KOBAYASHI Pharmaceutical Co., Ltd.

Creativity and Innovation

Annual Report 2008

Year Ended March 31, 2008

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." In the past, the Company developed a unique identity in its three principal businesses: the Consumer Products Operation, its core business, and the Medical Devices Operation and the Wholesale Operation. Starting from January 2008, however, wholesale operations are excluded from our scope of consolidation. Going forward, Kobayashi Pharmaceutical will focus its efforts on the remaining two businesses as we continue to seek growth.

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. and China.

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 happen," while creating new markets and differentiating our brand.

Contents

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.

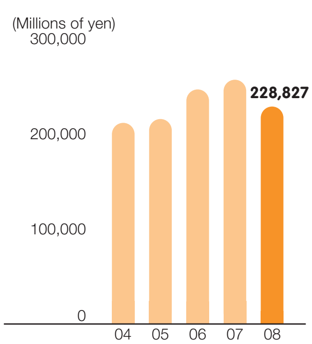
Consolidated Financial Highlights

Years ended March 31

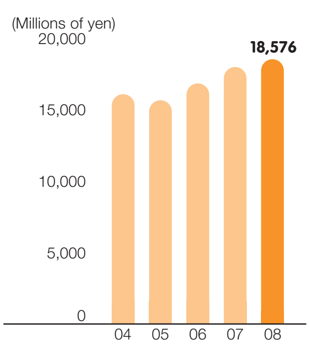
	Millions of yen			
	2006	2007	2008	Change (%)
For the Year				
Net Sales	¥ 246,853	¥ 257,022	**¥ 228,827**	(11.0)
Operating Income	16,880	18,029	**18,576**	3.0
Net Income	7,475	8,298	**8,505**	2.5
Per Share Data (Yen)				
Net Income	179.17	200.77	**205.62**	2.4
Net Assets	1,617.10	1,799.87	**1,863.24**	3.5
Cash Dividends	38.0	50.0	**54.0**	8.0
At Year-end				
Total Assets	151,945	164,556	**122,410**	(25.6)
Total Net Assets*	66,812	77,236	**77,183**	(0.1)
				Change (Point)
Ratios (%)				
ROA	5.2	5.0	**6.9**	1.9
ROE	11.8	11.7	**11.2**	(0.5)
Equity	44.0	45.2	**63.0**	17.8

* Total Net Assets in 2006 does not include minority interests.

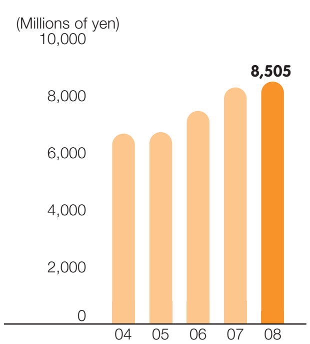
Net Sales



Operating Income



Net Income



To Our Stakeholders

"We believe that maintaining a constant sense of urgency and a conscious intent to continuously develop new products is essential to our growth strategy."

Chairman and Chief Executive Officer

Kobayashi Pharmaceutical—"You make a wish and we make it happen"

"You make a wish and we make it happen"—our brand slogan firmly defines our belief that "Creativity and Innovation" are the source of growth, and also encompasses our mission: to meet our customers' needs for products, services and systems that provide them with greater convenience in their daily lives. This mission has provided the Group with a corporate vision since its establishment. It is the source of inspiration that has guided us in creating numerous products that have been well received by our customers. Many of these have now become an integral part of customers' lives.

However, if we remain complacent with what we have achieved so far, our business will stagnate and be unable to keep up with the accelerating pace of change in society today. Hence, we believe that maintaining a constant sense of urgency and a conscious intent to continuously develop new products is essential to our growth strategy. While our slogan "You make a wish and we make it happen," conveys the Group's stance to our customers, it also reminds employees never to forget the commitments that form Kobayashi Pharmaceutical's DNA: "to be a development-focused company," and "to be exceptionally committed to our customers."

Corporate Strategy That Moves With the Times

With the completion of the January 2008 stock swap between our subsidiary, Kobashou Co., Ltd., and Mediceo Paltac Holdings Co., Ltd., Kobayashi Pharmaceutical took a definitive step toward specializing in manufacturing. Although the wholesale division complemented the manufacturing division, we regard the decision to specialize in manufacturing as a natural progression. Taking this step has also clarified our stance of placing importance not only on turnover figures, but also on profitability. The merger of Kobashou, with its strengths in OTC pharmaceutical products, and Paltac Corporation, —which is a subsidiary of Mediceo Paltac Holdings, a strong player in the sundries and cosmetics business— has also had a significant impact on the wholesale industry, where restructuring has become the order of the day. Going forward, the creation of a cooperative framework remains an important issue for the Group. In addition, the Group will actively consider mergers and acquisitions as part of its future growth strategy, as long as they dovetail with the Group's aim of being a development-focused company.

The Ideal Kobayashi Pharmaceutical

Product development at the Kobayashi Pharmaceutical Group is marked by a focus on creating new, niche markets and our objective of becoming the market leader in our chosen fields. Even if the scale of each individual market is small, we firmly believe that we can pave the way to the future if we can build up our position as the market leader in a number of niche markets. In the day-to-day work environment, I believe that my role is to continue to work toward providing employees with a vibrant working environment, and to be a company in which employees take pride.

August 2008

Kazumasa Kobayashi
Chairman and Chief Executive Officer

Interview With the President

> “In this day and age, the risks of not engineering change are infinitely greater than the risks of changing, and ‘the power to transform’ is now seen as of key importance.”

President and Chief Operating Officer

Q. How would you evaluate Kobayashi Pharmaceutical’s performance and the operating environment for the fiscal year ended March 2008?

A.

With regard to operating results, our Wholesale Operation, including Kobashou Co., Ltd., was excluded from consolidation from the fourth quarter of the fiscal year, and therefore recorded a decline in sales. However, sales of products such as OTC pharmaceuticals and body warmers in the Consumer Products Operation grew, allowing us to achieve earnings growth for the 10th consecutive year since we began reporting consolidated results.

In January 2008, *Nikkei*, Japan’s leading business daily newspaper, ran an article on the rise of crude oil prices to US$100 a barrel. This was rather shocking news; oil prices had doubled from the previous price range of US$50 to US$60. And amid the subsequent appreciation of the yen against the U.S. dollar and the global stock market decline, the cost of various other products has also climbed. Consequently, consumers felt that the prices of everything, including items of personal use, were on the rise and tightened their purse strings. In response to this environment of rocketing raw material prices, we had to create high-value-added products to encourage consumer spending, while keeping costs as low as possible. It was not enough to create better products—if we wanted to survive, we had to create the best products. The operating environment could be described as being extremely harsh.

Q. What are some of the remaining issues?

A.

Although it is not specific to the fiscal year ended March 2008, what we need to do is carefully assess consumer needs and continue to offer a stable supply of products and brands that they will support. To accomplish this, it will be important to increase the precision of regional marketing research and product sales forecasts.

We are aiming to create a system that will enable us to generate more realistic sales projections for new products based on the success of test sales, which will help raise sales of new products.

At the same time, however, we will also have products with a short life cycle, and in some cases these products will be retired as a result of returns. Simply because the Company's business is based on small-volume production of many products, the retirement rate is relatively high. Going forward, however, we will need to rebuild our brand withdrawal standards and work to minimize product retirements.

Q. With respect to the Wholesale Operation, how would you describe the impact of the share exchange with Mediceo Paltac Holdings Co., Ltd.?

A.

First, regular investment in logistics facilities and IT will no longer be necessary. This will free up management resources for investment in other Group businesses. Kobashou, which specialized in the sale of OTC pharmaceuticals, has merged with Paltac, whose strength is in sundries and cosmetics, to become Paltac KS Corporation, a specialist in the wholesale business.

We will now forge a good business relationship with Paltac KS, as we have done with other wholesalers.

Q. How did the Consumer Products Operation perform for the fiscal year ended March 2008, and what were the related issues?

A.

The Consumer Products Operation posted strong growth, recording an increase of 8.2% in net sales and 8.7% in operating income compared to the previous fiscal year. In particular, sales of pharmaceuticals, which have a high profit margin, increased as a percentage of total sales, and that contributed to the growth in profits. When I was appointed president, the Healthcare Department, which handles pharmaceuticals, foods and oral hygiene products, represented 44% of total sales and the Daily Goods Department, which handles deodorizing air fresheners, sanitary products, and household sundries, 56%. My goal was to get the ratio to 50:50, and we came very close to that in the fiscal year ended March 2008, with 49:51.

Further cost reduction is an issue we have to tackle in the Consumer Products Operation. Despite the fact that we are cutting costs every year, raw material price hikes are hitting us wave after wave during the year ending March 2009. So it is imperative that we take firm steps to further trim costs.

Q. It seems that Kobayashi Pharmaceutical has lowered the number of new products to be launched for the period ending March 2009.

A.

Until now, the sales forecast for new products was based on the marketing department's projections, and on the feedback from buyers and wholesalers at business meetings in each market. Even then, there were certain factors we could not gauge precisely without actually putting products up for sale. As a result, our financial results were sometimes impacted when sales of new products failed to match forecasts. To overcome these problems, however, we introduced new forecasting methods in the second half of the fiscal year ended March 2008. First, we analyze consumer response to a new product through package tests, where we line our product up on a shelf with competing products and ask consumers for their opinions. Next, we test-market the product through mass merchandisers and develop forecasts using POS data. During this time, we do not conduct any advertising in particular. Instead, we try to ascertain how many times per week or month consumers will buy the product, and estimate production volumes based on those figures. Finally, the results are evaluated at a development meeting, and a final decision is made on whether or not to launch the product on a national scale. We hope this approach will raise the hit ratio for new products and reduce the number of product returns and disposals.

Q. Could you comment on business results and issues in the Medical Devices Operation for the fiscal year ended March 2008?

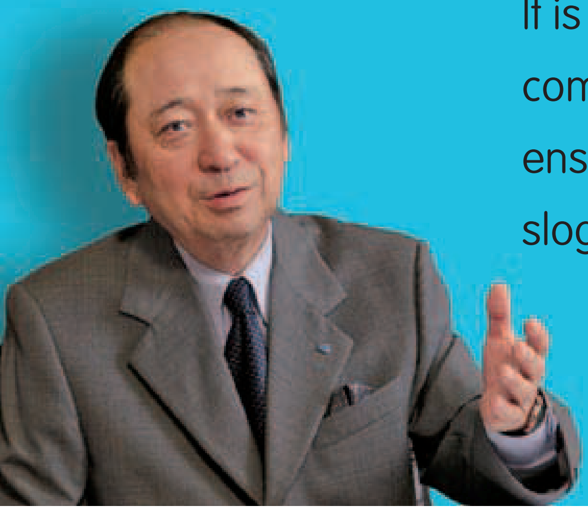
A.

Our Medical Devices Operation comprises Kobayashi Medical Division and two companies, Medicon, Inc. and eVent Medical Ltd. During the year under review, Kobayashi Medical Division recorded steady growth in the fiscal year ended March 2008 with sales of ¥8.8 billion, up 9.6% compared to the previous fiscal year. However, National Health Insurance (NHI) reimbursement prices are lowered every other year, as part of a national policy to narrow domestic and international price differentials, and we believe this will have an impact on the segment's performance in the current fiscal year. Moving forward, we need to put greater efforts into not only pursuing sales, but also ensuring profitability, particularly in light of intensifying competition in the domestic marketplace. Meanwhile, equity-method affiliate Medicon, Inc., a joint venture with C.R. Bard, Inc. of the U.S., achieved its sales target of ¥20 billion. Medicon is now working towards achieving its current targets of raising sales 10%, and operating income 5%, year on year. With regard to eVent Medical Ltd., the artificial ventilator manufacturer we acquired in November 2006, sales for the fiscal year ended March 2008, its first full year as a Kobayashi Pharmaceutical subsidiary, amounted to approximately ¥0.8 billion. eVent is targeting sales of ¥1.2 billion for the fiscal year ending March 2009, and the company will actively expand its business, centered on North America. Once we have captured a certain share of the U.S. market, there are plans to launch artificial ventilators in Japan as well.

Q. What are the growth strategies for the two businesses that are expected to be the Group's main pillars in the future?

A.

In the Consumer Products Operation, it is important to put greater effort into the core competency of new product development and to ensure thorough implementation of our brand slogan, "You make a wish and we make it happen." We need to pursue both in-house product development and mergers and acquisitions. With regard to the former, while promoting speedy product development through Idea Meetings and suggestion schemes, we also emphasized a "Mother Concept" approach to development, which takes a medium- to long-term perspective. It was this "Mother Concept" approach that led to the development of *Nicitol 85*, an anti-obesity medication. Following the introduction of specified health screenings and health guidance in April 2008 in Japan, we believe that we need to make greater efforts in this field. Meanwhile, in the Medical Devices Operation, it is certain that demand will grow as the population ages. In particular, we are anticipating growth in the field of respirator products. Going forward, we will reform our profitability structure through selection and focus, with the aim of achieving an operating margin of 5% as early as possible. In addition, eVent Medical will focus on global expansion, including increasing sales in the United States.



"It is important to put greater effort into the core competency of new product development and to ensure thorough implementation of our brand slogan, 'You make a wish and we make it happen.'"

Q. Could you tell us more about the policy regarding profit sharing with shareholders?

A.

Investors are increasingly demanding that companies increase dividends and maintain a certain minimum payout ratio. We plan to actively share profit with our shareholders. As part of measures in this regard, we plan to start paying an interim dividend from the current fiscal year. Furthermore, for the fiscal year ended March 2008, we increased the annual dividend from ¥50 to ¥54 per share. Also, we repurchased our own stock in May 2008. We will continue considering share buybacks as needed as part of our capital policy to prepare us to flexibly respond to changes in the operating environment.

At the same time, we will share profits while building up adequate internal reserves to sustain high growth rates. We will use these funds to make investments in mergers and acquisitions—a key focus of our growth strategies—and to aggressively expand overseas.

Q. Finally, what is the outlook for the future?

A.

With the operating environment becoming increasingly harsh, we need to brace ourselves to respond to it this fiscal year. In this day and age, the risks of not engineering change are infinitely greater than the risks of changing, and "the ability to transform" is now seen as of key importance. Overseas strategies are also becoming increasingly important as the Japanese market approaches saturation. In the medium to long term, we plan to focus on body warmers and deodorizing air fresheners, and aggressively expand sales in the U.S., as well as in China and Southeast Asia, where there is exceptional economic growth.

Kobayashi Pharmaceutical: The Power to Transform

Kobayashi Pharmaceutical was reborn in January 2008.
Narrowing our scope of operations from three companies to two has allowed us to concentrate resources and make our business structure more robust and profitable.

January 2008

Consumer Products Operation

Kobayashi Pharmaceutical is working to speed up product development in the Consumer Products Operation through its integrated Category System of product development and incubation, and through top-management involvement in Idea Meetings from the earliest stages of product development. Kobayashi Pharmaceutical constantly markets new products with the aim of raising the contribution to earnings from new products and consistently having an impact on the market.

We focus on pharmaceuticals, oral hygiene products, and food products categories in the Healthcare Department and aggressively pursue M&As. Overseas, we are focusing resources on body warmers.

Growth strategy

- Focus on healthcare field
- Overseas expansion

Medical Devices Operation

The Kobayashi Medical Division imports and markets medical devices produced by European and U.S. manufacturers. In April 2002, it also began manufacturing and marketing its own *Kobamed* brand of proprietary products, and converted eVent Medical Ltd. into a subsidiary in November 2006. In addition to its mainstay trading functions, Kobayashi Medical Division is increasing its capabilities as a manufacturer, aiming to increase sales of proprietary brand products to 25% of total division sales. Going forward, we will concentrate particularly on the orthopedics and surgery room markets, where continued growth is expected.

Growth strategy

- Strengthening manufacturing functions

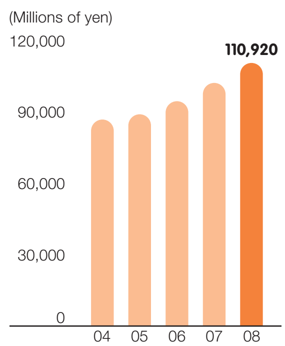
Aggressive investment in growth fields to create a robust, highly profitable company

Wholesale Operation

In 2001, Kobayashi Pharmaceutical spun off its wholesale operation to form Kobashou Co., Ltd. In 2006, Kobashou made Sowa Co., Ltd. a consolidated subsidiary, extending its area of operations to cover the whole of Japan excluding Kyushu. As a means to achieve further growth, Kobashou became a wholly owned subsidiary of Mediceo Paltac Holdings Co., Ltd. through an exchange of shares in January 2008.

Consumer Products Operation

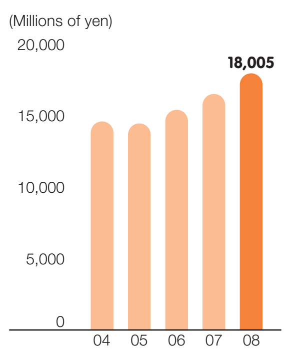
Net Sales




In-store sales


Production line at a plant

Operating Income

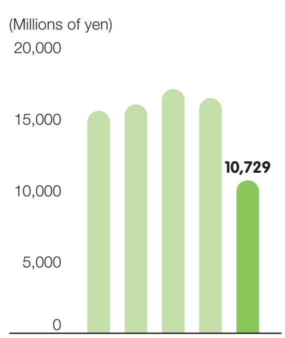



A product development meeting

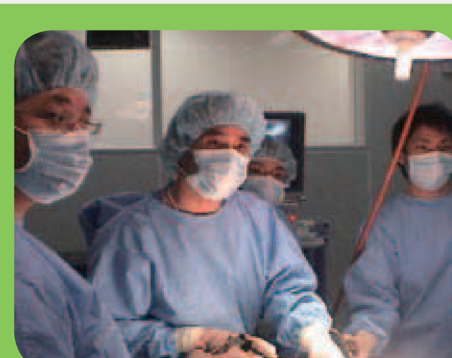

The Central Research Laboratory

Medical Devices Operation

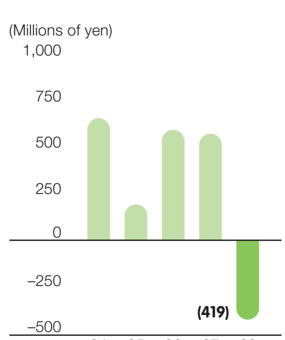
Net Sales




Medical device on display at an academic conference


Surgical training

Operating Income (Loss)




Product development


KIAPEX hip prosthesis system (in a hospital)

Kobayashi Pharmaceutical: The Power to Transform

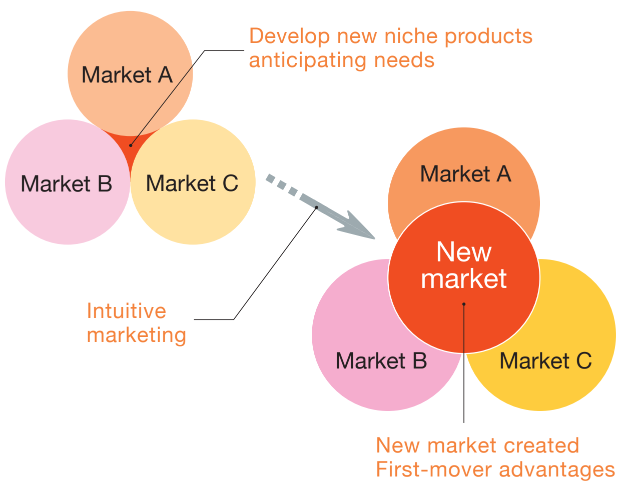
Consumer Products Operation

We support comfortable, healthy living by making consumers' wishes happen.

