769	44,965
Unfunded retirement benefit obligation	(7,268)	(7,932)	(61,871)
Unrecognized prior service cost	726	830	6,180
Unrecognized actuarial differences	283	1,094	2,409
Net retirement benefit obligation	(6,259)	(6,008)	(53,282)
Prepaid pension cost	(806)	(466)	(6,861)
Accrued retirement benefits for employees	¥ (7,065)	¥ (6,474)	\$ (60,143)

The components of net pension cost for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service cost	¥ 864	¥ 681	\$ 7,355
Interest cost	224	201	1,907
Expected return on pension plan assets	(75)	(57)	(638)
Amortization:			
Prior service cost	103	104	877
Actuarial differences	438	75	3,728
Pension cost	¥1,554	¥1,004	\$13,229

The assumptions used in determining the actuarial present value of the projected benefit obligation at March 31, 2006 and 2005 were as follows:

	2006	2005
Discount rate	2.0%	2.0%
Expected rate of return on plan assets	2.0%	2.0%

10. Leases

The following pro forma amounts present the acquisition cost and the related accumulated depreciation of property and accumulated loss on impairment of property leased to the Group at March 31, 2006 and 2005, 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
	2006	2005	2006
Machinery and equipment:			
Acquisition cost	¥ 8,197	¥ 8,185	\$ 69,780
Accumulated depreciation	(4,873)	(4,878)	(41,483)
Accumulated loss on impairment of leased property	(152)	—	(1,294)
	¥ 3,172	¥ 3,307	\$ 27,003
Furniture and fixtures:			
Acquisition cost	¥ 2,441	¥ 2,301	\$ 20,780
Accumulated depreciation	(1,412)	(1,325)	(12,020)
	¥ 1,029	¥ 976	\$ 8,760
Others:			
Acquisition cost	¥ 2,617	¥ 2,541	\$ 22,278
Accumulated depreciation	(2,122)	(1,846)	(18,064)
	¥ 495	¥ 695	\$ 4,214
Total	¥ 4,696	¥ 4,978	\$ 39,977

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2006 for finance leases other than those which transfer ownership of the leased property to the lessees are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2007	¥2,100	\$17,877
2008 and thereafter	2,795	23,793
Total	¥4,895	\$41,670

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, 2006 and 2005, are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Lease expenses	¥2,311	¥2,381	\$19,673
Reversal of loss on impairment of leased property	36	—	306
Estimated depreciation expense	2,104	2,253	17,911
Estimated interest expense	83	105	707
Loss on impairment of leased property	152	—	1,294

11. 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.

12. 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, 2006 and 2005, amounted to ¥340 million (\$2,894 thousand) and ¥330 million, respectively.

The new Corporation Law of Japan (the "Law"), which superseded most of the provisions of the Code, went into effect on May 1, 2006. The Law stipulates requirements on distributions of earnings which are similar to those of the Code. Under the Law, however, such distributions can be made at any time by resolution of the shareholders, or by the Board of Directors if certain conditions are met.

In accordance with the Code, a stock option plan for directors, certain employees of the Company and certain subsidiaries, and certain statutory auditors of the Company was approved at the annual general meeting of the shareholders held on June 27, 2003. Under the terms of this plan, 243,000 shares of common stock have been reserved at an exercise price of ¥3,051 per share. The options became exercisable on July 1, 2005 and are scheduled to expire on June 30, 2008.

13. Selling, General and Administrative Expenses

The major components of selling, general and administrative expenses for the years ended March 31, 2006 and 2005 were as follows:

Account	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Sales promotional activities	¥ 5,289	¥ 4,715	\$ 45,024
Freight and storage	9,928	8,059	84,515
Advertising	12,371	11,494	105,312
Salaries and bonuses	12,887	11,571	109,705
Office rent and other rental charges	3,110	2,705	26,475
External services	4,012	3,572	34,153
Research and development costs	2,378	2,115	20,243

14. 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% for the years ended March 31, 2006 and 2005. The overseas subsidiaries are subject to the income taxes of their countries of domicile.