Basic Policy

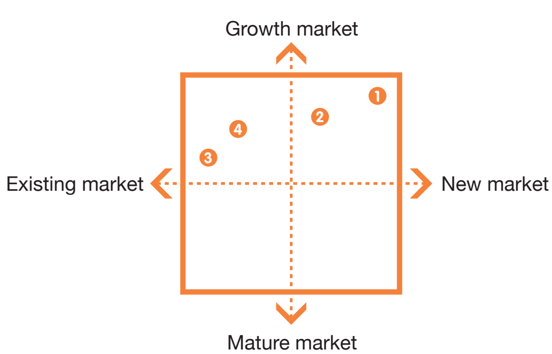
• Cultivating new markets

At Kobayashi Pharmaceutical we believe that as long as there are consumers, there will be an unlimited number of potential niche markets. Accordingly, we cultivate new markets and work to expand them.



• Product portfolio

The new products we develop are classified into four types, which enable us to engage in strategic and concentrated sales promotion activities.



❶ Products for Creating New Demand:
Development of entirely new products, never before seen in the market, and creation of new markets in the process

❷ Products for Expanding Existing Demand:
Powerful products brought to emerging markets to promote fast expansion

❸ Products for Taking on Competitors:
Products that protect existing offerings from those of rival companies when new players enter markets we have created

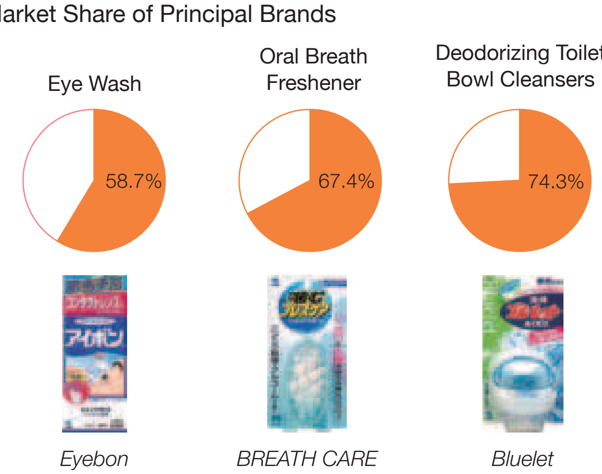
❹ Products for Brand-Based Line Extension:
The addition of value to existing products under a single brand in a way that expands the lineup and further reinforces the brand Portfolio

• Business strategy

Cultivating niche markets has enabled us to establish top brands in their respective areas. We have already developed such established brands as *Eyebon*, *BREATH CARE*, and *Bluelet*, and recently *Nicitol 85* has gained recognition as a leading brand in the markets for obesity and constipation medications. The Company pioneered a wide range of product categories in Japan, in fields including OTC pharmaceuticals, oral hygiene products and sanitary products. Despite a succession of competitors entering these respective markets, we have built a solid foundation for further development.

Turning to the management of our brands, brand managers assume full responsibility, and work to secure sales and profits, withdrawing or revamping unprofitable products as needed. Kobayashi Pharmaceutical will continue to develop products for creating new demand and products for expanding existing demand, while aiming to increase growth by developing several major brands in each of these areas.

Market Share of Principal Brands



Source: Kobayashi Pharmaceutical's research

New Product Development

New product development is the lifeline of the Company, and we have earned the trust of our customers by consistently offering products that meet their wishes. Beginning in 2005, we introduced a category-based development framework in which teams of four people—a product development manager, a researcher, a technology development manager and a brand manager—are assembled with the aim of accelerating new product development. During the development process, representatives of each category propose ideas from their own individual standpoint, and new product concepts are created after many hours of lively debate. Ideas for new products in each category are then presented at monthly Idea Meetings, attended by the president and each in-house company president, where decisions are made on whether to proceed with development.

From the fiscal year under review, we have started conducting test marketing to assess the rate of sales before making a decision on whether to roll out a product nationwide.

Moreover, in 1982 the Group instituted a system enabling all employees to freely propose new product ideas at any time, and the system has become so firmly entrenched that each year 35,000 ideas for new products and operational improvements are proposed. Of course the cooperation of research, marketing and many other departments is essential to the process of transforming an idea into a new product, but our corporate culture in which all employees are constantly focused on development underpins Kobayashi Pharmaceutical's standing as an enterprise that emphasizes product development.

• New products launched in spring and fall 2007

• New products launched in spring 2008

Another of our product development methods is the "Mother Concept" approach. The idea is to analyze major social trends over the medium and long terms, anticipate likely future demand trends, and then establish themes called "Mother Concepts" that define areas where development should be concentrated. Products based on this approach include *Inochi No Haha A*, a medication related to menopause, *Nicitol 85*, an anti-obesity drug and *Dorcitol*, medicine for high serum cholesterol.

Inochi No Haha A

Nicitol 85

Dorcitol

Focus on the Healthcare Market

As consumers have become more health-oriented in recent years, there is still plenty of room to cultivate new markets in the healthcare field. In order to establish ourselves as the leading company in the healthcare market, pursuing M&As is a vital complement to the development of new products. Through such initiatives as acquiring the *Inochi No Haha A* brand from Sasaoka Yakuhin Corporation and a share transfer with Aloe Pharmaceutical Co., Ltd., we have achieved steady success, particularly with regard to expanding our business domains. Looking ahead, we plan to improve synergies with existing operations while pursuing M&As that equally benefit our Company and our partner companies.

In the OTC drug market, future growth is anticipated in areas connected with such key themes as lifestyle-related disease and physical discomfort, and aging, and the Company is investing aggressively in these areas. In terms of lifestyle-related diseases, metabolic syndrome has become a social problem, and many companies are looking to enter the market in this area. Kobayashi Pharmaceutical was the first to do so with *Nicitol 85*, which has achieved a high level of market recognition. *Nicitol 85* is a Chinese herbal medicine for oral use that is effective in helping to break down and burn abdominal fat. Containing extracts of 18 types of herbal medicines in tablet form, *Nicitol 85* is effective in treating obesity. The product is ideal for people who have gained excess weight in the form of fat, and particularly for those who tend to gain weight around the abdomen, or have a tendency to suffer from constipation. Another product, *Dorcitol*, reduces cholesterol and promotes smooth blood flow. Going forward, we will continue to develop new healthcare products including the health-oriented tea product *Tochucha*.

Sales Strategy

• Targeting drug stores

In recent years, we have been particularly focused on a carefully crafted approach to marketing that utilizes the characteristics of each distribution channel. For example, we are deploying personnel responsible exclusively for marketing at drugstores, which are accounting for a greater proportion of sales year by year. These personnel offer suggestions to marketing managers around Japan with regard to three areas in particular: the knowledge required to succeed in business negotiations; in-store display techniques; and effective sales promotion tools. In another development that will help us expand the drugstore channel, Kobashou Co., Ltd.—a Group Company until December 31, 2007—entered into a business merger with Paltac Corporation. The result was the establishment of Paltac KS Corporation, a powerful wholesaler of sundries and drugs. Through our partnership with Paltac KS, which shares many of our key customers, we will further enhance our ability to sell to drugstores.

• Mail-order shopping business

For the mail-order shopping business, which has been positioned as a growth field, we established the Mail-Order Shopping Business Department in April 2007. Through this department, we have enhanced our sales structure for products like nutritional supplements, and skincare brands *hifmid* and *Real Labo*.

• "Long tail" products

There is a certain set of our products that are referred to as "long tail" products. The market size for these items is small, but the consumers who use them are highly satisfied, and they tend to have high repeat purchase rates. Without advertising activities, however, sales in retail stores are limited.

Because there is virtually no competition for these niches and price competition can be avoided, these "long tail" products have the special characteristic of being extremely profitable. We believe that they can provide new value to retail stores as well, and expanding them to retail venues would boost both sales and profit.

In the future, we will actively promote these "long tail" products.

hifmid

Real Labo

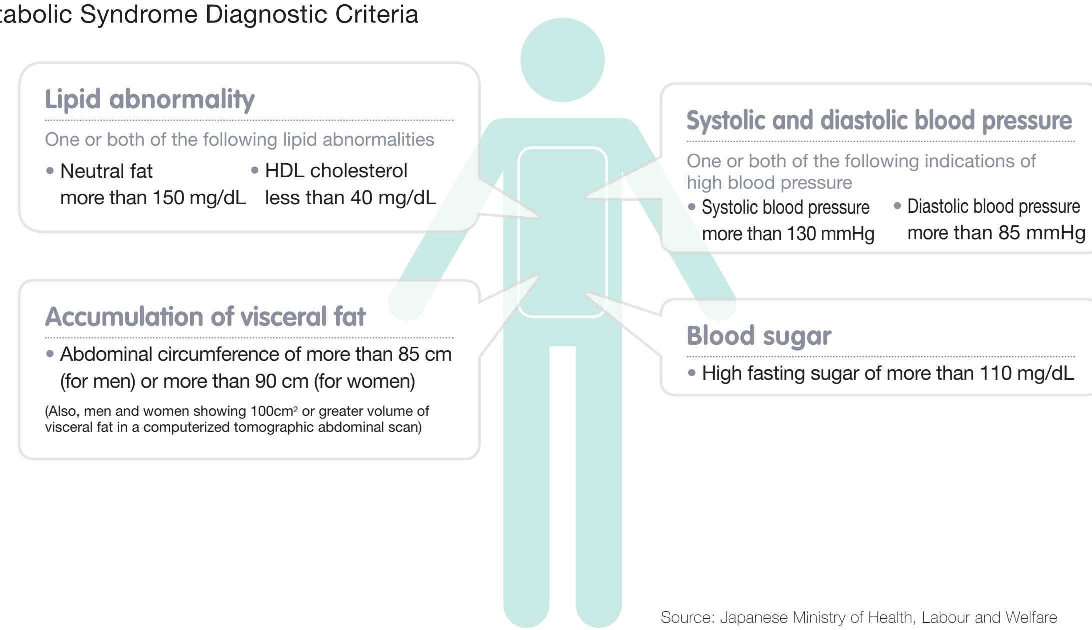
Nutritional supplements

Growth in the Market for Metabolic-Syndrome-Related Treatments

A day rarely passes without mention of metabolic syndrome in a newspaper or on television. The accumulation of visceral fat around the abdominal organs can trigger various conditions that increase the risk of arteriosclerosis, including obesity, high blood pressure, high blood sugar, and hyperlipemia, greatly increasing the risk of heart disease.

According to the Japanese Ministry of Health, Labour and Welfare, metabolic syndrome and many other lifestyle diseases are caused by abdominal obesity resulting from multiple unhealthy habits. The ministry has clearly stated that such diseases are the most significant factor shortening the lives of Japanese people and contribute greatly to the national cost of medical care. The number of people in Japan classified as metabolic syndrome positive or in danger of developing the condition has been estimated at roughly 20 million. As a means to provide health counseling to people in this group, the Japanese government has launched a system that mandates the provision of specified health screenings and health guidance to persons over 40 years old covered by a national health insurance plan. Prevention of metabolic syndrome has been identified as an important national issue as it will support Japan's public health insurance system by reducing national healthcare expenses.

Metabolic Syndrome Diagnostic Criteria



Source: Japanese Ministry of Health, Labour and Welfare

Specified health screenings and guidance

Effective April 2008, the Japanese Ministry of Health, Labour and Welfare has established a specified health screenings and guidance program that works through health insurance associations to provide patients with guidance on improving lifestyle habits such as a controlled diet and regular exercise. The purpose of the program is to prevent lifestyle diseases and limit the occurrence of critical illnesses such as arteriosclerosis in Japan. The program is aimed at all people aged 40-74 who are enrolled in one of Japan's national health insurance plans, as well as their dependents of the same age range.

With roughly one in every six deaths in Japan related to a lifestyle disease, it is important to take early preventative measures. We now understand that lifestyle diseases such as high blood pressure, hyperlipemia, and diabetes are not unrelated, but share a common cause—visceral fat obesity.

In light of this situation, the government has decided to devote a portion of the national health insurance budget to these specified health screenings and health guidance to prevent lifestyle diseases. This program identifies people with metabolic syndrome and those in danger of developing the condition and supports them in efforts to improve their health.

Overseas Business

One of the Kobayashi Pharmaceutical Group's business policies for the year ending March 2009 is to strengthen the business foundation of our overseas businesses and make them profitable. One pillar of our overseas strategy is expanding the number of sales channels for body warmers. In November 2006, we made HeatMax, Inc. a wholly owned subsidiary. HeatMax not only boasts the No. 1 market share in the U.S. body warmer market, but has focused on the field of therapeutic body warmers by aggressively pursuing sales of its own brand, as well as OEM products sold through major drugstore chains and volume retailers. By further leveraging HeatMax's distribution network and high profit margins, we anticipate further expansion for the U.S. business. Additionally, in China, which continues to experience high economic growth, the markets for deodorizing air fresheners, body warmers, and other consumer products continue to expand steadily. And in China and elsewhere in East Asia, we are reinforcing our sales structure and increasing sales.

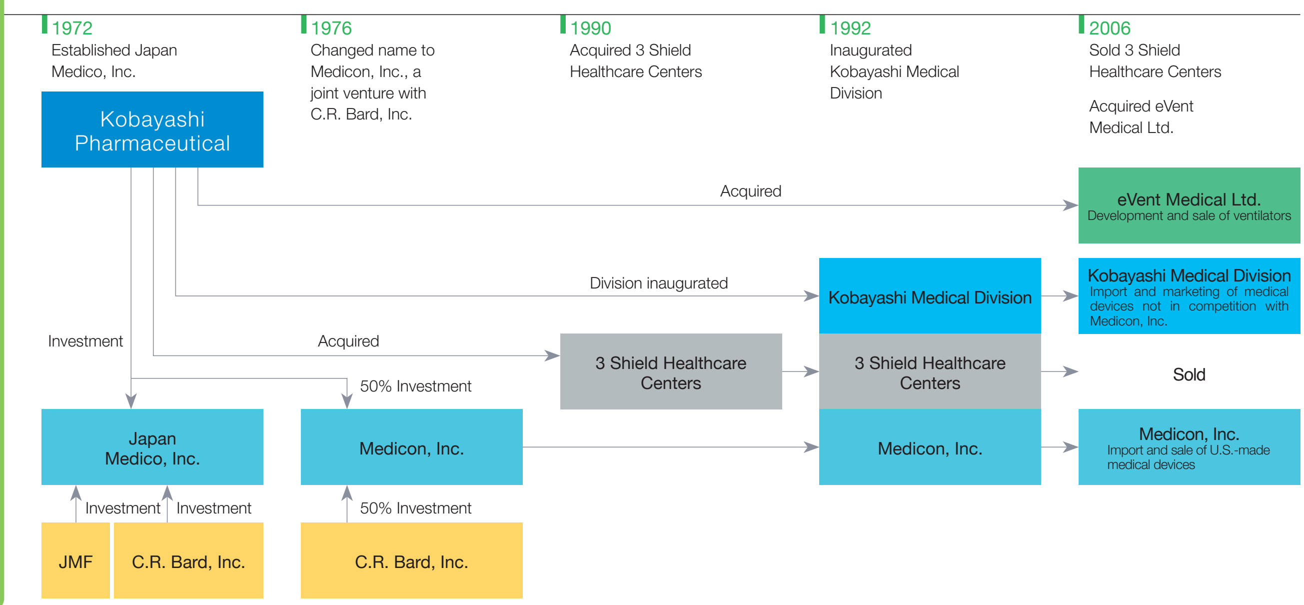
International locations

Products sold overseas

Medical Devices Operation

We are advancing our Medical Devices Operation as both a trading company and a manufacturer, ensuring that all our business activities are founded on safety, reliability and trust.

Kobayashi Pharmaceutical's Growing Medical Devices Operation



Business Environment

In the past, the fact that prices for medical devices were two or three times higher in Japan than overseas was a major problem. Accordingly, NHI list prices are lowered on alternate years, and as the fiscal year ended March 2008 was a year in which such price reductions were implemented, the difference between domestic and foreign prices is expected to drop to around 1.5–1.7 times. Moreover, complicated distribution routes had also been a factor in the price difference, but prices are expected to drop thanks to faster consolidation in the medical devices wholesale industry. These developments are also expected to have an effect on the profitability of the Company's Medical Devices Operation.

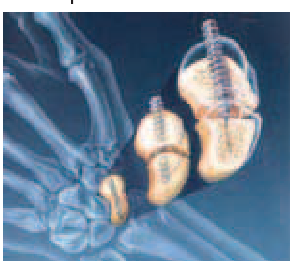
Furthermore, as the aging of Japanese society advances, the number of surgical operations is increasing. Since the division deals in surgical equipment, this should act as an additional contributing factor in terms of performance.