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

	2006	2005
Statutory tax rate	40.6%	40.6%
Tax loss carryforwards of consolidated subsidiaries	2.7	3.2
Utilization of tax loss carryforward	(1.5)	—
Tax credits on research and development costs	(2.0)	(2.0)
Amortization of excess of cost over net assets acquired	1.7	2.1
Expenses not deductible for tax purposes	1.4	1.6
Equity in earnings of affiliates	(0.9)	(1.3)
Other	2.8	2.5
Effective tax rates	44.8%	46.7%

The tax effects of the temporary differences which gave rise to a significant portion of the deferred tax assets and liabilities at March 31, 2006 and 2005 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Accrued retirement benefits for employees	¥ 2,451	¥ 2,242	\$ 20,865
Net operating loss carryforwards	2,359	1,750	20,082
Reserve for employees' bonuses	816	755	6,947
Accrued retirement benefits for directors and statutory auditors	575	527	4,895
Allowance for doubtful accounts	201	392	1,711
Accrued expenses	736	667	6,265
Accrued enterprise tax	379	262	3,226
Unrealized intercompany profits	409	276	3,482
Loss on impairment	656	—	5,584
Other	973	624	8,283
Gross deferred tax assets	9,555	7,495	81,340
Valuation allowance	(2,583)	(1,730)	(21,989)
Total deferred tax assets	6,972	5,765	59,351
Deferred tax liabilities:			
Unrealized holding gain on securities	(1,889)	(1,017)	(16,080)
Total deferred tax liabilities	(1,889)	(1,017)	(16,080)
Net deferred tax assets	¥ 5,083	¥ 4,748	\$ 43,271

15. Loss on Impairment of Fixed Assets

The Company and its domestic consolidated subsidiaries group their fixed assets for business use at each business segment unit and these are defined as the smallest identifiable group of assets generating cash inflows. The head office building, delivery center and others are grouped as one common asset group.

For the year ended March 31, 2006, the carrying value of leased property and idle land whose market value has decreased significantly from their carrying value, and that of production facilities which are not anticipated to be utilized in the future, have been reduced to their respective recoverable amounts and a loss on impairment was recognized in the accompanying financial statements. The recoverable amounts of land are measured at their estimated selling value, which is principally equivalent to the valuation submitted by real estate appraisers. The recoverable amounts of other assets are measured based on value in use (the present value of future cash flows or their estimated selling price).

Loss on impairment of fixed assets is summarized as follows:

Place	Description	Classification	Millions of yen	Thousands of U.S. dollars
Osaka and other	Production facilities	Machinery and equipment and other	¥ 67	\$ 570
Osaka and other	Production facilities	Leased property (currently accounted for as operating leases)	¥ 151	\$1,285
Osaka	Leasing	Land	¥1,076	\$9,160
Miyagi	Idle assets	Land	¥ 362	\$3,082

16. Supplementary Cash Flow Information

In September 2005, the Company purchased shares of Seiei Co., Ltd. and initially consolidated the accounts of Seiei Co., Ltd. for the year ended March 31, 2006. The assets and liabilities included in consolidation are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
	2006	2006
Current assets	¥1,943	\$17,161
Long-term assets	77	680
Total assets	¥2,020	\$17,841
Current liabilities	¥1,903	\$16,808
Long-term liabilities	10	88
Total liabilities	¥1,913	\$16,896

17. 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, 2006 and 2005 is outlined as follows:

	Millions of yen						
	2006						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations	Consolidated
I. Sales and operating income							
Sales to third parties	¥68,869	¥156,934	¥17,127	¥ 3,923	¥246,853	¥ –	¥246,853
Inter-group sales and transfers	25,908	1	–	9,053	34,962	(34,962)	–
Total sales	94,777	156,935	17,127	12,976	281,815	(34,962)	246,853
Operating expenses	79,330	156,499	16,544	12,574	264,947	(34,974)	229,973
Operating income	¥15,447	¥ 436	¥ 583	¥ 402	¥ 16,868	¥ 12	¥ 16,880
II. Assets, depreciation and capital expenditures							
Total assets	¥59,095	¥ 51,954	¥ 9,878	¥ 7,728	¥128,655	¥ 23,290	¥151,945
Depreciation	2,024	196	325	172	2,717	97	2,814
Loss on impairment	580	–	–	–	580	1,076	1,656
Capital expenditures	1,915	261	262	110	2,548	249	2,797

	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

Thousands of U.S. dollars							
2006							
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations	Consolidated
I. Sales and operating income							
Sales to third parties	\$586,269	\$1,335,950	\$145,799	\$ 33,395	\$2,101,413	\$ –	\$2,101,413
Inter-group sales and transfers	220,550	9	–	77,066	297,625	(297,625)	–
Total sales	806,819	1,335,959	145,799	110,461	2,399,038	(297,625)	2,101,413
Operating expenses	675,321	1,332,247	140,836	107,040	2,255,444	(297,727)	1,957,717
Operating income	\$131,498	\$ 3,712	\$ 4,963	\$ 3,421	\$ 143,594	\$ 102	\$ 143,696
II. Assets, depreciation and capital expenditures							
Total assets	\$503,065	\$ 442,275	\$ 84,090	\$ 65,786	\$1,095,216	\$ 198,263	\$1,293,479
Depreciation	17,230	1,669	2,767	1,463	23,129	826	23,955
Loss on impairment	4,937	–	–	–	4,937	9,160	14,097
Capital expenditures	16,302	2,222	2,230	937	21,691	2,120	23,811

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 total consolidated sales.

18. Subsequent Event

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, 2006, were approved at a general meeting of the shareholders held on June 29, 2006:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥38.00 = U.S.\$0.3 per share)	¥1,569	\$13,357
Bonuses to directors and statutory auditors	40	341



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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, 2006 and 2005, 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, 2006 and 2005, 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 3, effective April 1, 2005, the Company and its domestic consolidated subsidiaries have adopted a new accounting standard for the impairment of fixed assets.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 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, 2006

A handwritten signature in black ink that reads 'Ernst & Young Shin Nihon' in a cursive script.

Six-year Consolidated Financial Summary

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

	Millions of yen					
	2006	2005	2004	2003	2002	2001
For the Year						
Net Sales	¥246,853	¥215,708	¥211,670	¥210,922	¥204,647	¥185,001
Cost of Sales						
(after provisions for returned products)	167,239	143,912	141,388	141,675	139,404	123,140
Gross Profit						
(after provisions for returned products)	79,614	71,796	70,282	69,247	65,243	61,861
Selling, General and						
Administrative Expenses	62,734	56,097	54,159	53,394	51,613	48,054
Operating Income	16,880	15,699	16,123	15,853	13,630	13,807
Income before Income Taxes and						
Minority Interests	14,010	12,770	11,825	12,840	10,924	11,453
Net Income	7,475	6,731	6,677	6,606	6,595	6,020
Per Share Data (Yen)						
Net Income	179.17	160.64	157.25	231.25	232.64	212.34
Cash Dividends	38	33	21	21	18.5	17.5
Cash Flows from Operating Activities	13,159	8,364	6,971	12,046	4,039	3,961
Free Cash Flows	6,744	4,428	4,613	11,770	(2,892)	(817)
Depreciation and Amortization Expenses	3,414	3,239	3,350	3,480	2,598	2,157
Capital Expenditures ^{*1}	2,798	5,021	2,441	2,631	4,329	4,926
R&D Expenses	2,377	2,115	2,010	1,785	1,778	1,774
At Year-end						
Current Assets	98,906	86,705	80,031	77,315	72,759	64,849
Property, Plant and Equipment, Net	22,788	25,003	24,567	27,758	28,301	26,000
Current Liabilities	72,040	65,007	64,298	65,926	62,645	57,871
Long-term Liabilities	10,175	8,960	9,094	99,367	13,218	10,068
Shareholders' Equity	66,812	60,116	54,454	49,267	44,428	38,436
Total Assets	151,945	134,629	128,326	125,680	120,855	106,391
Working Capital	26,866	21,698	15,733	11,389	10,114	6,978
Interest-bearing Debt	1,633	3,034	5,417	7,859	9,196	3,461
Financial Ratios (%)						
As a percent of net sales:						
Gross Profit	32.3%	33.3%	33.2%	32.8%	31.9%	33.4%
Operating Income	6.8	7.3	7.6	7.5	6.7	7.5
Net Income	3.0	3.1	3.2	3.1	3.2	3.3
Current Ratio	137.3	133.4	124.5	117.3	116.1	112.1
ROE	11.8	11.7	12.9	14.1	15.9	17.1
ROA	5.2	5.0	5.3	5.4	5.8	5.7
Shareholders' Equity Ratio	44.0	44.7	42.4	39.2	36.8	36.1
Debt-equity Ratio (times) ^{*2}	0.02	0.05	0.10	0.16	0.21	0.09

*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.

- 1886** Founder Chubei Kobayashi established Kobayashi Seidaido, Ltd., an unlimited general partnership in the Monzen-cho district of Naka-ku, Nagoya. The company sold general merchandise, cosmetics, and western liquor.
- 1919** Established Kobayashi Daiyakubo, Ltd. in Nishi-ku, Osaka.
- 1940** Spun off the manufacturing unit of Kobayashi Daiyakubo, Ltd. to establish Kobayashi Pharmaceutical Co., Ltd.
- 1956** Kobayashi Daiyakubo Co., Ltd. and Kobayashi Pharmaceutical Co., Ltd. were merged and renamed Kobayashi Pharmaceutical Co., Ltd.