Overview of Medical Devices Operation

The Medical Devices Operation comprises Kobayashi Medical Division, Medicon, Inc., a joint venture with C.R. Bard, Inc. of the U.S., and eVent Medical Ltd., an overseas subsidiary. The Kobayashi Medical Division principally handles medical devices in the fields of orthopedics, surgical and operating rooms, pulmonology, brain surgery and otology, and imports and sells leading-edge medical devices from abroad into Japan. We also develop products required by medical institutions in Japan under our own *Kobamed* brand. Medicon imports and sells leading-edge medical instruments and devices developed by C.R. Bard, focusing on the urological and gastrointestinal fields. Since its founding, eVent has worked to develop, manufacture, and sell reliable ventilators that are easy for clinicians to use and trouble-free.

• Products handled by Kobayashi Medical Division

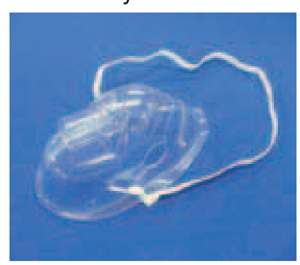
Orthopedic



Acumed LLC.
Acutrak headless compression screw
Implants for mending fractured bones

ArthroCare Corporation
Atlas® System
Devices for treating arthritis

Pulmonary



KOBAYASHI Pharmaceutical Co., Ltd.
Inspiron
Respiratory therapy products

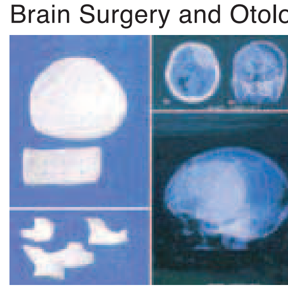
Pharma Systems Inc.
Nasal prostheses
Filters to aid breathing

Surgical

CONMED Corporation
System 5000™
Electrosurgical generator

SurgRx, Inc.
EnSeal System
Blood vessel sealing device

Brain Surgery and Otology



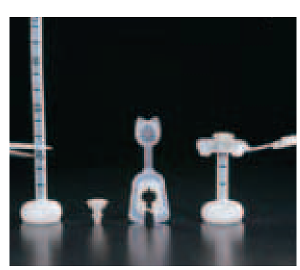
NGK Spark Plug Co., Ltd.
Ceratite® custom-made
Bone prostheses for mending cranial bone fractures

Gunze Limited
Neofix
Bioabsorbable bone-fixation device

• Products handled by Medicon

C.R. Bard, Inc.
Bardex® I.C. Complete Care®
Foley catheter system

C.R. Bard, Inc.
X-Port isp™ with Groshong catheter
Subdermal injection system



C.R. Bard, Inc.
Gauderer Genie™ PEG System
Feeding tubes

• Products handled by eVent

eVent Medical, Inc.
Inspiration LS
Ventilator

Global Expansion Through eVent

Consolidated subsidiary eVent develops, manufactures, and sells reliable ventilators that are easy for clinicians to use, and has already built a sales network in Europe, Asia, and the U.S. Now eVent is working to improve the quality of its products, for example by improving software and adding touch panels to existing products in the Inspiration line. The company has also been focusing on increasing sales channels in North America by bolstering its own sales network and developing a sales strategy targeting the infant ventilator for young children.

At the same time, eVent is currently working on development of new products which are expected to be completed in summer 2009. The company is working to bolster its selling capability by increasing the range of products it offers, and is striving to realize single-year profitability at the earliest possible date. eVent also plans to sell in Japan through the Kobayashi Medical Division, and aims to increase uptake for its own products in addition to the Inspiron ventilator-related products already being sold.

Ventilators targeting international markets
Inspiration LS (left)
Inspiration Infant (right)

Establishing Profitability Through Selectivity and Concentration

Kobayashi Medical Division has established a product development center in order to add manufacturing capabilities to its expanding trading company functionality. The center launched our own Kobamed brand in order to offer products designed for the Japanese market. Products launched under this brand to date include instruments for minimum incision surgery in the urological field, the KIAPEX hip prosthesis system, and the ACROFIX compression hip screw system. Now that the Medical Devices Operation has joined the Consumer Products Operation in becoming one of the Company's two business pillars, our expectations for the Medical Devices Operation are greater than ever. We have established the goal of increasing sales by 10% for the year ending March 31, 2009, and will continue to promote our manufacturing capability in order to further increase sales and profits. We will continue selecting and concentrating on the most promising products to gain the top market share by narrowing the focus of our brand, even within Kobayashi Medical Division's specialist domains. In doing so, we will aim to become a more profitable enterprise.

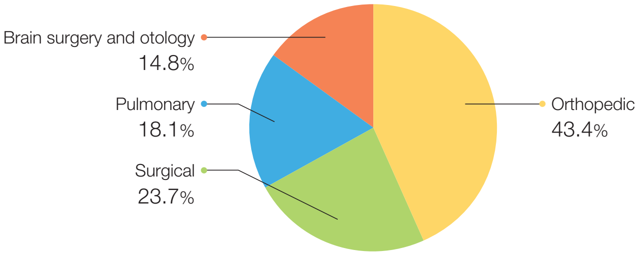
By department, in the orthopedics department, we will utilize the Company's strengths by focusing on our proprietary KIAPEX and ACROFIX products and reinforcing products used for femoral neck fractures. We are focusing on electrosurgical generators and EnSeal System for operating room equipment, Inspiron oxygen masks for respiratory equipment, and Custom Cerapest for neurosurgery and otolaryngology, with the goal of becoming No. 1 in each field.

• Proprietary products—*Kobamed* brand

KIAPEX: Bipolar hip prosthesis for femoral neck fractures

ACROFIX: Screw system for femoral neck fractures

Kobayashi Medical Division: Sales Composition by Product Category



Kobayashi Pharmaceutical's Approach to CSR

Every company must fulfill its role as a member of society. That role includes providing safe, reassuring products and services and developing the human resources needed to do so. In addition, companies are able to contribute to local communities and to the solution of social problems in a way that individuals and other organizations cannot. The Kobayashi Pharmaceutical Group is committed to fulfilling those roles as a responsible member of society.

Promoting Corporate Brand Management

Since 2002, Kobayashi Pharmaceutical has implemented corporate brand management to enhance corporate value under the brand slogan, "You make a wish and we make it happen."

Now, more than five years later, corporate brand management has spread throughout the Company, and is largely understood by employees, but the fact remains that there are still many associated issues we need to address. This recognition prompted us to take action in laying the groundwork to advance corporate brand management to the next level. To this end we launched a Group-wide project to enhance the corporate brand, clarifying outstanding issues and creating a proposal for specific innovations (for further details, please see page 22 of this annual report).

Awarded Gold Prize in the Corporate Brand Champion Competition* for the year ended March 31, 2008

During the fiscal year under review, Kobayashi Pharmaceutical continued to collaborate with health workers in focusing on patients' wishes during the actual treatment process as a means of approaching medical care from the patient's viewpoint. Within this context, specific consideration was given to the importance of managing post-operative scarring and maintaining the patient's visual appearance. These efforts culminated in Kobayashi Pharmaceutical contributing to the establishment of a new study group on cosmetics and neurosurgery.

* Every year employees create small-group-based action plans for enhancing the corporate brand, and the resulting achievements are announced in the Corporate Brand Champion Competition at the end of the fiscal year. The aim of the competition is to revitalize and enhance corporate-brand-related activities, while encouraging equal involvement by all employees.

Product Quality and Safety

Product quality and safety are key points of focus for product manufacturers. To ensure high levels of quality and safety, the Kobayashi Pharmaceutical Group has established stringent standards for multifaceted review and evaluation at every stage, starting with the initial stage of product development.

In its pharmaceutical product operations, the Quality Assurance Department, which reports directly to the head of pharmaceutical products, establishes quality assurance frameworks and conducts inspections. The department monitors the entire process from the product development and planning stages through to raw materials and equipment used in the manufacturing plant. In addition, it uses feedback obtained through the Customer Consulting Office to strive to improve product quality.

In Medical Devices Operations, the Quality Assurance Division is in charge of overall quality and safety. The division supervises the process from manufacturing to shipment in accordance with the requirements of ISO 13485, the international standard for quality management systems pertaining to medical devices. In addition, the division cooperates with sales divisions to obtain information on how products perform during actual treatment of patients.

• Evaluating efficacy and safety for humans

In order to provide products for which quality can be guaranteed, the Kobayashi Pharmaceutical Group has established three specialized committees based on product development stage. In this way, we are working to ensure efficacy and safety for humans.

The Safety Testing and Analysis Committee determines items to be evaluated for safety and evaluation methods needed for each product. The Animal Testing Committee considers ethical issues and scientific justification in regard to the necessity and appropriateness of animal testing. In accordance with the Declaration of Helsinki,* the Internal Clinical Testing Committee examines clinical testing plans from both ethical and scientific viewpoints.

* Ethical rules for medical research involving humans

Human Resources Development

Human resources development is an important priority for implementing "Creativity and Innovation," the key point of our management philosophy, and our slogan, "You make a wish and we make it happen."

In 2005, we revamped our employee training programs. To rapidly cultivate candidates for management positions and realize strong frontline operations, we are working to reinforce managerial abilities and to enhance the capabilities of all employees.

Moreover, with a clear image of the attributes that we are looking for in our employees and a commitment to job security, whether the Company is performing well or not, we are working to sustain and continually improve the capabilities of our human resources. Furthermore, by aggressively recruiting mid-career employees, we ensure that our employees have diverse attributes and introduce new expertise. In these ways, we endeavor to establish a corporate culture that continually fosters "Creativity and Innovation."

10 Attributes We Look for in Employees

1. Likes new things
2. Hates to lose
3. Asserts him/herself clearly
4. Communicates frankly
5. Perseveres
6. Energetic
7. Devoted to work
8. Not afraid of challenges or failure
9. Offers something unusual
10. Pleasant and likeable

Environmental Initiatives

The Kobayashi Pharmaceutical Group is aware of the impact its products have on the environment at every stage of the product life cycle from development and design through manufacture, sales and eventual disposal. As such, it is engaged in efforts to protect the environment, such as making the most effective use of resources and preventing global warming.

In the fiscal year ended March 2008, we achieved a number of our targets: we reduced CO_2 emissions by 3.6% per production unit*1 through more efficient operation of manufacturing equipment; we achieved zero emissions at five operating bases; and we improved yields to reduce emissions of PRTR*2 substances at all manufacturing plants to 100 kg or less. Moreover, we embarked on an action plan to make our products more environmentally sound, reviewing our environment-related standards for chemical substances and ensuring that these standards are feasible. We also increased the number of materials sourced using "green procurement," among other measures.

Looking ahead, Kobayashi Pharmaceutical will continue to consider environmental protection activities one of its most essential management tasks and step up its measures at every stage from development and design to manufacture, distribution, use and disposal.

*1 Emissions per production unit: A means of linking regulation of CO_2 emissions to the level of manufacturing activity, rather than specifying total emission volume.
*2 PRTR (Pollutant Release and Transfer Register): A system whereby businesses are required to publicly disclose, and report to the government, the volume of their emissions and transfers of chemical substances that could be harmful to people's health or the ecosystem.

Social Contribution Activities

In November 1993, the Group established the Kobayashi Pharmaceutical UNICEF Fund, whereby it collects donations to support the underprivileged worldwide. The Company is also actively participating in such activities as the breast cancer Pink Ribbon Campaign, disaster relief activities, and local clean-up and tree-planting initiatives.

• Donation of wheelchairs

Kobayashi Pharmaceutical has donated a total of 90 wheelchairs to public-sector care facilities through the auspices of 15 regional social welfare councils throughout Japan. Representatives of the facilities receiving the wheelchairs expressed their appreciation, with many saying that they hoped we would continue with this initiative. Enquiries during the presentation ceremonies revealed that the wheelchairs are required primarily for loaning to local residents, for schoolchildren to use during practical lessons concerning disability-related issues in schools and elsewhere, and for use in facilities such as homes for the elderly.

Presentation of wheelchairs to the Tokyo Council of Social Welfare

• Community clean-up activities

Ehime Kobayashi Pharmaceutical Co., Ltd.

Ehime Kobayashi Pharmaceutical is registered under the Adopt a Public Facility Program,* which is run by Niihama City in Ehime Prefecture. The company conducted two clean-ups during the fiscal year under review, one in May and one in December, mainly in the parking area of Kuroshima Seaside Park, which is near to its Niihama Plant.

* Niihama City's Adopt a Public Facility Program
A scheme whereby the local government recruits volunteers to "adopt" a specific amenity such as a park, a road, a river, or a beach, and works with them to make improvements to the area.

Cleaning up at Kuroshima Seaside Park

• Supporting foreign students from other Asian countries

The Kobayashi International Scholarship Foundation was established in April 2002, and through it we support foreign students from elsewhere in Asia who are pursuing studies in Japan. Going forward, we will continue to contribute to the education of talented young people and the promotion of international friendship and goodwill in Asia by offering scholarships to foreign students. During the fiscal year ended March 2008, we granted scholarships of ¥100,000 per month to 63 students, in addition to hosting social events.

A social event for foreign students

Corporate Governance

Enhancing Management Transparency and Long-term Corporate Value

Fundamental Corporate Governance Policy

The Kobayashi Pharmaceutical Group believes that to realize its fundamental management philosophy of maximizing corporate value, it is important to win the support of all stakeholders, including customers, shareholders, business partners, employees and local communities. The key to achieving this is to enhance the transparency of management by improving corporate governance. Moreover, we aim to raise corporate value further still by establishing robust corporate governance to ensure the Company is better able to transform itself quickly at the management level to adapt rapidly to changes in the ever-evolving business environment.

Establishing a Framework for Corporate Governance

In June 2000, the management structure of the Kobayashi Pharmaceutical Group was reshaped to promote the separation of management and business execution functions. Reforms included the adoption of an executive officer system and an “in-house company system.” Furthermore, in April 2004, the Group introduced a system whereby executive officers execute business operations under the president and general managers of operating divisions, while 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.

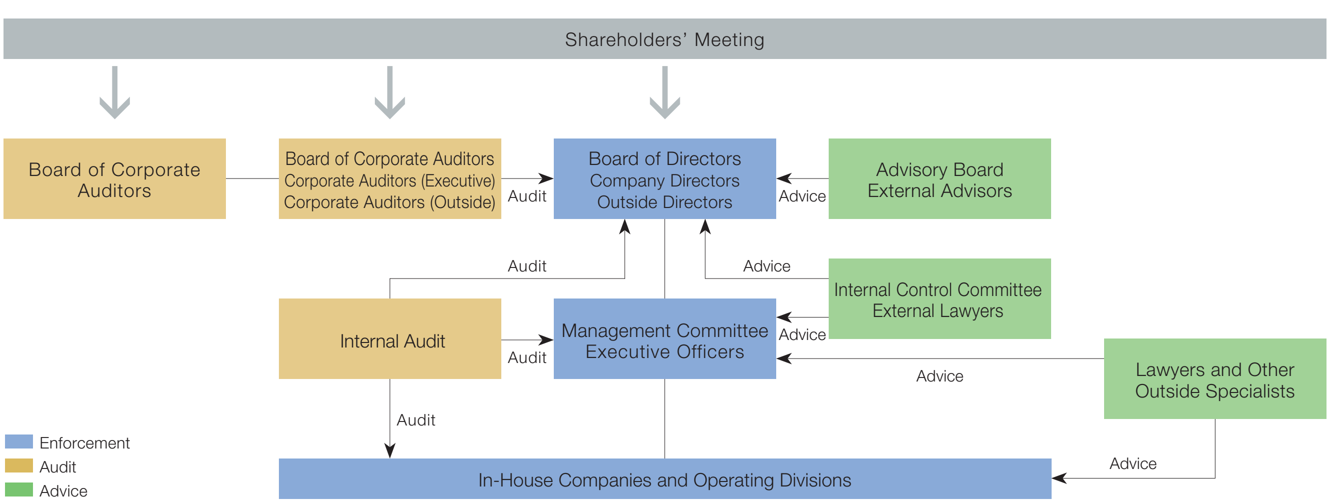
The Board of Directors holds regular monthly meetings and special meetings as necessary. The Board decides on important matters relating to management and other issues required by law and regulations, and regularly monitors the execution of operations. In June 2008, the Company appointed an outside director, further bolstering the ability of the Board of Directors and the Board of Auditors to oversee and audit business execution by directors.

The Company holds regular monthly meetings with its independent auditor, Ernst & Young ShinNihon, to exchange views on improving its operations. As part of the decision-making process, management also refers to advice from legal counsel and others on issues related to company management and day-to-day business affairs, as necessary.

At the general shareholders’ meeting held in June 2007, the introduction of countermeasures to large-scale stock acquisitions (anti-takeover measures) was approved. The objectives of these measures are to secure and further enhance corporate value and profits.

The Board of Directors’ meeting held in May 2006 decided on a fundamental policy regarding the system of internal controls to ensure appropriate business activities at the Kobayashi Pharmaceutical Group. This policy was subsequently implemented and amended at the Board of Directors’ meetings held in July 2007 and June 2008. On the basis of these amendments, Kobayashi Pharmaceutical is now in the process of improving its internal control provisions, including reassessing management risks and revising related internal rules, reorganizing the Internal Control Committee, and preventing the influence of anti-social elements.

Corporate Governance Organization (As of July 1, 2008)



Compliance

Working Together to Live Up to the Ideal and Values of Our Code of Conduct

In line with our responsibilities as a comprehensive healthcare company providing products that improve the lives and health of our customers, the Kobayashi Pharmaceutical Group resolves to implement a thorough legal compliance system that, where appropriate, implements standards even stricter than those set by the law. We have therefore drawn up and disseminated a new, expanded code of conduct that incorporates our management philosophy, brand charter, and code of conduct as a means to promote common values throughout the Group. In addition, we constantly strive to strengthen systems and activities related to compliance through our Internal Control Committee and Employee Consulting Centers and conduct compliance education.

Internal Control Committee

In April 2003, Kobayashi Pharmaceutical established a Compliance Committee that reports directly to the Board of Directors. The president of the Company chairs this committee which, with the assistance of outside legal counsel, manages the compliance system of the entire Kobayashi Pharmaceutical Group. In addition to offering advice and guidance on measures to be taken, the Committee promotes and strengthens awareness of compliance-related matters across all Group activities. In May 2007, the name was changed to the Internal Control Committee and it took charge of overseeing internal control systems as mandated in the Companies Act and the Financial Instruments and Exchange Act and ensuring that the Group is in compliance with the relevant laws.

Special Committees Under the Internal Control Committee

The Company is conducting an ongoing review of its committees and subcommittees. In the fiscal year ended March 2008, two committees were active under the Internal Control Committee—the Personal Information Protection Committee, and the Group Health and Safety Supervisory Committee. An additional four special committees also operated within the Internal Control Committee—the Special Committee on Pharmaceutical Affairs, the Special Committee on Financial Affairs, the Special Committee on Non-financial Affairs, and the Special Committee on Fair Trade.

Previously, each of these areas of focus was managed independently, but these committees now conduct oversight from the additional perspective of internal control. The Personal Information Protection Committee conducts management, oversight, and educational activities designed to raise awareness of personal information protection and strengthen our system to protect personal information in line with the Privacy Mark accreditation the Company received in March 2007. The Group Health and Safety Supervisory Committee handles issues related to health screenings and conducts educational activities to promote traffic safety.

The Special Committee on Pharmaceutical Affairs ensures both that drugs and medical devices comply with the revised Pharmaceutical Affairs Act (and scheduled revisions to the law) and that food products comply with relevant laws and regulations. The Special Committee on Financial Affairs conducts business process documentation, elimination and reduction of risk, walkthroughs (efficacy assessments), and institution of key controls with the aim of constructing an internal financial control system in line with the Financial Instruments and Exchange Act.

The Special Committee on Non-financial Affairs manages the internal control system, reviews regulations, and evaluates risks in line with the Internal Control System Basic Plan established by the Board of Directors in July 2007 as a means to establish an internal control system for non-financial affairs in line with the Companies Act.

Employee Consulting Centers

In January 2003, Employee Consulting Centers were established both inside and outside the Group (in a law office) to give employees a venue for consultation and questions about compliance-related issues. In order to assure the privacy of individuals making use of these Employee Consulting Centers and protect them from unfair treatment as a result of such consultation, Regulations Regarding the Employee Consulting Center have been established and are followed carefully, and matters brought to these centers are resolved in a timely fashion.

Education via the Group Newsletter and Intranet

Starting in March 2007, the Group newsletter has included a regular column titled “You, Me, and Compliance.” The column seeks not only to enhance employees’ awareness of compliance issues, but also to inform them in detail regarding important revisions to the law. Compliance case studies published on the Group intranet are another tool that helps increase awareness of compliance issues.

Group Training

New employees and newly appointed managers in the Kobayashi Pharmaceutical Group are given compliance training. In the year ended March 2008, executives and managers were instructed regarding sexual harassment and power harassment by Kobayashi Pharmaceutical legal counsel. We will continue to strive to strengthen educational activities to ensure that compliance is the norm for all employees.

Corporate Brand Management

As one aspect of our brand management activities, the Kobayashi Pharmaceutical Group charges each employee with the mission of representing Kobayashi Pharmaceutical in a manner that will make it a company loved around the world. In this way, the entire Group works to improve the corporate brand.

Corporate Brand: A Key to Raising Corporate Value

Kobayashi Pharmaceutical's corporate brand management is rooted in our commitment to CSR, giving rise to our corporate slogan: "You make a wish and we make it happen." We believe the most important key to achieving growth is training human resources to become the next generation of managers. The Kobayashi Pharmaceutical Group works to improve our corporate brand in line with our brand slogan which expresses our ideals.

To encourage each employee to take an independent and proactive approach to driving forward corporate brand-related activities, every year since 2003, each Group department has had its own action plan aimed at enhancing the corporate brand.

In addition, in October 2006 we launched the Group-wide "You make a wish and we make it happen" Corporate Brand Project as a means to review a variety of issues. In this project, we created committees for each of five themes: "an active company," "a company that nurtures human resources," "a trustworthy company," "a company with character" and "an interesting company." Over the nine months ending in July 2007, these committees met to identify, discuss and formulate concrete proposals for resolving relevant issues.

Committee Members From All Divisions

The committees were headed by directors serving as leaders and sub-leaders, and employees from all divisions of every Group company were encouraged to participate. After meetings, committee members returned to their workplaces to report on the issues being discussed and improvement measures being considered. This communication raised the employee interest and awareness of the corporate brand, as each employee began to view the project as their own.

Actions in Four Areas

The Group-wide "You make a wish and we make it happen" Corporate Brand Project identified four areas in which the Company could act to realize outstanding customer orientation and enhance the corporate brand and corporate value.

① Communicate the management and corporate philosophies
- Establish a management philosophy, disseminate a code of conduct, and create a system that allows these principles to take root throughout the Company

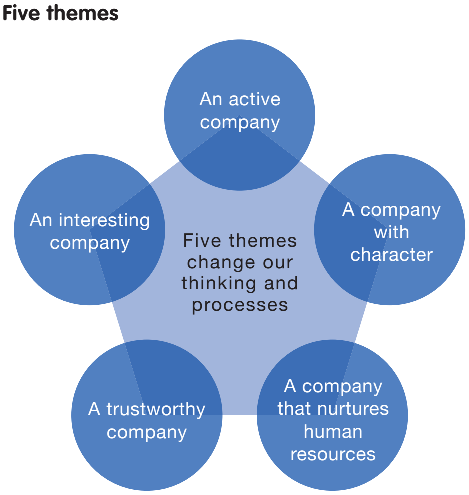
② Develop human resources and encourage a sense of ownership
- Give each employee the opportunity to grow as a contributor to the improvement of the corporate brand

③ Improve modes of business
- Review and improve work processes

④ Enhance quality for customers
- Link product brands with the Company name to represent Kobayashi Pharmaceutical as an interesting company

Kobayashi Pharmaceutical aims to improve the corporate brand and enhance corporate value (increase customer satisfaction) by taking action in these four areas.

Five themes



Management Principles

Management Philosophy
We will provide people and society with comfort by cultivating originality through tireless creativity and innovation

Group Brand Charter
Our mission is not only to make products that our customers want now but also to develop new and innovative products for our consumer's future needs. True to our brand slogan of "You make a wish and we make it happen", we will strive to research, develop, manufacture, and deliver products as quickly as possible.

Products and services will be developed to the highest standards and quality to exceed our customers' expectations.

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

We are committed to being an innovative, development focused company that contributes to society, builds lasting relationships with customers, and exceeds all expectations in customer satisfaction.

Outstanding customer orientation
Constantly looking at things from the customer's perspective enables us to truly understand our customers

High-quality operations that live up to expectations
Winning the trust of customers by carefully evaluating the level of quality of the products and services they expect and maintaining this level of quality

The spirit of creativity and innovation
Wonder and admiration are earned not by repeating the past, but through the ongoing pursuit of creativity and innovation.

Directors, Corporate Auditors and Officers

(As of June 27, 2008)

Directors

Kazumasa Kobayashi
Chairman and Chief Executive Officer

Yutaka Kobayashi
President and Chief Operating Officer

Akira Horiguchi
Executive Vice President
Senior General Manager, Medical Device Business Headquarters

Jyoji Miki
Senior Executive Director
President, Product Sales Company

Masaaki Tanaka
Executive Director
President, Manufacturing Company

Takashi Tsujino
Executive Director
President, Research and Development Company

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

Satoshi Yamane
Director
Senior General Manager, Group Corporate Business Headquarters

Haruo Tsuji
Outside Director

Corporate Auditors

Toshiyuki Morii
Statutory Auditor

Masahiro Hiraoka
Statutory Auditor

Hiroshi Hayashi
Outside Officer

Ryuji Sakai
Outside Officer

Executive Officers

Hiroshi Nomoto
President, Kiribai Chemical Co., Ltd.

Takafumi Sakaguchi
President, Kobayashi Medical Company

Hidetsugu Yamamoto
President, Business System Center

Kunio Moriya
General Manager of the Tokyo Metropolitan Area, Product Sales Company

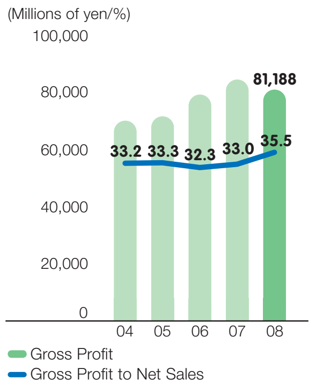
Susumu Horiuchi
General Manager, Product Sales Company

Toshio Nanba
General Manager, Research and Development Division, Research and Development Company

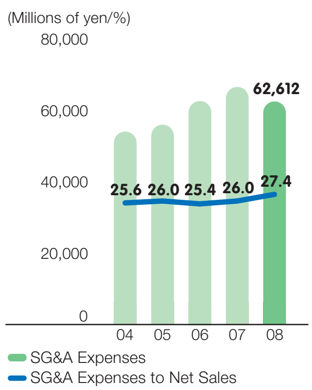
* Yutaka Kobayashi, Akira Horiguchi, Jyoji Miki, Masaaki Tanaka, Takashi Tsujino, Akihiro Kobayashi and Satoshi Yamane concurrently serve as executive officers.

Management's Discussion and Analysis

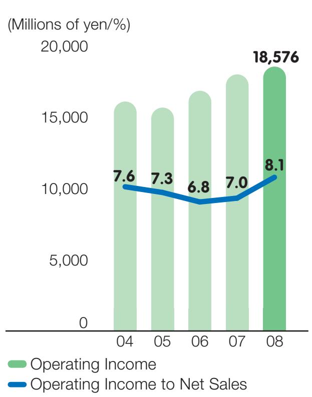
Gross Profit and Gross Profit to Net Sales



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



Operating Income and Operating Income to Net Sales



"You make a wish and we make it happen"

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 happen"—by providing products and services for the health, comfort and happiness of all stakeholders.

Kobayashi Pharmaceutical is committed to the ongoing pursuit of "Something New, Something Different" through the development of products and services that meet consumer needs in the current age of rapid change and intensifying competition. We believe that this process is the driving force behind growth, and through this pursuit, we will work to 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 (11 in Japan and 15 overseas) and 2 affiliates in Japan accounted for by the equity method. The Company classifies its business activities into three segments: the Consumer Products Operation (15 consolidated subsidiaries and 1 equity-method affiliate); the Medical Devices Operation (7 consolidated subsidiaries and 1 equity-method affiliate); and Other Operations (6 consolidated subsidiaries).

Overview

In the fiscal year ended March 31, 2008, the Japanese economy generally maintained a recovery course, driven by improved corporate profits and underlying strength in consumer spending. However, the future outlook remains unclear due to the U.S. subprime loan problem and the prolonged run-up in crude oil prices.

In this environment, the Kobayashi Pharmaceutical Group took steps to fully express the spirit of its management philosophy of "Creativity and Innovation." The Group cultivated latent customer needs by introducing new products and services to seed new markets while activating existing markets by offering products and services with new added value. At the same time, Kobayashi Pharmaceutical also made aggressive efforts to form business partnerships, acquire companies, and pursue overseas business expansion.

Additionally, Kobashou Co., Ltd., which operated the Wholesale Operation, became a wholly owned subsidiary of Mediceo Paltac Holdings Co., Ltd., through a share swap in January 2008. As a result, the Wholesale Operation was removed from the scope of consolidation in the fourth quarter of fiscal 2008, resulting in a decline in consolidated net sales.

Meanwhile, operating income increased on higher sales in categories with high profit margins as a result of aggressive investment in advertising to develop the Kobayashi brand. Another contributing factor was manufacturing cost reductions achieved through rigorous cost-reduction measures and reviews of sales promotion expenses.

Net Sales

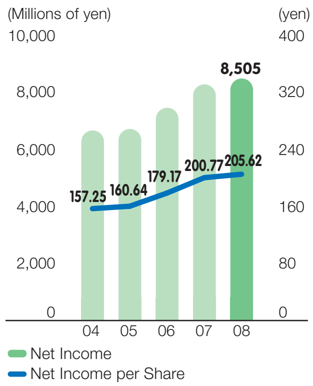
The Consumer Products Operation recorded an increase in sales mainly due to the contribution of new products and to stronger overseas sales of body warmers. In the Wholesale Operation, sales declined due to the removal of Kobashou from the scope of consolidation in the fourth quarter. In the Medical Devices Operation, sales in the surgery room and orthopedics fields grew steadily. However, due to the sale of all shares in the three Shield Healthcare Centers, which ran the home-nursing business, overall sales in the Medical Devices Operation declined.

As a result, consolidated net sales for the fiscal year ended March 31, 2008 fell 11.0% from the previous fiscal year, to ¥228,827 million.

Gross Profit and Operating Income

After provisions for returned products, the cost of sales declined 14.3%, to ¥147,639 million, from the previous fiscal year, and gross profit fell 4.2% to ¥81,188 million. Selling, general and administrative (SG&A) expenses decreased 6.1%, to ¥62,612 million, due to the removal of the Wholesale Operation from the scope of consolidation in the fourth quarter. As a net result of the foregoing, operating income increased 3.0%, to ¥18,576 million.

Net Income and Net Income per Share



The ratio of gross profit to net sales rose from 33.0% in the previous fiscal year to 35.5% in the year under review, and the ratio of operating income to net sales increased from 7.0% to 8.1%. These gains were primarily attributable to the large growth rate in sales recorded by the Consumer Products Operation, which has high profit margins.

Income Before Income Taxes and Net Income

Income before income taxes and minority interests declined 1.5%, to ¥15,800 million, and net income rose 2.5% to ¥8,505 million.

Net income per share increased 2.4%, to ¥205.62, compared to ¥200.77 in the previous fiscal year.

Segment Information

The Kobayashi Pharmaceutical Group's business is classified into three segments: the Consumer Products Operation, the Medical Devices Operation, and Other Operations.

Inter-group sales and transfers, which are included in segment sales, amounted to ¥39,930 million in the fiscal year ended March 31, 2007 and ¥32,879 million in the fiscal year ended March 31, 2008.

Net Sales and Operating Income (Loss) by Segment

Net Sales

	Millions of yen				
Consumer Products Operation	2004	2005	2006	2007	**2008**
Sales to third parties	66,523	67,525	68,869	71,717	**84,707**
Inter-group sales and transfers	20,532	21,749	25,908	30,786	**26,213**
	87,055	89,274	94,777	102,503	**110,920**
Wholesale Operation					
Sales to third parties	126,080	128,356	156,934	164,839	**131,603**
Inter-group sales and transfers	–	–	0	1	**360**
	126,080	128,356	156,934	164,840	**131,963**
Medical Devices Operation					
Sales to third parties	15,609	16,056	17,127	16,496	**10,729**
Other Operations					
Sales to third parties	3,458	3,771	3,923	3,970	**1,788**
Inter-group sales and transfers	8,401	8,434	9,053	9,143	**6,306**
	11,859	12,205	12,976	13,113	**8,094**

Operating Income (Loss)

	Millions of yen				
	2004	2005	2006	2007	**2008**
Consumer Products Operation	14,631	14,493	15,447	16,560	**18,005**
Wholesale Operation	535	799	436	324	**(131)**
Medical Devices Operation	645	190	583	561	**(419)**
Other Operations	153	140	402	391	**431**

■ Consumer Products Operation

We launched 24 new consumer products, not including nutritional supplements, as part of efforts to create new markets and expand existing markets. Of these products, especially strong contributions to our improved performance were made by the internal medicine *Naripitan* that helps ringing of the ears, the sanitary product *Sarasaty Sara Li E*, which provides all-day comfort for women, and *Toilet Shoshu Shabon*, an air deodorizing freshener that gives bathrooms a refreshing, clean scent. In existing products, sales of *Nicitol 85*, a diet pill for reducing abdominal fat, increased as the market for metabolic-syndrome-related products expanded, and sales of *Bluelet* toilet bowl cleanser also remained strong. Domestic sales of body warmers were strong in the year under review, partly because of a stretch of cold weather from the start of the year. Overseas, HeatMax, Inc., a U.S.-based body warmer maker that we acquired, contributed to consolidated results for the whole of the fiscal year ended March 31, 2008 and, as a result, sales increased.

Fiscal 2008 Net Sales and Operating Income (Loss)

In the fiscal year ended March 31, 2008, sales in the Consumer Products Operation increased 8.2% from the previous fiscal year, to ¥110,920 million. By category, sales of body warmers increased substantially by 32.7%, sales of pharmaceuticals rose 9.6%, and sales of deodorizing air fresheners increased 1.9%. Additionally, sales of oral hygiene products, sanitary products and food products increased 6.3%, 6.7%, and 7.2%, respectively. However, sales of household sundries declined 5.3%.

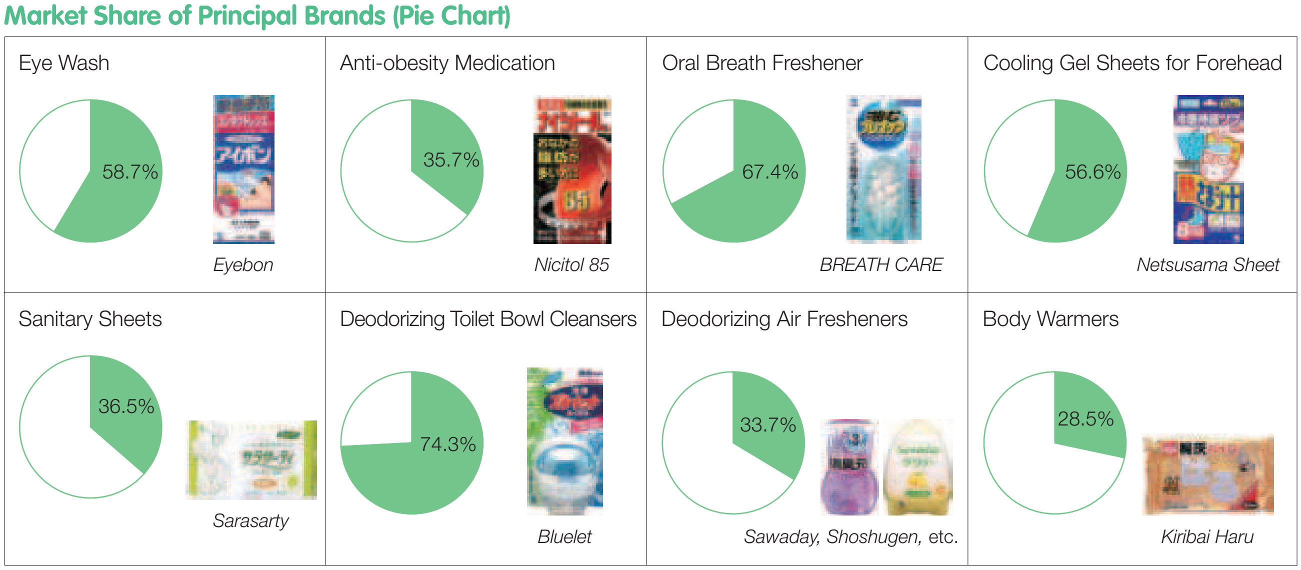
Operating income increased 8.7% year on year to ¥18,005 million for various reasons, including growth in sales of product categories with high profit margins such as OTC pharmaceuticals, and reductions in production costs as a result of thorough cost-cutting efforts.