Relocated the Head Office to Chuo-ku, Osaka.
- 1967** Launched *Anmerts*, a treatment for sore shoulders.
- 1969** Launched *Bluelet*, a deodorizing toilet bowl cleanser that became the Company's first toiletries product.
- 1972** Formed partnership with C.R. Bard Inc. of the U.S. to establish Medicon, Inc.
- 1975** Launched *Sawaday*, a deodorizing air freshener for toilets.
- 1982** Established Toyama Kobayashi Pharmaceutical Co., Ltd.
- 1990** Acquired Shield Healthcare Centers to enter the field of home nursing care services.
- 1993** Established Sendai Kobayashi Pharmaceutical Co., Ltd.
- 1998** Established Shanghai Kobayashi Friendship Daily Chemicals Co., Ltd. in China.

Established Kobayashi Healthcare, Inc. in the U.S.
- 1999** Listed on the Second Section of the Osaka Securities Exchange.
- 2000** Introduced the in-house company and executive officer systems.

Listed on the first sections of the Tokyo Stock Exchange and Osaka Securities Exchange.

Spun-off the Trade Company to form Kobashou Co., Ltd.
- 2001** Established Kobayashi Healthcare Europe Ltd. in UK

Acquired Kiribai Chemical Co., Ltd.
- 2002** Sold all shares of Kobayashi Sofamor Danek K.K., following the dissolution of a joint venture agreement.

Established Kobayashi Pharmaceutical (Hong Kong) Co., Ltd. in Hong Kong.

Took over the *Tochucha* health food business of Hitachi Zosen Bio Corporation.
- 2003** Established Seiei Co., Ltd., an OTC pharmaceutical wholesaler with operations covering the entire Shikoku region, through a joint investment by four wholesalers, namely subsidiary Kobashou Co., Ltd., ASTIS Co., Ltd., Kowa Pharmaceutical Wholesalers Co., Ltd., and DAIWA Pharmaceutical Wholesalers Co., Ltd.
- 2004** Kobashou Co., Ltd. concluded business alliance agreements with Mitsubishi Corporation and Ryoshoku Ltd.

Reorganized the Kobayashi Pharmaceutical Group into four business headquarters.
- 2005** Acquired the OTC pharmaceutical business of Suzuken Co., Ltd.

Formed an equity-based alliance with Itoh Kanpo Pharmaceutical Co., Ltd.

Group Companies (As of March 31, 2006)