Sales by Category

Millions of yen

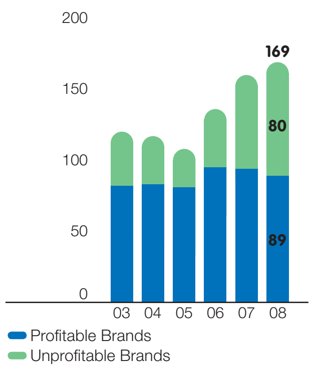
	2007		2008		Changes	
	Sales	% of Total Sales	Sales	% of Total Sales	Amount	Change (%)
Pharmaceuticals	19,799	19.3	**21,702**	**19.6**	1,903	9.6
Oral hygiene products	11,811	11.5	**12,553**	**11.3**	742	6.3
Sanitary products	13,796	13.5	**14,714**	**13.3**	918	6.7
Deodorizing air fresheners	30,020	29.3	**30,578**	**27.6**	558	1.9
Household sundries	4,502	4.4	**4,265**	**3.8**	(237)	(5.3)
Food products	11,186	10.9	**11,991**	**10.8**	805	7.2
Body warmers	11,389	11.1	**15,117**	**13.6**	3,728	32.7
Total	102,503	100.0	**110,920**	**100.0**	8,417	8.2

Market Share of Principal Brands (Pie Chart)

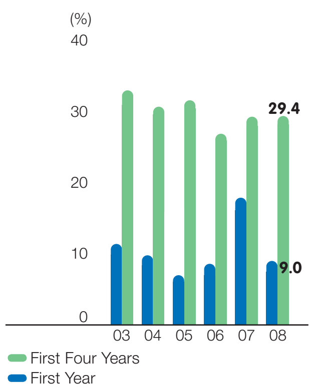


Source: Kobayashi Pharmaceutical's research

Number of Profitable and Unprofitable Brands



New Products as a Percentage of Sales



Number of Profitable and Unprofitable Brands

We were active in bringing to market new products requiring upfront marketing investment, and since these products make a loss immediately after their market launch, the number of unprofitable brands increased. However, we were able to keep the total loss at the same level as in the previous fiscal year by taking measures that included withdrawing underperforming products.

	2003	2004	2005	2006	2007	2008
Profitable brands	82	83	81	95	94	**89**
Unprofitable brands	38	34	27	41	66	**80**

* The number of unprofitable brands includes certain new products.

New Products as a Percentage of Sales

(%)

	2003	2004	2005	2006	2007	2008
First year	11.4	9.8	7.0	8.6	17.9	**9.0**
First four years	33.0	30.7	31.6	26.9	29.3	**29.4**

Issues to Be Addressed in the Fiscal Year Ending March 31, 2009

In an environment where product prices have generally stabilized, we worked to further increase sales with the launch in spring 2008 of six new products targeting emerging customer needs. These products included *Dorcitol* to reduce excessive cholesterol in the blood and improve blood flow, the medicine *Inochi No Haha White* to alleviate menstrual discomfort for which there was previously no treatment, and the toilet tank cleanser *Bluelet Hyouhakudama Plus*, which leaves bowls white and shiny through the dual cleaning power of bleach balls and a cleaning liquid. For existing brands, the Company will aggressively promote sales in line with marketing plans formulated for each brand. In overseas operations, we are continuing to work on expanding markets, centered on body warmers. As a result of these measures, we expect segment sales to increase 4.3% to ¥115,700 million.

We will continue working to reduce costs, but the impact of changes in accounting treatment following the application of new accounting rules regarding valuation of inventories, aggressive investments in advertising to develop our brands, and sharp increases in raw materials prices mean that we are forecasting a year-on-year decline of 12.8% in operating income, to ¥15,700 million compared with the fiscal year ended March 31, 2008. Based on a comparison applying the new accounting standards to the fiscal year ended March 31, 2008, our forecast is for an 8.7% increase in operating income to ¥1,263 million.

■ Wholesale Operation

Kobashou, which had operated the Wholesale Operation, become a wholly owned subsidiary of Mediceo Paltac Holdings through an exchange of shares in January 2008. As a result, the Wholesale Operation was removed from the scope of consolidation in the fourth quarter of fiscal 2008.

Fiscal 2008 Net Sales and Operating Income (Loss)

Sales for the first nine months of the fiscal year totaled ¥131,963 million. Although market conditions for mainstay contact lens care products were harsh, sales of traditional Chinese herbal products to improve people's lives, winter goods and food products were strong. The segment's contribution to consolidated net sales decreased from 64.1% in the previous fiscal year to 57.7%.

By product category, in drugs, sales of products declined 14.9% and sales of merchandise fell 20.7%. In sundries and food, sales of products declined 18.3%, and sales of merchandise were down 20.8%.

With regard to profits, there was fierce competition among drugstore operators, our principal customers, to open new outlets and price-based competition intensified. As a result, there was an operating loss of ¥131 million.

Sales by Category

		Millions of yen					
		2007		**2008**		Changes	
		Sales	% of Total Sales	Sales	% of Total Sales	Amount	Change (%)
Drugs	Products	13,901	8.4	**11,832**	**9.0**	(2,069)	(14.9)
	Merchandise	62,852	38.1	**49,841**	**37.8**	(13,011)	(20.7)
Sundries and food	Products	20,680	12.6	**16,894**	**12.8**	(3,786)	(18.3)
	Merchandise	67,407	40.9	**53,396**	**40.4**	(14,011)	(20.8)
Total		164,840	100.0	**131,963**	**100.0**	(32,877)	(19.9)

Note: “Products” refers to goods procured from Kobayashi Pharmaceutical Co., Ltd., while “merchandise” refers to goods procured from other companies.

■ Medical Devices Operation

The Kobayashi Medical Division, which leads the Medical Devices Operation, focused its sales efforts on surgical products, such as electrosurgical generators, and in the orthopedic surgery field, where demand is expected to increase, resulting in steadily increasing sales.

Net Sales and Operating Income (Loss)

In the Medical Devices Operation in the year under review, eVent Medical Ltd., a maker of ventilators that was acquired in November 2006, was included in the scope of consolidation. However, in the same month, we sold all shares in the three Shield Healthcare Centers, which were involved in the home nursing care business. As a result, segment sales declined by 35.0% to ¥10,729 million, and the segment’s contribution to consolidated net sales declined from 6.4% to 4.7%.

By product category, sales in the Kobayashi Medical Division, which is strong in orthopedics and operating room-related fields, posted a 9.6% increase in sales. As for profits, due to aggressive investments to grow eVent Medical’s artificial ventilator business, the segment recorded an operating loss of ¥419 million.

Sales by Category

	Millions of yen					
	2007		**2008**		Changes	
	Sales	% of Total Sales	Sales	% of Total Sales	Amount	Change (%)
Kobayashi Medical Division	8,072	48.9	**8,847**	**82.5**	775	9.6
Shield Healthcare Centers (3 firms)	7,263	44.0	**–**	**–**	(7,263)	–
eVent	65	0.4	**868**	**8.1**	803	1,235.4
Others	1,096	6.7	**1,014**	**9.4**	(82)	(7.5)
Total	16,496	100.0	**10,729**	**100.0**	(5,767)	(35.0)

Issues to Be Addressed in the Fiscal Year Ending March 31, 2009

The Kobayashi Medical Division will bolster its product lineups in existing fields, such as operating room and orthopedic surgery products. At the same time, the division will aggressively develop proprietary products. eVent Medical, meanwhile, will pursue global sales of ventilators and the development of new products. We expect a year-on-year increase of 10.0% in segment sales, to ¥11,800 million.

We expect profits to improve by ¥19 million during the fiscal year ending March 31, 2009, to an operating loss of ¥400 million. Based on a comparison applying new accounting standards to the fiscal year under review, our forecast is for an improvement to an operating loss of ¥136 million.

■ Other Operations

Other Operations, which include such activities as transportation, sales promotion, and market research, are conducted on a financially independent basis. Their objective is to support 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 provided by companies here.

Sales of Other Operations declined 38.3%, to ¥8,094 million. Operating income increased 10.2%, to ¥431 million.

Analysis of Financial Position

Assets

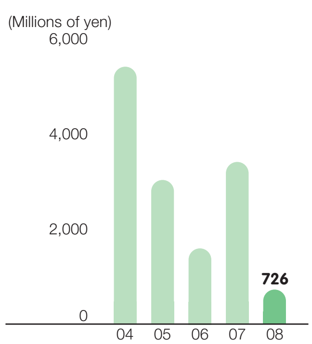
Total assets were ¥122,410 million as of March 31, 2008, a decrease of 25.6% from the end of the previous fiscal year.

Due to the removal of the Wholesale Operation from the scope of consolidation, current assets declined 35.3%, to ¥66,069 million. This was primarily attributable to a decline of 48.9%, or ¥25,109 million, in trade notes and accounts receivable and a decrease of 37.8%, or ¥7,494 million, in inventories compared to the previous fiscal year-end.

Property, plant and equipment, net declined 31.6% to ¥15,236 million. This was mainly the result of depreciation and amortization of existing assets.

Investments and other assets were up 2.3% from the end of the previous fiscal year, to ¥41,105 million.

Interest-bearing Debt



Liabilities

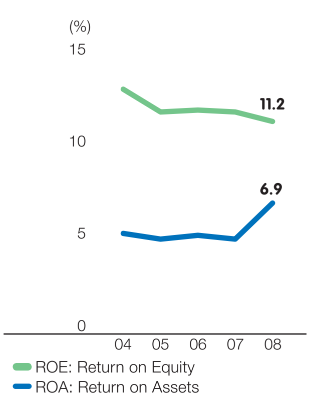
Total liabilities were ¥45,227 million at March 31, 2008, down 48.2% from the previous fiscal year-end. Current liabilities declined 50.7% to ¥37,941 million. This was mainly due to a decrease of ¥35,944 million, or 70.1%, in trade notes and accounts payable resulting from the removal of subsidiaries from the scope of consolidation. Short-term loans payable declined 77.4%, to ¥726 million. Consequently, the current ratio improved 41.5 percentage points from a year earlier, to 174.1%.

Long-term liabilities were down 29.2%, to ¥7,286 million. This rise was principally due to a decrease of ¥3,073 million, or 40.6%, in accrued retirement benefits for employees.

Net Assets

Net assets, the total of shareholders' equity and minority interests at fiscal year-end, were down slightly to ¥77,183 million. While retained earnings increased ¥5,355 million, valuation and translation adjustments declined ¥2,768 million. Treasury stock, at cost, declined ¥81 million, to ¥3,230 million, due principally to the exercise of stock options. As a result, the equity ratio increased 17.8 percentage points, from 45.2% a year earlier to 63.0% at the end of the fiscal year under review. The return on equity (ROE) decreased 0.5 percentage point, from 11.7% to 11.2%. The ratio of net income to total assets (ROA) increased 1.9 percentage points, from 5.0% to 6.9%.

ROE and ROA



Cash Flow Analysis

Cash Flows From Operating Activities

In the fiscal year ended March 2008, net cash provided by operating activities was ¥12,192 million, a 38.0% increase compared with the previous fiscal year. The main factors were ¥15,800 million in income before income taxes and minority interests, a ¥3,489 million increase in trade notes and accounts receivable, a ¥6,644 million increase in trade notes and accounts payable and ¥7,658 million in income taxes paid.

Cash Flows From Investing Activities

Net cash used in investing activities was ¥6,425 million, a 45.6% decrease from the previous fiscal year. This result was primarily due to ¥21,477 million used for purchases of short-term securities, ¥19,501 million in proceeds from redemption of short-term securities, ¥1,596 million in payments for purchases of property, plant and equipment, ¥1,033 million in payments for purchases of intangible assets, ¥2,536 million for increase in investments in securities, and ¥1,277 million in proceeds from sales of goodwill.

Cash Flows From Financing Activities

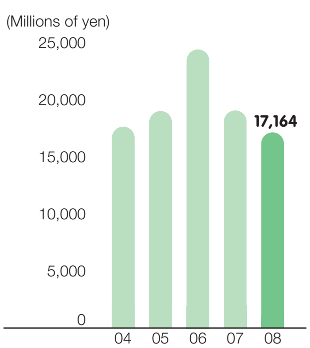
Net cash used in financing activities was ¥5,311 million, a 118.3% increase compared with the previous fiscal year. Principal factors were a ¥2,078 million decrease in short-term loans, net and ¥3,184 million in dividends paid.

Decline in Cash and Cash Equivalents Associated With Change in Scope of Consolidation

Due to the conclusion of a share exchange between Kobashou and Mediceo Paltac Holdings in January 2008, cash and cash equivalents declined by ¥2,356 million.

As a result, the balance of cash and cash equivalents at the fiscal year-end declined ¥1,927 million from a year earlier to ¥17,164 million.

Cash and Cash Equivalents at End of Year



Cash Flows

	Millions of yen			
	2007	**2008**	Changes	
	Amount	Amount	Amount	Change (%)
Cash flows from operating activities	8,834	**12,192**	3,358	38.0
Cash flows from investing activities	(11,803)	**(6,425)**	5,378	(45.6)
Free cash flows	(2,969)	**5,767**	8,736	–
Cash flows from financing activities	(2,433)	**(5,311)**	(2,878)	118.3
Cash and cash equivalents at end of year	19,091	**17,164**	(1,927)	(10.1)

* Free cash flows = Cash flows from operating activities + cash flows from investing activities

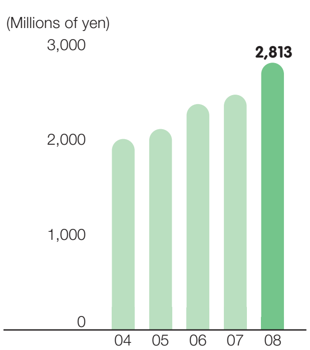
R&D Expenses

We believe that R&D underpins new product development, which is one of our core strengths. In the fiscal year ended March 31, 2008, the Consumer Products Operation developed 24 products, not including nutritional supplements. These products, which will help consumers to lead healthy and comfortable lives, were developed in six categories—pharmaceuticals, oral hygiene, sanitary products, deodorizing air fresheners, household sundries and food products.

In addition, the Medical Devices Operation worked aggressively to develop proprietary products.

Consequently, R&D expenses, which are included in selling, general and administrative expenses, increased ¥337 million from the previous year, to ¥2,813 million.

R&D Expenses



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 and 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 Act 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) Product Liability Risk

The Group's products include pharmaceuticals, quasi-pharmaceuticals, cosmetics, medical equipment and foods. Any health problems caused to consumers or patients as a result of quality defects in these products may result in large damages to the Group. This could affect the Group's operating results and financial position.

(6) 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.

(7) 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.

(8) 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.

(9) 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.

(10) 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, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2008	2007	2008
Assets			
Current assets:			
Cash and time deposits (Note 5)	¥ 17,164	¥ 18,091	$ 171,315
Trade notes and accounts receivable (Note 6)	26,231	51,340	261,813
Securities (Note 7)	5,799	3,795	57,880
Inventories (Note 8)	12,353	19,847	123,296
Deferred income taxes (Note 15)	3,199	2,954	31,929
Other current assets	1,326	6,262	13,234
Allowance for doubtful accounts	(3)	(187)	(30)
Total current assets	66,069	102,102	659,437
Property, plant and equipment, at cost:			
Land	5,245	8,667	52,351
Buildings and structures	16,989	22,799	169,568
Machinery and equipment (Note 16)	4,739	4,552	47,300
Construction in progress	24	91	240
Other (Note 16)	5,168	5,114	51,581
	32,165	41,223	321,040
Accumulated depreciation	(16,929)	(18,944)	(168,969)
Property, plant and equipment, net	15,236	22,279	152,071
Investments and other assets:			
Investments in securities (Note 7):			
Unconsolidated subsidiaries and affiliates	7,406	8,461	73,920
Other	17,271	9,505	172,382
Allowance for loss on devaluation of investments in securities	–	(244)	–
	24,677	17,722	246,302
Deferred income taxes (Note 15)	985	1,767	9,831
Goodwill	10,675	11,870	106,548
Software	747	1,179	7,456
Other intangible assets	1,381	1,554	13,784
Other assets	2,713	7,059	27,079
Allowance for doubtful accounts	(73)	(976)	(729)
Total investments and other assets	41,105	40,175	410,271
Total assets	¥122,410	¥164,556	$1,221,779

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2008	2007	2008
Liabilities and Net Assets			
Current liabilities:			
Short-term loans (Note 9)	¥ 726	¥ 3,206	$ 7,246
Trade notes and accounts payable (Note 6)	15,317	51,261	152,880
Accrued income taxes (Note 15)	3,691	4,506	36,840
Accrued expenses	15,730	16,109	157,002
Other current liabilities (Note 10)	2,477	1,946	24,723
Total current liabilities	37,941	77,028	378,691
Long-term liabilities:			
Long-term debt (Note 9)	–	208	–
Accrued retirement benefits for employees (Note 10)	4,487	7,560	44,785
Accrued retirement benefits for directors and corporate auditors	1,451	1,400	14,482
Other liabilities (Note 10)	1,348	1,124	13,455
Total long-term liabilities	7,286	10,292	72,722
Total liabilities	45,227	87,320	451,413
Net Assets			
Shareholders' equity (Note 13)**:**			
Common stock:			
Authorized – 170,100,000 shares			
Issued – 42,525,000 shares in 2008 and 2007	3,450	3,450	34,435
Capital surplus	4,214	4,207	42,060
Retained earnings	72,130	66,775	719,932
Treasury stock, at cost	(3,230)	(3,311)	(32,239)
Total shareholders' equity	76,564	71,121	764,188
Valuation and translation adjustments:			
Unrealized holding gain on securities	1,571	2,815	15,680
Unrealized (loss) gain on deferred hedges	(691)	292	(6,897)
Translation adjustments	(340)	201	(3,394)
Total valuation and translation adjustments	540	3,308	5,389
Stock acquisition rights	63	–	629
Minority interests	16	2,807	160
Total net assets	77,183	77,236	770,366
Total liabilities and net assets	¥122,410	¥164,556	$1,221,779

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2008	2007	**2008**
Net sales (Note 18)	**¥228,827**	¥257,022	**$2,283,930**
Cost of sales	**147,639**	172,304	**1,473,590**
Gross profit	**81,188**	84,718	**810,340**
Selling, general and administrative expenses (Note 14)	**62,612**	66,689	**624,932**
Operating income (Note 18)	**18,576**	18,029	**185,408**
Other income (expenses):			
Interest and dividend income	**307**	178	**3,064**
Equity in earnings of affiliates	**197**	187	**1,966**
Interest expense	**(71)**	(71)	**(709)**
Sales discounts	**(1,253)**	(1,260)	**(12,506)**
Exchange loss	**(149)**	(93)	**(1,487)**
Loss on disposal or write-offs of inventories	**(4,293)**	(3,603)	**(42,849)**
Gain on sales of property, plant and equipment	**2**	1,183	**20**
Royalty income	**584**	540	**5,829**
Loss on disposal of property, plant and equipment	**(138)**	(408)	**(1,377)**
Loss on impairment of fixed assets (Note 16)	**(30)**	(124)	**(299)**
Gain on sales of goodwill (Note 4)	**1,277**	1,128	**12,746**
Loss on devaluation of investments in unconsolidated subsidiaries and affiliates	**(525)**	(405)	**(5,240)**
Gain on exchange of shares (Notes 17 and 20)	**1,501**	–	**14,982**
Gain on partial termination of defined benefit plans (Note 10)	**216**	–	**2,156**
Expenses for the 90th anniversary events	**(390)**	–	**(3,893)**
Other, net	**(11)**	757	**(111)**
Income before income taxes and minority interests	**15,800**	16,038	**157,700**
Income taxes (Note 15)**:**			
Current	**6,901**	7,452	**68,879**
Deferred	**396**	408	**3,952**
	7,297	7,860	**72,831**
Minority interests	**2**	120	**20**
Net income	**¥ 8,505**	¥ 8,298	**$ 84,889**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Net Assets

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

		Millions of yen									
	Number of shares in issue (Thousands)	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized holding gain on securities	Unrealized (loss) gain on deferred hedges	Translation adjustments	Stock acquisition rights	Minority interests	Total net assets
Balance at March 31, 2006	42,525	¥ 3,450	¥ 4,192	¥ 60,087	¥ (3,480)	¥ 2,857	¥ –	¥ (294)	¥ –	¥ 2,918	¥ 69,730
Net income for the year	–	–	–	8,298	–	–	–	–	–	–	8,298
Cash dividends	–	–	–	(1,569)	–	–	–	–	–	–	(1,569)
Bonuses to directors and corporate auditors	–	–	–	(41)	–	–	–	–	–	–	(41)
Purchases of treasury stock	–	–	–	–	(10)	–	–	–	–	–	(10)
Disposition of treasury stock	–	–	15	–	179	–	–	–	–	–	194
Other changes	–	–	–	–	–	(42)	292	495	–	(111)	634
Balance at March 31, 2007	42,525	3,450	4,207	66,775	(3,311)	2,815	292	201	–	2,807	77,236
Net income for the year	**–**	**–**	**–**	**8,505**	**–**	**–**	**–**	**–**	**–**	**–**	**8,505**
Cash dividends	**–**	**–**	**–**	**(3,184)**	**–**	**–**	**–**	**–**	**–**	**–**	**(3,184)**
Purchases of treasury stock	**–**	**–**	**–**	**–**	**(4)**	**–**	**–**	**–**	**–**	**–**	**(4)**
Disposition of treasury stock	**–**	**–**	**7**	**–**	**85**	**–**	**–**	**–**	**–**	**–**	**92**
Increase in retained earnings resulting from exclusion of subsidiaries from consolidation	**–**	**–**	**–**	**34**	**–**	**–**	**–**	**–**	**–**	**–**	**34**
Other changes	**–**	**–**	**–**	**–**	**–**	**(1,244)**	**(983)**	**(541)**	**63**	**(2,791)**	**(5,496)**
Balance at March 31, 2008	**42,525**	**¥ 3,450**	**¥ 4,214**	**¥ 72,130**	**¥ (3,230)**	**¥ 1,571**	**¥ (691)**	**¥ (340)**	**¥ 63**	**¥ 16**	**¥ 77,183**

	Thousands of U.S. dollars (Note 1)									
	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized holding gain on securities	Unrealized (loss) gain on deferred hedges	Translation adjustments	Stock acquisition rights	Minority interests	Total net assets
Balance at March 31, 2007	$34,435	$41,990	$666,484	$(33,047)	$ 28,097	$ 2,914	$ 2,006	$ –	$ 28,017	$770,896
Net income for the year	**–**	**–**	**84,889**	**–**	**–**	**–**	**–**	**–**	**–**	**84,889**
Cash dividends	**–**	**–**	**(31,780)**	**–**	**–**	**–**	**–**	**–**	**–**	**(31,780)**
Purchases of treasury stock	**–**	**–**	**–**	**(40)**	**–**	**–**	**–**	**–**	**–**	**(40)**
Disposition of treasury stock	**–**	**70**	**–**	**848**	**–**	**–**	**–**	**–**	**–**	**918**
Increase in retained earnings resulting from exclusion of subsidiaries from consolidation	**–**	**–**	**339**	**–**	**–**	**–**	**–**	**–**	**–**	**339**
Other changes	**–**	**–**	**–**	**–**	**(12,417)**	**(9,811)**	**(5,400)**	**629**	**(27,857)**	**(54,856)**
Balance at March 31, 2008	**$34,435**	**$42,060**	**$719,932**	**$(32,239)**	**$ 15,680**	**$(6,897)**	**$(3,394)**	**$629**	**$ 160**	**$770,366**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2008	2007	**2008**
Cash flows from operating activities:			
Income before income taxes and minority interests	**¥ 15,800**	¥ 16,038	**$ 157,700**
Adjustments for:			
Depreciation and amortization	**3,765**	3,375	**37,579**
Loss on impairment of fixed assets	**30**	124	**299**
Decrease in allowance for doubtful accounts	**(337)**	(774)	**(3,364)**
(Decrease) increase in accrued retirement benefits	**(948)**	495	**(9,462)**
Interest and dividend income	**(307)**	(178)	**(3,064)**
Interest expense	**71**	71	**709**
Equity in earnings of affiliates	**(197)**	(187)	**(1,966)**
Loss on disposal or write-offs of inventories	**4,293**	3,603	**42,849**
Gain on sales of goodwill	**(1,277)**	(1,128)	**(12,746)**
Loss on disposal of property, plant and equipment	**138**	408	**1,377**
Allowance for loss on devaluation of investments in securities	**–**	37	**–**
Gain on exchange of shares	**(1,501)**	–	**(14,982)**
Loss on devaluation of investments in unconsolidated subsidiaries and affiliates	**525**	405	**5,240**
Gain on partial termination of defined benefit plans	**(216)**	–	**(2,156)**
Changes in operating assets and liabilities:			
(Increase) decrease in trade notes and accounts receivable	**(3,489)**	333	**(34,824)**
Increase in inventories	**(5,908)**	(4,763)	**(58,968)**
Increase (decrease) in trade notes and accounts payable	**6,644**	(1,054)	**66,314**
Increase (decrease) in other payables	**2,698**	(422)	**26,929**
Decrease in consumption taxes payable	**(61)**	(34)	**(609)**
Other	**(94)**	141	**(937)**
Subtotal	**19,629**	16,490	**195,918**
Interest and dividends received	**284**	178	**2,835**
Interest paid	**(63)**	(70)	**(629)**
Income taxes paid	**(7,658)**	(7,764)	**(76,435)**
Net cash provided by operating activities	**12,192**	8,834	**121,689**
Cash flows from investing activities:			
Purchases of short-term securities	**(21,477)**	(4,093)	**(214,363)**
Proceeds from redemption of short-term securities	**19,501**	2,800	**194,640**
Payments for purchases of property, plant and equipment	**(1,596)**	(1,478)	**(15,930)**
Proceeds from sales of property, plant and equipment	**9**	1,491	**90**
Payments for purchases of intangible assets	**(1,033)**	(469)	**(10,310)**
Increase in investments in securities	**(2,536)**	(2,021)	**(25,312)**
Increase in other assets	**(388)**	(1,355)	**(3,873)**
(Increase) decrease in short-term loans receivable	**(160)**	1	**(1,597)**
Proceeds from sales of goodwill	**1,277**	1,128	**12,746**
Acquisition of subsidiaries resulting in inclusion in consolidation	**–**	(9,063)	**–**
Proceeds from sale of a subsidiary's stock resulting in change in scope of consolidation	**–**	933	**–**
Other	**(22)**	323	**(219)**
Net cash used in investing activities	**(6,425)**	(11,803)	**(64,128)**
Cash flows from financing activities:			
Decrease in short-term loans, net	**(2,078)**	(556)	**(20,741)**
Repayment of long-term debt	**(136)**	(494)	**(1,357)**
Dividends paid	**(3,184)**	(1,569)	**(31,780)**
Increase in treasury stock	**(4)**	(8)	**(40)**
Other	**91**	194	**909**
Net cash used in financing activities	**(5,311)**	(2,433)	**(53,009)**
Effect of exchange rate changes on cash and cash equivalents	**(27)**	56	**(270)**
Net increase (decrease) in cash and cash equivalents	**429**	(5,346)	**4,282**
Cash and cash equivalents at beginning of year	**19,091**	24,437	**190,548**
Decrease in cash and cash equivalents resulting from exclusion of subsidiaries from consolidation (Notes 17 and 20)	**(2,356)**	–	**(23,515)**
Cash and cash equivalents at end of year (Note 5)	**¥ 17,164**	¥ 19,091	**$ 171,315**

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Years ended March 31, 2008 and 2007

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 Corporation Law of Japan and the Financial Instruments and Exchange Act 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 consolidated subsidiaries (collectively, the "Group") as required by the Financial Instruments and Exchange Act.

In preparing the accompanying consolidated financial statements, certain reclassifications have been made to the consolidated financial statements issued domestically in order to present them in a format which is more familiar to readers outside Japan. In addition, certain notes included herein are not required under accounting principles generally accepted in Japan but are presented as additional information.

The U.S. dollar amounts included in the accompanying consolidated financial statements and the notes thereto are presented solely for convenience and are translated, as a matter of arithmetic computation only, at ¥100.19 = U.S.$1.00, the approximate exchange rate in effect on March 31, 2008. 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. Goodwill and negative goodwill are amortized principally by the straight-line method over a twenty-year period. Minor differences are charged or credited 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. For consolidation purposes, the financial statements of the subsidiary were prepared as of and for the year ended March 31, 2008.

(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 year-end date of the financial statements and the reported amounts of revenues and expenses for 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

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

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 net assets excluding minority interests are translated at their historical exchange rates. Revenue 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 “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 credited or charged to income. Held-to-maturity debt securities are stated at 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 net assets. 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 are 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 an allowance for doubtful accounts principally at an amount based on their historical bad debt ratio. In addition, an additional allowance is provided at an estimate of uncollectible amounts with respect to certain specific doubtful receivables.

(i) Reserve for sales returns
The Company and certain domestic subsidiaries provide a reserve for sales returns based on their historical sales return ratio. The reserve for sales returns is included in “Other current liabilities.”

(j) Accrued retirement benefits
The Company and certain 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.

Accrued retirement benefits for employees of the Company and certain 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 such differences are 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 corporate auditors (collectively, "officers") are customarily entitled, subject to shareholders' approval, to lump-sum payments under an unfunded retirement allowances plan. Accrued retirement benefits for directors and corporate auditors have been made at an estimated amount based on the Company's and its consolidated subsidiaries' internal regulations.

The Company and a domestic subsidiary transferred a portion of their lump-sum retirement benefit plan to a defined contribution pension plan in June 2007, and have adopted an accounting standard, "Accounting for the Transfer between Retirement Benefit plans" (Accounting Standard Board of Japan Implementation Guidance No. 1), effective the year ended March 31, 2008. The effect of these changes was represented in the accompanying consolidated statement of income for the year ended March 31, 2008 as "Gain on partial termination of defined benefit plans" of ¥216 million ($2,156 thousand).

(k) Allowance for loss on devaluation of investments in securities

An allowance for loss on devaluation of investments in 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 costs 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 future income or cost savings. Such expenditures are capitalized as assets and are amortized over their respective estimated useful lives, customarily 5 years.

(o) Distribution of retained earnings

Under the Corporation Law, the distribution of retained earnings with respect to a given financial period can be made by resolution of the Board of Directors at a meeting held subsequent to the close of the financial period. The accounts for that period do not, therefore, reflect such distribution (see Note 22).

(p) Derivatives and hedging activities

Derivative financial instruments, which include forward foreign exchange contracts and currency options, are used to offset the Group's risk of exposure to fluctuation in 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 unrealized gain or loss is deferred as net assets. When a forward foreign exchange contract meets certain criteria, receivables and payables covered by the contract are translated at the contracted rates.

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 underlying hedged item from the commencement of the hedge.

3. Changes in Accounting Policy

(a) Presentation of net assets in the balance sheet

Effective the year ended March 31, 2007, the Company adopted "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Accounting Standards Board of Japan (ASBJ) Statement No. 5 issued on December 9, 2005) and "Guidance on Accounting Standard for Presentation of Net Assets in the Balance Sheet" (ASBJ Guidance No. 8 issued on December 9, 2005).

As a result of the adoption of this accounting standard and the related guidance, there was no impact on the Company's operating results for the year ended March 31, 2007.

(b) Practical solution on unification of accounting policies applied to foreign subsidiaries for consolidated financial statements

Effective the year ended March 31, 2007, the Company adopted "Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for Consolidated Financial Statements" (ASBJ Practical Solution No. 18 issued on May 17, 2006). As a result of the adoption of this practical solution, operating income and income before income taxes and minority interests decreased by ¥31 million from the amounts which would have been recorded under the previous method.

(c) Accounting standards for business combinations

Effective the year ended March 31, 2007, the Company adopted "Accounting Standard for Business Combinations" (issued on October 31, 2003 by the Business Accounting Council), and "Accounting Standard for Business Divestitures" and "Guidance on Accounting Standard for Business Combinations and Accounting Standard for Business Divestitures" ASBJ Statement No. 7 and ASBJ Guidance No. 10, respectively, both of which were issued on December 27, 2005).

4. Termination of a 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 in installments the proceeds from the sale of the distribution rights in Japan. This revenue will be recorded in the Company's books of account on a cash basis as follows:

	Thousands of U.S. dollars
In April 2008	$ 11,000

5. Cash and Cash Equivalents

A reconciliation of cash and time deposits in the accompanying consolidated balance sheets to cash and cash equivalents in the accompanying consolidated statements of cash flows at March 31, 2008 and 2007 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Cash and time deposits	¥17,164	¥18,091	$171,315
Short-term investments whose redemption dates are within three months of the dates of acquisition, included in "Securities"	–	1,000	–
Cash and cash equivalents	¥17,164	¥19,091	$171,315

6. Notes Receivable and Notes Payable

Although the balance sheet date for the year ended March 31, 2007 fell on a bank holiday, notes receivable, trade of ¥1,229 million and notes payable, trade of ¥1,604 million with due dates of March 31, 2007 were excluded from the respective account balances on the balance sheet as of March 31, 2007 and were settled on the next business day.

7. Securities and Investments in Securities

Securities classified as “other securities” at March 31, 2008 and 2007 are summarized as follows:

(a) Securities whose carrying value exceeds their acquisition cost

	Millions of yen					
	2008			2007		
	Acquisition cost	Carrying value	Unrealized gain	Acquisition cost	Carrying value	Unrealized gain
Equity securities	¥ 10,803	¥ 13,691	¥ 2,888	¥ 734	¥5,470	¥4,736
Debt securities	2,496	2,504	8	599	599	0
	¥ 13,299	¥ 16,195	¥ 2,896	¥1,333	¥6,069	¥4,736

	Thousands of U.S. dollars		
	2008		
	Acquisition cost	Carrying value	Unrealized gain
Equity securities	$107,825	$136,650	$28,825
Debt securities	24,913	24,992	79
	$132,738	$161,642	$28,904

(b) Securities whose acquisition cost exceeds their carrying value

	Millions of yen					
	2008			2007		
	Acquisition cost	Carrying value	Unrealized loss	Acquisition cost	Carrying value	Unrealized loss
Equity securities	¥ 1,111	¥ 850	¥ (261)	¥ 760	¥ 652	¥ (108)
Debt securities	4,800	4,799	(1)	5,197	5,189	(8)
	¥ 5,911	¥ 5,649	¥ (262)	¥5,957	¥5,841	¥ (116)

	Thousands of U.S. dollars		
	2008		
	Acquisition cost	Carrying value	Unrealized loss
Equity securities	$ 11,089	$ 8,484	$ (2,605)
Debt securities	47,909	47,899	(10)
	$ 58,998	$ 56,383	$ (2,615)

(c) Securities whose market value is not determinable

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Unlisted stock other than those traded on the over-the-counter market	¥1,226	¥1,390	$12,237

(d) Redemption schedule for other securities with maturities

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Due within one year	¥ 5,799	¥ 3,795	$ 57,880
Due after one year but within five years	1,504	1,993	15,011
	¥ 7,303	¥ 5,788	$ 72,891

(e) Proceeds from sales of, and gross realized gain on, other securities

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Proceeds from sales	¥ 0	¥ 10	$ 0
Gross realized gain	0	2	0

8. Inventories

Inventories at March 31, 2008 and 2007 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Commodities	¥ 2,648	¥ 9,828	$ 26,430
Finished goods	7,367	7,908	73,530
Raw materials, work in process and supplies	2,338	2,111	23,336
	¥12,353	¥19,847	$123,296

9. Short-Term Loans and Long-Term Debt

The average interest rates on short-term bank loans at March 31, 2008 and 2007 were 4.09% and 1.77%, respectively.