Company	Address	Capital	Main Business
Domestic consolidated subsidiaries			
■ Sendai Kobayashi Pharmaceutical Co., Ltd.	4-3 Matsuzaka Taira, Yamato-cho, Kurokawa-gun, Miyagi 981-3408, Japan	¥200 million	Manufacturing of pharmaceuticals and other products
■ Toyama Kobayashi Pharmaceutical Co., Ltd.	100-1 Nakaokubo, Toyama 939-2295, Japan	¥100 million	Manufacturing of pharmaceuticals and other products
■ Ehime Kobayashi Pharmaceutical Co., Ltd.	930-70 Kuroshima, Niihama, Ehime 792-0892, Japan	¥77 million	Hygienic and paper goods manufacturing
■ Kiribai Chemical Co., Ltd.	1-10-5 Niitaka, Yodogawa-ku, Osaka 532-0033, Japan	¥49.50 million	Disposable body warmer manufacturing and sales
■ Kobashou Co., Ltd.	3-3-8 Motoishi-cho, Nihonbashi, Chuo-ku, Tokyo 103-0021, Japan	¥4,297 million	Pharmaceutical products wholesaling
■ Kenshou Co., Ltd.	245-68 Gongen, Touge-aza, Hatsukaichi, Hiroshima 738-0202, Japan	¥465 million	Pharmaceutical products wholesaling
■ Seiei Co., Ltd.	35-1 Yoshimitsu, Kounan-cho, Takamatsu, Kagawa 761-1403, Japan	¥300 million	Pharmaceutical products wholesaling
■ KS Hokkaido Co., Ltd.	3-1 Kita Rokujo Higashi, Higashi-ku, Sapporo, Hokkaido 060-0906, Japan	¥10 million	Pharmaceutical products wholesaling
■ KS Tokai Co., Ltd.	3-12-20 Imaike, Chidane-ku, Nagoya, Aichi 464-0850, Japan	¥10 million	Pharmaceutical products wholesaling
■ Aotiori Distribution Co., Ltd.	4-3-6 Doshomachi, Chuo-ku, Osaka 541-0045, Japan	¥99 million	Transportation services
■ Kobayashi Seiyaku Plax Co., Ltd.	20 Yokohi, Toyama 939-2216, Japan	¥95 million	Synthetic resin products manufacturing
■ Suehiro Sangyo Co., Ltd.	4-3-6 Doshomachi, Chuo-ku, Osaka 541-0045, Japan	¥15 million	Daily goods sales
■ Archer Corporation	4-6-7 Nihonbashi Honcho, Chuo-ku, Tokyo 103-0023	¥10 million	Advertising, planning and creation
■ SP-Planning, Inc.	4-4-10 Doshomachi, Chuo-ku, Osaka 541-0045, Japan	¥10 million	Displays and model production
■ Kobayashi Pharmaceutical Life Service Co., Ltd.	4-3-6 Doshomachi, Chuo-ku, Osaka 541-0045, Japan	¥10 million	Insurance agency and real estate management
Overseas consolidated companies			
■ Kobayashi Healthcare LLC	Pennsylvania, U.S.A.	US\$3,710,000	Daily goods sales
■ Kobayashi Healthcare, Inc.	Pennsylvania, U.S.A.	US\$10,000	Daily goods sales
■ Kobayashi Healthcare Europe, Ltd.	London, U.K.	UK£11,165.00	Daily goods sales
■ Kobayashi Healthcare Germany GmbH	Dusseldorf, Germany	974,000 Euro	Daily goods sales
■ Shanghai Kobayashi Daily Chemicals Co., Ltd.	Shanghai, China	98,370,198 RMB	Daily goods manufacturing and sales
■ Kobayashi Pharmaceutical (Hong Kong) Co., Ltd.	Hong Kong, China	HK\$1,570,000	Daily goods sales
■ Kobayashi Pharmaceuticals of America Incorporated	California, U.S.A.	US\$1	Management of U.S. operations
■ Shield California Healthcare Centers, Inc.	California, U.S.A.	US\$20,000	Home healthcare and medical device sales
■ Shield Denver Healthcare Centers, Inc.	Colorado, U.S.A.	US\$1,000	Home healthcare and medical device sales
■ Shield Distribution Inc.	California, U.S.A.	US\$10,000	Home healthcare and medical device sales by mail
■ Bluebird Development LLC	Dissolved on May 15.	US\$4,601,009	Collection of medical business information
Equity-method affiliates			
■ Medicon, Inc.	2-5-8 Hiranomachi, Chuo-ku, Osaka 541-0046	¥160 million	Medical equipment and device import and sales
■ Itoh Kanpo Pharmaceutical Co., Ltd.	2-4-1 Nagata-higashi, Higashi Osaka, Osaka 577-0012	¥2,085 million	Daily goods manufacturing and sales

Notes: 1. During the year ended March 31, 2006, the following companies became affiliated companies: KS Hokkaido Co., Ltd., KS Tokai Co., Ltd., Seiei Co., Ltd., Kobayashi Healthcare LLC, Kobayashi Healthcare Germany GmbH, and Itoh Pharmaceutical Co., Ltd.
2. Kobayashi Pharmaceutical absorbed its subsidiary, Kobayashi-Combe Ltd. in December 15, 2005.
3. Mail Order Medical Supplies, Inc. was renamed Shield Distribution Inc.
4. Bluebird Development LLC was dissolved on May 15, 2006.

■ Consumer Products Operation ■ Wholesale Operation ■ Medical Devices Operation ■ Other Operations

Corporate Data

- 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: 2,422 (Consolidated)
- Consolidated Subsidiaries: 26
- Non-consolidated Subsidiaries: 6
- Affiliates Accounted for by the Equity Method: 2

Investor Information

- Common Stock: ¥3,450 million
- Number of Shares Authorized: 170,100,000 (As of June 29, 2005)
- Number of Shares Issued: 42,525,000
- Number of Shareholders: 6,883
- Stock Exchange Listing: Tokyo Stock Exchange 1st Section, Osaka Securities Exchange 1st Section
- Transfer Agent: Mitsubishi UFJ Trust and Banking Corporation
- Annual Shareholders' Meeting: June
- Investor Relations: KOBAYASHI PHARMACEUTICAL CO., LTD.

Finance & Accounting Department

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