Long-term debt at March 31, 2008 and 2007 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Loans from banks with an average interest rate of 1.04% for 2007	¥ –	¥ 309	$ –
Less amounts due within one year	–	(101)	–
	¥ –	¥ 208	$ –

In order to achieve more efficient and flexible financing, the Company and its certain consolidated subsidiaries have concluded line-of-credit agreements with certain financial institutions. The status of these at March 31, 2008 is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Lines of credit	¥22,665	$226,220
Credit used	(917)	(9,152)
Available credit	¥21,748	$217,068

10. Accrued Retirement Benefits for Employees

The following table sets forth the funded and accrued status of the plans, and the amounts recognized in the accompanying consolidated balance sheets at March 31, 2008 and 2007 for the Group's defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Projected benefit obligation	¥(8,856)	¥(13,819)	$(88,392)
Fair value of pension plan assets	3,849	5,984	38,417
Unfunded retirement benefit obligation	(5,007)	(7,835)	(49,975)
Unrecognized prior service cost	342	620	3,413
Unrecognized actuarial differences	1,008	656	10,061
Net retirement benefit obligation	(3,657)	(6,559)	(36,501)
Prepaid pension cost	(830)	(1,001)	(8,284)
Accrued retirement benefits for employees	¥(4,487)	¥ (7,560)	$(44,785)

In June 2007, the Company and a domestic subsidiary transferred a portion of their lump-sum retirement benefit plan to a defined contribution pension plan. As a result of the transition, projected benefit obligation, unrecognized actuarial differences and accrued retirement benefits for employees decreased by ¥1,455 million ($14,522 thousand), ¥237 million ($2,365 thousand) and ¥1,218 million ($12,157 thousand), respectively, at March 31, 2008.

The pension plan assets which were transferred to the defined contribution pension plan amounted to ¥1,010 million ($10,081 thousand). The Company and the domestic subsidiary plan to complete the transition over a period of 3 years. Accrued retirement benefits for employees of ¥755 million ($7,535 thousand), which is planned to be transferred to the defined contribution pension plan was reclassified to other current liabilities and other liabilities in the accompanying consolidated balance sheet at March 31, 2008.

The components of net pension cost for the years ended March 31, 2008 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Service cost	¥ 708	¥ 806	$ 7,067
Interest cost	163	236	1,627
Expected return on pension plan assets	(83)	(106)	(829)
Amortization:			
Prior service cost	68	103	679
Actuarial differences	102	76	1,018
Net pension cost	¥ 958	¥ 1,115	$ 9,562

The assumptions used in accounting for the above plans for the years ended March 31, 2008 and 2007 were as follows:

	2008	2007
Discount rate	2.0%	2.0%
Expected rate of return on plan assets	2.0%	2.0%

11. Leases

The following *pro forma* amounts represent the acquisition cost and the related accumulated depreciation and accumulated loss on impairment of property leased to the Group at March 31, 2008 and 2007, which would have been reflected in the accompanying 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
	2008	2007	2008
Machinery and equipment:			
Acquisition cost	¥ 5,632	¥ 8,587	$ 56,213
Accumulated depreciation	(3,209)	(5,188)	(32,029)
Accumulated loss on impairment of leased property	(177)	(212)	(1,767)
	2,246	3,187	22,417
Furniture and fixtures:			
Acquisition cost	877	2,212	8,754
Accumulated depreciation	(538)	(1,297)	(5,370)
	339	915	3,384
Other:			
Acquisition cost	140	3,397	1,397
Accumulated depreciation	(55)	(2,646)	(549)
	85	751	848
Total	¥ 2,670	¥ 4,853	$ 26,649

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2008 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
2009	¥ 861	$ 8,594
2010 and thereafter	1,938	19,343
Total	¥2,799	$27,937

Allowance for loss on impairment of leased property at March 31, 2008 and 2007 amounted to ¥79 million ($789 thousand) and ¥131 million, respectively.

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2008 for non-cancelable operating leases are summarized as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars
2009	¥ 135	$ 1,347
2010 and thereafter	416	4,153
Total	¥ 551	$ 5,500

Lease payments related to finance leases accounted for as operating leases and estimated depreciation and interest expense, which have not been reflected in the accompanying consolidated statements of income for the years ended March 31, 2008 and 2007, are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Lease expense	¥1,534	¥2,281	$15,311
Reversal of allowance for loss on impairment of leased property	68	60	679
Estimated depreciation expense	1,401	2,111	13,983
Estimated interest expense	78	99	779
Loss on impairment of leased property	16	87	159

12. Derivatives and Hedging Activities

The Company utilizes forward foreign exchange contracts and currency options to reduce the risk arising from fluctuation in 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.

The forward foreign exchange contracts outstanding as of March 31, 2007 are summarized as follows:

	Millions of yen			
	2007			
	Notional amount			
	Total	Amount maturing after more than one year	Fair value	Valuation gain
Buy Euro	¥60	–	¥65	¥5
	¥60	–	¥65	¥5

There were no open derivatives positions at March 31, 2008.

13. Shareholders' Equity

The Corporation Law of Japan (the "Law") provides that an amount equal to 10% of the amount to be disbursed as distributions of capital surplus (other than the capital reserve) and retained earnings (other than the legal reserve) be transferred to the capital reserve and the legal reserve, respectively, until the sum of the capital reserve and the legal reserve equals 25% of the capital stock account. Such distributions can be made at any time by resolution of the shareholders, or by the Board of Directors if certain conditions are met.

Retained earnings include the legal reserve provided in accordance with the provisions of the Law. The legal reserve of the Company included in retained earnings amounted to ¥340 million ($3,394 thousand) and ¥340 million at March 31, 2008 and 2007, respectively.

Stock-based compensation plan

At March 31, 2008, the Company had two stock option plans: the 2005 and 2009 stock option plans. The 2005 stock option plan (the 2005 plan) was approved at the annual general meeting of shareholders of the Company held on June 27, 2003. The 2005 plan provides for granting options to purchase 295,500 shares of common stock to directors, corporate auditors and certain key employees of the Company, and directors and certain key employees of certain consolidated subsidiaries. The exercise price was ¥3,051 ($30) per share at March 31, 2008. This exercise price is subject to adjustment in certain cases which include stock splits. The options became exercisable on July 1, 2005 and are scheduled to expire on June 30, 2008.

The 2009 stock option plan (the 2009 plan) was approved at the annual general meeting of shareholders of the Company held on June 28, 2007. The 2009 plan provides for granting options to purchase 260,800 shares of common stock to directors, corporate auditors and certain key employees of the Company, and directors and certain key employees of certain consolidated subsidiaries. The exercise price was ¥4,329 ($43) per share at March 31, 2008. This exercise price is subject to adjustment in certain cases which include stock splits. The options became exercisable on July 1, 2007 and are scheduled to expire on June 30, 2010.

Information regarding the Company's stock option plans was as follows:

	The 2005 plan	The 2009 plan
Number of options:		
Outstanding at April 1, 2006	243,000	–
Granted	–	–
Cancelled	1,050	–
Exercised	63,750	–
Outstanding at March 31, 2007	178,200	–
Granted	**–**	**260,800**
Cancelled	**2,250**	**11,100**
Exercised	**29,850**	**–**
Outstanding at March 31, 2008	**146,100**	**249,700**
	Yen	
Weighted average price of shares upon exercise during the year ended March 31, 2007	¥4,495	¥ –
Weighted average price of shares upon exercise during the year ended March 31, 2008	4,052	–
Fair value of options as of the grant date	–	645
	U.S. dollars	
Weighted average price of shares upon exercise during the year ended March 31, 2008	$40.44	$ –
Fair value of options as of the grant date	–	6.44

Treasury stock

Movements in treasury stock during the years ended March 31, 2008 and 2007 are summarized as follows:

	Number of shares			
	2008			
	March 31, 2007	Increase	Decrease	March 31, 2008
Treasury stock	**1,172,506**	**1,061**	**29,950**	**1,143,617**

	Number of shares			
	2007			
	March 31, 2007	Increase	Decrease	March 31, 2008
Treasury stock	1,234,262	2,044	63,800	1,172,506

14. Selling, General and Administrative Expenses

The major components of selling, general and administrative expenses for the years ended March 31, 2008 and 2007 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Sales promotional activities	¥ 5,727	¥ 5,720	$ 57,161
Freight and storage	9,666	10,976	96,477
Advertising	13,607	13,129	135,812
Salaries and bonuses	11,390	13,115	113,684
Office rent and other rental charges	2,231	3,102	22,268
External services	5,231	4,612	52,211
Research and development costs	2,813	2,476	28,077
Other	11,947	13,559	119,242
Total	¥62,612	¥66,689	$624,932

15. 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, 2008 and 2007. The overseas subsidiaries are subject to the income taxes of their respective 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 for the years ended March 31, 2008 and 2007 is as follows:

	2008	2007
Statutory tax rate	40.6%	40.6%
Tax loss carryforwards of consolidated subsidiaries	4.1	4.1
Valuation allowances	1.9	5.0
Utilization of tax loss carryforwards	(0.3)	(2.6)
Tax credits on research and development costs	(2.2)	(1.3)
Amortization of excess of cost over net assets acquired	2.0	2.0
Expenses not deductible for tax purposes	1.2	1.1
Equity in earnings of affiliates	(0.5)	(0.1)
Other	(0.6)	0.2
Effective tax rates	46.2%	49.0%

The tax effects of the temporary differences which gave rise to a significant portion of the deferred tax assets and liabilities at March 31, 2008 and 2007 are presented below:

	Millions of yen		Thousands of U.S. dollars
	2008	2007	**2008**
Deferred tax assets:			
Accrued retirement benefits for employees	**¥ 1,738**	¥ 2,608	**$ 17,347**
Net operating loss carryforwards	**876**	2,569	**8,743**
Accrued bonuses for employees	**691**	799	**6,897**
Accrued retirement benefits for directors and corporate auditors	**588**	568	**5,869**
Allowance for doubtful accounts	**3**	74	**30**
Accrued expenses	**786**	737	**7,845**
Accrued enterprise taxes	**328**	358	**3,274**
Unrealized intercompany profits	**99**	369	**988**
Loss on impairment of fixed assets	**642**	664	**6,408**
Loss on disposal or write-offs of inventories	**652**	436	**6,508**
Other	**1,222**	886	**12,195**
Gross deferred tax assets	**7,625**	10,068	**76,104**
Valuation allowance	**(1,938)**	(3,679)	**(19,343)**
Total deferred tax assets	**5,687**	6,389	**56,761**
Deferred tax liabilities:			
Unrealized holding gain on securities	**(1,069)**	(1,641)	**(10,669)**
Gain on exchange of shares	**(434)**	–	**(4,332)**
Other	**–**	(77)	**–**
Total deferred tax liabilities	**(1,503)**	(1,718)	**(15,001)**
Net deferred tax assets	**¥ 4,184**	¥ 4,671	**$ 41,760**

16. 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 groups of assets generating cash inflows. The head office building, delivery centers and certain other assets are grouped as one common asset group.

For the years ended March 31, 2008 and 2007, the carrying value of leased property and that of production facilities which were not anticipated to be utilized in the future, have been reduced to their respective recoverable amounts and loss on impairment of fixed assets was recognized in the accompanying consolidated statements of income for the years then ended. The recoverable amounts of production facilities were measured based on value in use (the present value of future cash flows or the estimated selling price).

Loss on impairment of fixed assets for the years ended March 31, 2008 and 2007 are summarized as follows:

Place	Description	Classification	Millions of yen 2008	Thousands of U.S. dollars 2008
Osaka and other	Production facilities	Machinery and equipment and other	¥ 14	$140
Osaka and other	Production facilities	Leased property (currently accounted for as operating leases)	16	159
			¥ 30	$299

Place	Description	Classification	Millions of yen 2007
Osaka and other	Production facilities	Machinery and equipment and other	¥ 37
Osaka and other	Production facilities	Leased property (currently accounted for as operating leases)	87
			¥124

17. Supplementary Cash Flow Information

On January 1, 2008, the Company exchanged shares of Kobashou Co., Ltd. and, as a result, Kobashou Co., Ltd. and its 5 consolidated subsidiaries were excluded from the scope of consolidation. Assets and liabilities of Kobashou Co., Ltd. at December 31, 2007 are summarized as follows:

	Millions of yen 2008	Thousands of U.S. dollars 2008
Current assets	¥45,372	$452,860
Fixed assets	4,562	45,533
Total assets	¥49,934	$498,393
Current liabilities	¥44,825	$447,400
Long-term liabilities	2,374	23,695
Total liabilities	¥47,199	$471,095

In April 2006, the Company purchased shares of KS Tohoku Co., Ltd. and initially consolidated the accounts of KS Tohoku Co., Ltd. as of and for the year ended March 31, 2007. The assets and liabilities included in consolidation are summarized as follows:

	Millions of yen 2007
Current assets	¥ 4,478
Fixed assets	967
Total assets	¥ 5,445
Current liabilities	¥ 5,222
Long-term liabilities	418
Total liabilities	¥ 5,640

In November 2006, the Company purchased shares of HEATMAX Inc. and initially consolidated the accounts of HEATMAX Inc. and its consolidated subsidiaries as of and for the year ended March 31, 2007. The assets and liabilities included in consolidation are summarized as follows:

	Millions of yen
	2007
Current assets	¥1,601
Fixed assets	7,816
Total assets	¥9,417
Current liabilities	¥ 495
Long-term liabilities	10
Total liabilities	¥ 505

In November 2006, the Company purchased shares of eVent Medical Ltd. and initially consolidated the accounts of eVent Medical Ltd. and its consolidated subsidiaries as of and for the year ended March 31, 2007. The assets and liabilities included in consolidation are summarized as follows:

	Millions of yen
	2007
Current assets	¥ 101
Fixed assets	70
Total assets	¥ 171
Current liabilities	¥ 791
Long-term liabilities	–
Total liabilities	¥ 791

In November 2006, the Company sold shares of Shield California Healthcare Centers Inc. and excluded the accounts of Shield California Healthcare Centers Inc. and its consolidated subsidiaries from consolidation as of and for the year ended March 31, 2007. The assets and liabilities excluded from consolidation are summarized as follows:

	Millions of yen
	2007
Current assets	¥2,795
Fixed assets	909
Total assets	¥3,704
Current liabilities	¥ 598
Long-term liabilities	312
Total liabilities	¥ 910

18. Segment Information

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

Business Segment Information

The business segment information of the Company and its consolidated subsidiaries for the years ended March 31, 2008 and 2007 is outlined as follows:

	Millions of yen						
	2008						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations or unallocable accounts	Consolidated
I. Sales and operating income (loss)							
Sales to third parties	¥ 84,707	¥ 131,603	¥ 10,729	¥ 1,788	¥ 228,827	¥ –	¥ 228,827
Inter-group sales and transfers	26,213	360	–	6,306	32,879	(32,879)	–
Net sales	110,920	131,963	10,729	8,094	261,706	(32,879)	228,827
Operating expenses	92,915	132,094	11,148	7,663	243,820	(33,569)	210,251
Operating income (loss)	¥ 18,005	¥ (131)	¥ (419)	¥ 431	¥ 17,886	¥ 690	¥ 18,576
II. Total assets, depreciation and amortization, loss on impairment of fixed assets and capital expenditures							
Total assets	¥ 70,317	¥ –	¥ 12,382	¥ 3,994	¥ 86,693	¥ 35,717	¥ 122,410
Depreciation and amortization	3,024	245	341	74	3,684	81	3,765
Loss on impairment of fixed assets	30	–	–	–	30	–	30
Capital expenditures	2,158	275	351	37	2,821	74	2,895

	Millions of yen						
	2007						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations or unallocable accounts	Consolidated
I. Sales and operating income							
Sales to third parties	¥ 71,717	¥ 164,839	¥ 16,496	¥ 3,970	¥ 257,022	¥ –	¥ 257,022
Inter-group sales and transfers	30,786	1	–	9,143	39,930	(39,930)	–
Net sales	102,503	164,840	16,496	13,113	296,952	(39,930)	257,022
Operating expenses	85,943	164,516	15,935	12,722	279,116	(40,123)	238,993
Operating income	¥ 16,560	¥ 324	¥ 561	¥ 391	¥ 17,836	¥ 193	¥ 18,029
II. Total assets, depreciation and amortization, loss on impairment of fixed assets and capital expenditures							
Total assets	¥ 66,653	¥ 57,975	¥ 14,674	¥ 7,998	¥ 147,300	¥ 17,256	¥ 164,556
Depreciation and amortization	2,540	247	330	168	3,285	90	3,375
Loss on impairment of fixed assets	37	–	–	–	37	–	37
Capital expenditures	1,646	310	76	125	2,157	72	2,229

	Thousands of U.S. dollars						
	2008						
	Consumer Products Operation	Wholesale Operation	Medical Devices Operation	Other Operations	Total	Eliminations or unallocable accounts	Consolidated
I. Sales and operating income (loss)							
Sales to third parties	$ 845,464	$1,313,534	$107,087	$17,845	$2,283,930	$ –	$2,283,930
Intra-group sales and transfers	261,633	3,593	–	62,940	328,166	(328,166)	–
Net sales	$1,107,097	1,317,127	107,087	80,785	2,612,096	(328,166)	2,283,930
Operating expenses	927,388	1,318,435	111,269	76,483	2,433,575	(335,053)	2,098,522
Operating income (loss)	$ 179,709	$ (1,308)	$ (4,182)	$ 4,302	$ 178,521	$6,887	$ 185,408
II. Total assets, depreciation and amortization, loss on impairment of fixed assets and capital expenditures							
Total assets	$ 701,837	$ –	$123,585	$39,864	$ 865,286	$ 356,493	$1,221,779
Depreciation and amortization	30,183	2,445	3,404	739	36,771	808	37,579
Loss on impairment of fixed assets	299	–	–	–	299	–	299
Capital expenditures	21,539	2,745	3,503	369	28,156	739	28,895

Geographic Segment Information

The geographic segment information of the Company and its consolidated subsidiaries for the years ended March 31, 2008 and 2007 is outlined as follows:

	Millions of yen						
	2008						
	Japan	North America	Europe	Asia	Total	Eliminations and unallocable accounts	Consolidated
I. Sales and operating income (loss)							
Sales to third parties	¥ 222,081	¥ 3,361	¥ 1,496	¥ 1,889	¥ 228,827	¥ –	¥ 228,827
Intra-group sales and transfers	718	176	211	1,086	2,191	(2,191)	–
Net sales	222,799	3,537	1,707	2,975	231,018	(2,191)	228,827
Operating expenses	203,051	4,246	1,961	3,144	212,402	(2,151)	210,251
Operating income (loss)	¥ 19,748	¥ (709)	¥ (254)	¥ (169)	¥ 18,616	¥ (40)	¥ 18,576
II. Total assets							
Total assets	¥ 82,731	¥ 14,801	¥ 827	¥ 1,704	¥ 100,063	¥ 22,347	¥ 122,410

	Millions of yen						
	2007						
	Japan	North America	Europe	Asia	Total	Eliminations and unallocable accounts	Consolidated
I. Sales and operating income (loss)							
Sales to third parties	¥ 246,428	¥ 8,333	¥ 731	¥ 1,530	¥ 257,022	¥ –	¥ 257,022
Intra-group sales and transfers	376	42	0	738	1,156	(1,156)	–
Net sales	246,804	8,375	731	2,268	258,178	(1,156)	257,022
Operating expenses	228,009	8,434	1,138	2,599	240,180	(1,187)	238,993
Operating income (loss)	¥ 18,795	¥ (59)	¥ (407)	¥ (331)	¥ 17,998	¥ 31	¥ 18,029
II. Total assets							
Total assets	¥ 112,848	¥ 16,786	¥ 608	¥ 1,839	¥ 132,081	¥ 32,475	¥ 164,556

	Thousands of U.S. dollars						
	2008						
	Japan	North America	Europe	Asia	Total	Eliminations and unallocable accounts	Consolidated
I. Sales and operating income (loss)							
Sales to third parties	$2,216,598	$ 33,546	$14,932	$18,854	$2,283,930	$ –	$2,283,930
Intra-group sales and transfers	7,166	1,757	2,106	10,839	21,868	(21,868)	–
Net sales	2,223,764	35,303	17,038	29,693	2,305,798	(21,868)	2,283,930
Operating expenses	2,026,659	42,379	19,573	31,380	2,119,991	(21,469)	2,098,522
Operating income (loss)	$ 197,105	$ (7,076)	$ (2,535)	$ (1,687)	$ 185,807	$ (399)	$ 185,408
II. Total assets							
Total assets	$ 825,741	$147,729	$ 8,254	$17,008	$ 998,732	$223,047	$1,221,779

Overseas Sales Information

Overseas sales information has been omitted for the years ended March 31, 2008 and 2007 because overseas sales, consisting of export sales of the Company and its domestic consolidated subsidiaries and sales (other than exports to Japan) of overseas consolidated subsidiaries, constituted less than 10% of total consolidated sales.

19. Amounts per Share

	Yen		U.S. dollars
	2008	2007	2008
Net income:			
Basic	¥ 205.62	¥ 200.77	$ 2.05
Diluted	205.42	200.47	2.05
Cash dividends	54.00	50.00	0.54
Net assets	1,863.24	1,799.87	18.60

Basic net income per share has been computed 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 has been computed based on the net income available for distribution 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 issuable upon the exercise of stock options issued by the Company. The amounts per share of net assets have been computed based on the number of shares of common stock outstanding at the year end.

Cash dividends per share represent the cash dividends proposed by the Board of Directors as applicable to the respective years together with the interim cash dividends paid.

20. Overview of Demerger

On January 1, 2008, the Company exchanged all of its shares of Kobashou Co., Ltd. for certain shares of Mediceo Paltac Holdings Co., Ltd. As a result of the exchange, Kobashou Co., Ltd. and its 5 consolidated subsidiaries of Kobashou Co., Ltd. became wholly-owned subsidiaries of Mediceo Paltac Holdings Co., Ltd.

Kobashou Co., Ltd. was the largest wholesaler of over-the-counter drugs and healthcare-related goods in Japan. The exchange was made in response to significant changes in the business environment regarding the wholesale industry.

As a result of the exchange, the Company recorded ¥1,501 million ($14,982 thousand) of gain on exchange of shares in the accompanying consolidated statement of income for the year ended March 31, 2008.

The amounts of assets and liabilities of Kobashou Co., Ltd. and its 5 consolidated subsidiaries at December 31, 2007 were as follows:

	Millions of yen	Thousands of U.S. dollars
Current assets	¥ 45,372	$ 452,860
Fixed assets	4,562	45,533
Total assets	¥ 49,934	$ 498,393
Current liabilities	¥ 44,825	$ 447,400
Long-term liabilities	2,374	23,695
Total liabilities	¥ 47,199	$ 471,095

The following information presents a summary of the results of operations for the period from April 1, 2007 to December 31, 2007 of Kobashou Co., Ltd. and its consolidated subsidiaries, which were included in the accompanying consolidated statement of income for the year ended March 31, 2008:

	Millions of yen	Thousands of U.S. dollars
Net sales	¥131,963	$1,317,127
Operating loss	¥ (131)	$ (1,308)

21. Acquisitions

On November 3, 2006, the Company acquired all of the outstanding shares of common stock of eVent Medical Ltd. ("eVent"). The eVent Group consists of eVent, eMed Ltd., and eVent Medical Inc. eVent produces and provides medical equipment. The Company determined that the acquisition would provide it with production technology regarding medical equipment and enable it to maintain its global market share. The aggregate purchase price was ¥1,276 million, which consisted of ¥1,167 million for purchases of shares of common stock and ¥109 million of transaction costs. The acquisition was accounted for using the purchase method of accounting. Goodwill arising from the acquisition is being amortized over seven to ten years using the straight-line method.

The accompanying consolidated statement of income for the year ended March 31, 2007 reflected the operating results of eVent for the period from November 4, 2006 to December 31, 2006. The amounts of assets acquired and liabilities assumed of eVent at the date of acquisition were as follows:

	Millions of yen
Current assets	¥ 101
Fixed assets	70
Current liabilities	791

The following unaudited *pro forma* information presents a summary of the results of operations of eVent as if the acquisition had occurred on January 1, 2006 and includes the related adjustment for the amortization of goodwill:

	Millions of yen
Net sales	¥ 425
Operating loss	(473)
Loss before income taxes and minority interests	(426)
Net loss	(426)

On November 30, 2006, the Company acquired all of the outstanding shares of common stock of HeatMax Inc. ("HeatMax"). The HeatMax Group consists of HeatMax, Mediheat Inc., and Thermomax Inc. HeatMax produces and provides body warmers, Cura-Heat and other products. The Company determined that the acquisition would expand its market share in North America. The aggregate purchase price was ¥9,144 million, which consisted of ¥9,020 million for purchases of shares of common stock and ¥124 million of transaction costs. The acquisition was accounted for using the purchase method of accounting. Goodwill arising from the acquisition is being amortized over four to twenty years using the straight-line method.

The accompanying consolidated statement of income for the year ended March 31, 2007 reflected the operating results of HeatMax for the period from December 1, 2006 to December 31, 2006. The amounts of the assets acquired and liabilities assumed of HeatMax at the date of acquisition were as follows:

	Millions of yen
Current assets	¥1,601
Fixed assets	7,816
Current liabilities	495
Long-term liabilities	10

The following unaudited *pro forma* information presents a summary of the results of operations of HEATMAX as if the acquisition had occurred on January 1, 2006 and includes the related adjustment for the amortization of goodwill.

	Millions of yen
Net sales	¥2,481
Operating income	5
Loss before income taxes and minority interests	(14)
Net loss	(8)

22. Subsequent Event

The following distribution of retained earnings of the Company, which has not been reflected in the accompanying consolidated financial statements for the year ended March 31, 2008, was approved at a meeting of the Board of Directors held on May 26, 2008:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥27.00 ($0.27) per share)	¥1,117	$11,149

Report of Independent Auditors

ERNST & YOUNG SHINNIHON

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

■ Tel : 06 4964 6669
Fax : 06 6263 5170

The Board of Directors
Kobayashi Pharmaceutical Co., Ltd.

We have audited the accompanying consolidated balance sheets of Kobayashi Pharmaceutical Co., Ltd. and consolidated subsidiaries as of March 31, 2008 and 2007, and the related consolidated statements of income, changes in net assets, and cash flows for the years then ended, all expressed in Japanese 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, 2008 and 2007, 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.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2008 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.

Osaka, Japan
June 27, 2008

Ernst & Young ShinNihon

Six-year Consolidated Financial Summary

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

	Millions of yen					
	2008	2007	2006	2005	2004	2003
For the Year						
Net Sales	¥228,827	¥257,022	¥246,853	¥215,708	¥211,670	¥210,922
Cost of Sales (after provisions for returned products)	147,639	172,304	167,239	143,912	141,388	141,675
Gross Profit (after provisions for returned products)	81,188	84,718	79,614	71,796	70,282	69,247
Selling, General and Administrative Expenses	62,612	66,689	62,734	56,097	54,159	53,394
Operating Income	18,576	18,029	16,880	15,699	16,123	15,853
Income before Income Taxes and Minority Interests	15,800	16,038	14,010	12,770	11,825	12,840
Net Income	8,505	8,298	7,475	6,731	6,677	6,606
Per Share Data (Yen)						
Net Income	205.62	200.77	179.17	160.64	157.25	231.25
Cash Dividends	54.0	50.0	38.0	33.0	21.0	21.0
Cash Flows from Operating Activities	12,192	8,834	13,159	8,364	6,971	12,046
Free Cash Flows	5,767	(2,969)	6,744	4,428	4,613	11,770
Depreciation and Amortization Expenses	3,765	3,375	3,414	3,239	3,350	3,480
Capital Expenditures*1	2,895	2,229	2,797	5,021	2,441	2,631
R&D Expenses	2,813	2,476	2,378	2,115	2,010	1,785
At Year-end						
Current Assets	66,069	102,102	98,906	86,705	80,031	77,315
Property, Plant and Equipment, Net	15,236	22,279	22,788	25,003	24,567	27,758
Current Liabilities	37,941	77,028	72,040	65,007	64,298	65,925
Long-term Liabilities	7,286	10,292	10,175	8,960	9,094	9,936
Total Net Assets*2	77,183	77,236	66,812	60,116	54,454	49,267
Total Assets	122,410	164,556	151,945	134,629	128,326	125,680
Working Capital	28,128	25,074	26,866	21,698	15,733	11,389
Interest-bearing Debt	726	3,414	1,633	3,034	5,417	7,859
Financial Ratios (%)						
As a percent of net sales:						
Gross Profit	35.8%	33.0%	32.3%	33.3%	33.2%	32.8%
Operating Income	8.1	7.0	6.8	7.3	7.6	7.5
Net Income	3.7	3.2	3.0	3.1	3.2	3.1
Current Ratio	174.1	132.6	137.3	133.4	124.5	117.3
ROE	11.2	11.7	11.8	11.7	12.9	14.1
ROA	6.9	5.0	5.2	5.0	5.3	5.4
Equity Ratio	63.0	45.2	44.0	44.7	42.4	39.2
Debt-equity Ratio (times)*3	0.01	0.05	0.02	0.05	0.10	0.16

*1 Capital expenditures as shown in Segment Information in the Notes to Consolidated Financial Statements.
*2 Total Net Assets in 2006 and preceding years does not include minority interests.
*3 Debt-equity ratio: Interest-bearing debt at the fiscal year-end divided by Shareholders' equity.

History

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. Conducted a 1.5-for-1 stock split.
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	Conducted a 1.5-for-1 stock split.
2004	Reorganized the Kobayashi Pharmaceutical Group into four business headquarters.
	Launched first product under the proprietary *Kobamed* brandname in the Medical Devices Operation.
2005	Formed an equity-based alliance with Itoh Kanpo Pharmaceutical Co., Ltd.
2006	Made eVent Medical Ltd. a subsidiary.
	Made Heatmax, Inc. a consolidated subsidiary.
2008	Kobashou Co., Ltd. and Mediceo Paltac Holdings Co., Ltd. conducted share exchange.

Group Companies

(As of March 31, 2008)

Company	Location	Capital	Main Business
Domestic consolidated subsidiaries			
Sendai Kobayashi Pharmaceutical Co., Ltd.	Yamato-cho, Kurokawa-gun, Miyagi, Japan	¥200 million	Manufacturing of pharmaceuticals and other products
Toyama Kobayashi Pharmaceutical Co., Ltd.	Toyama, Japan	¥100 million	Manufacturing of pharmaceuticals and other products
Ehime Kobayashi Pharmaceutical Co., Ltd.	Niihama, Ehime, Japan	¥77 million	Hygienic and paper goods manufacturing
Kiribai Chemical Co., Ltd.	Yodogawa-ku, Osaka, Japan	¥49 million	Disposable body warmer manufacturing and sales
Kobayashi Seiyaku Plax Co., Ltd.	Toyama, Japan	¥95 million	Synthetic resin products manufacturing
Suehiro Sangyo Co., Ltd.	Yodogawa-ku, Osaka, Japan	¥15 million	Daily goods sales
Archer Corporation	Chuo-ku, Tokyo	¥10 million	Advertising, planning and creation
SP-Planning, Inc.	Chuo-ku, Osaka, Japan	¥10 million	Displays and model production
Kobayashi Pharmaceutical Life Service Co., Ltd.	Chuo-ku, Osaka, Japan	¥10 million	Insurance agency and real estate management
Kobayashi Pharmaceutical Sales Promotion, Ltd.	Chuo-ku, Osaka, Japan	¥100 million	Marketing and sales promotional activities of pharmaceuticals and daily goods
Kobayashi Pharmaceutical Distribution Co., Ltd.	Chuo-ku, Osaka, Japan	¥10 million	Transportation Services
Overseas consolidated companies			
Kobayashi Healthcare, LLC.	Georgia, U.S.A.	US$5,110,000	Daily goods sales
Kobayashi Healthcare Europe, Ltd.	London, U.K.	UK£14,081	Daily goods sales
Kobayashi Healthcare Germany GmbH	Düsseldorf, Germany	Euro 974,000	Daily goods sales
Shanghai Kobayashi Daily Chemicals Co., Ltd.	Shanghai, China	141,428,621 RMB	Daily goods manufacturing and sales
Shanghai Kobayashi Pharmaceutical Trading Co., Ltd.	Shanghai, China	3,344,150 RMB	Mail-order sales within China
Kobayashi Pharmaceutical (Hong Kong) Co., Ltd.	Hong Kong, China	HK$1,570,000	Daily goods sales
HeatMax, Inc.	Georgia, U.S.A.	US$1,230,001	Disposable body warmer manufacturing and sales
Mediheat, Inc.	Georgia, U.S.A.	US$10	Disposable body warmer manufacturing and sales
Thermomax, Inc.	Georgia, U.S.A.	US$0	Disposable body warmer manufacturing and sales
Kobayashi Healthcare of America, Inc.	Georgia, U.S.A.	US$6,200	Holding company
Kobayashi Pharmaceuticals of America, Inc.	California, U.S.A.	US$1	Management of U.S. operations
Kobayashi Medical America, LLC.	California, U.S.A.	US$23,180,000	Research into imported products
eVent Medical Inc.	California, U.S.A.	US$0.1	Respirator sales
eVent Medical Ltd.	Galway, Ireland	Euro 2,660	Respirator manufacturing and sales
eMed Ltd.	Galway, Ireland	Euro 127	Respirator sales
Equity-method affiliates			
Medicon, Inc.	Chuo-ku, Osaka	¥160 million	Medical equipment and device import and sales
Itoh Kanpo Pharmaceutical Co., Ltd.	Higashi Osaka, Osaka	¥2,085 million	Daily goods manufacturing and sales

Notes: 1. The following companies are Specified Subsidiaries as defined by Japanese law: Toyama Kobayashi Pharmaceutical Co., Ltd.; Shanghai Kobayashi Daily Chemicals Co., Ltd.; Kobayashi Healthcare, LLC; and Kobayashi Medical America, LLC.

2. Following completion of its share exchange with Mediceo Paltac Holdings in January 2008, Kobashou was excluded from the scope of consolidation from the fourth quarter of the fiscal year under review. Furthermore, Kobashou's former subsidiaries—Kensho Co., Ltd.; KS Hokkaido Co., Ltd.; KS Tokai Co., Ltd.; KS Tohoku Co., Ltd.; and Seiei Co., Ltd.—were also excluded from the scope of consolidation in the fourth quarter.

■ Consumer Products Operation ■ Medical Devices Operation ■ Other Operations

Corporate Data / Investor Information

(As of March 31, 2008)

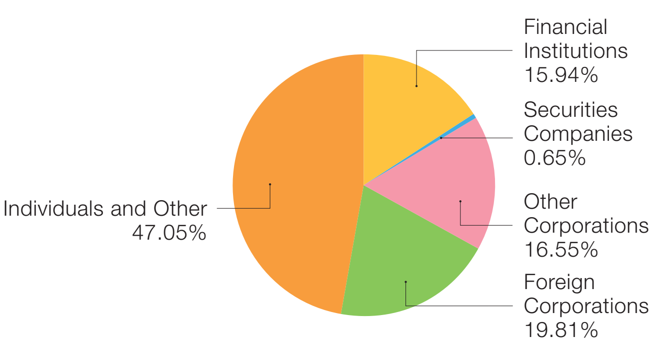
Corporate Data

- 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: 2,066 (Consolidated)
- Consolidated Subsidiaries: 26
- Non-consolidated Subsidiaries: 5
- Affiliates Accounted for by the Equity Method: 2

Investor Information

- Common Stock: ¥3,450 million
- Number of Shares Authorized: 170,100,000
- Number of Shares Issued: 42,525,000
- Number of Shareholders: 10,447
- 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.
  Corporate Communication Department
  Tel. 81-6-6222-0142
  Fax. 81-6-6222-4261
  E-mail: info@kobayashi.co.jp
  URL: http://www.kobayashi.co.jp/english/index.shtml

Shareholder Composition



Major Shareholders

Name	Percentage of Total Shares Held (%)
Akihiro Kobayashi	10.89
Kobayashi International Scholarship Foundation	7.05
Yukako Iue	6.10
The Master Trust Bank of Japan, Ltd.	4.62
Teruhisa Miyata	3.28
Ikuko Watanabe	3.22
Kobayashi Pharmaceutical Co., Ltd.	2.68
Ohtori Co., Ltd.	2.56
Japan Trustee Services Bank, Ltd.	2.55
Forum Co., Ltd.	2.47

KOBAYASHI Pharmaceutical Co., Ltd.

Head Office: 3-6, Doshomachi 4-chome, Chuo-ku, Osaka 541-0045, Japan
TEL : 81-6-6222-0897
URL: http://www.kobayashi.co.jp/

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