あったらいいな®
をカタチにする

You make a wish and
we make it happen

KOBAYASHI Pharm. Co., Ltd.

Integrated Report 2017

Fiscal Year Ended December 31, 2017

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Editorial Policy

To inform readers about the Kobayashi Group's management and corporate activities, this integrated report comprehensively covers non-financial information such as ESG activities, in addition to management's direction and strategy, and a review of operations. The International Integrated Reporting Framework provided by the International Integrated Reporting Council and the Guidance for Collaborative Value Creation formulated by Japan's Ministry of Economy, Trade and Industry were used as reference in compiling this report.

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You make a wish and
we make it happen

Management Principles

We never stop creating and innovating in our pursuit of something new that will delight people and society.

Group Brand Charter

Our mission is to not only make products that our customers want now but to also develop new and innovative products for our customers' 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.

Our Values

Exceptional Customer Focus

We constantly strive to discover needs that even our customers may not be aware of, and to transform customers' wishes into products and services.

Every Employee Plays an Important Role

We believe that respecting each other and improving our individual capabilities will lead to not only personal growth, but the growth of the Company.

Social Responsibility

We strive for fair business activities in accordance with socially accepted practices, including legal compliance, ethical conduct and environmental preservation.

Respect for Shareholders

By pursuing "service before profit," we believe we can ultimately deliver sound returns to our shareholders.

Our Standards of Behavior

Something New, Something Different

We maintain a commitment to applying our ideas and concepts to discover "Something New, Something Different."

Simple, Clear, Speed

We strive for simplicity, clarity and speed in everything we do.

Think, Make Decisions, Execute and Take Responsibility

Approaching our work with a spirit of equality, we do not wait for instructions when solving problems, but think and make decisions on our own, and assume responsibility for executing them.

Pioneer Spirit

Rather than doing nothing because we are afraid to fail, we continue to take on new challenges even if we fail.

"You make a wish and we make it happen."

That will always be our guiding principle.

The year 2017 is a milestone for the Kobayashi Pharmaceutical Group, marking our 100th fiscal period since incorporation. For this achievement, we owe our thanks to the consumers who use our products, as well as all our stakeholders for their longstanding support. You have our sincerest gratitude.

I believe that our strength comes from the way we "never stop creating and innovating," as expressed in our Management Principles, a commitment championed and embodied by each of our employees. It has enabled us to generate not only ideas for new products that solve customer problems, but also solutions for work-related issues, thereby creating value and improving business operations.

Coming up with new ideas is by no means an easy task. Through initiatives that include monthly new product idea meetings, business improvement idea meetings, and cost-cutting meetings, as well as our idea proposal system that has been in place for 35 years, we have crafted an environment where constant innovation is a must. As a result, each of our employees is engaged in the ongoing pursuit of something new, always exploring every possibility.

Looking to the future, we will further refine our ability to generate ideas by taking a customer-centered approach as we continue to launch new and unique products unlike those seen anywhere else. Furthermore, we will adopt a global focus in extending our field of activity beyond Japan, and realize our brand slogan, "You make a wish and we make it happen," in order to resolve the problems faced by people throughout the world.

The Kobayashi Pharmaceutical Group will continue to meet and exceed your expectations. We appreciate your steadfast support in this endeavor.

Akihiro Kobayashi

Representative Director,
President and Chief Operating Officer

Throughout our history, we have changed our business structure to continue to deliver what customers wish for

The Value We Offer

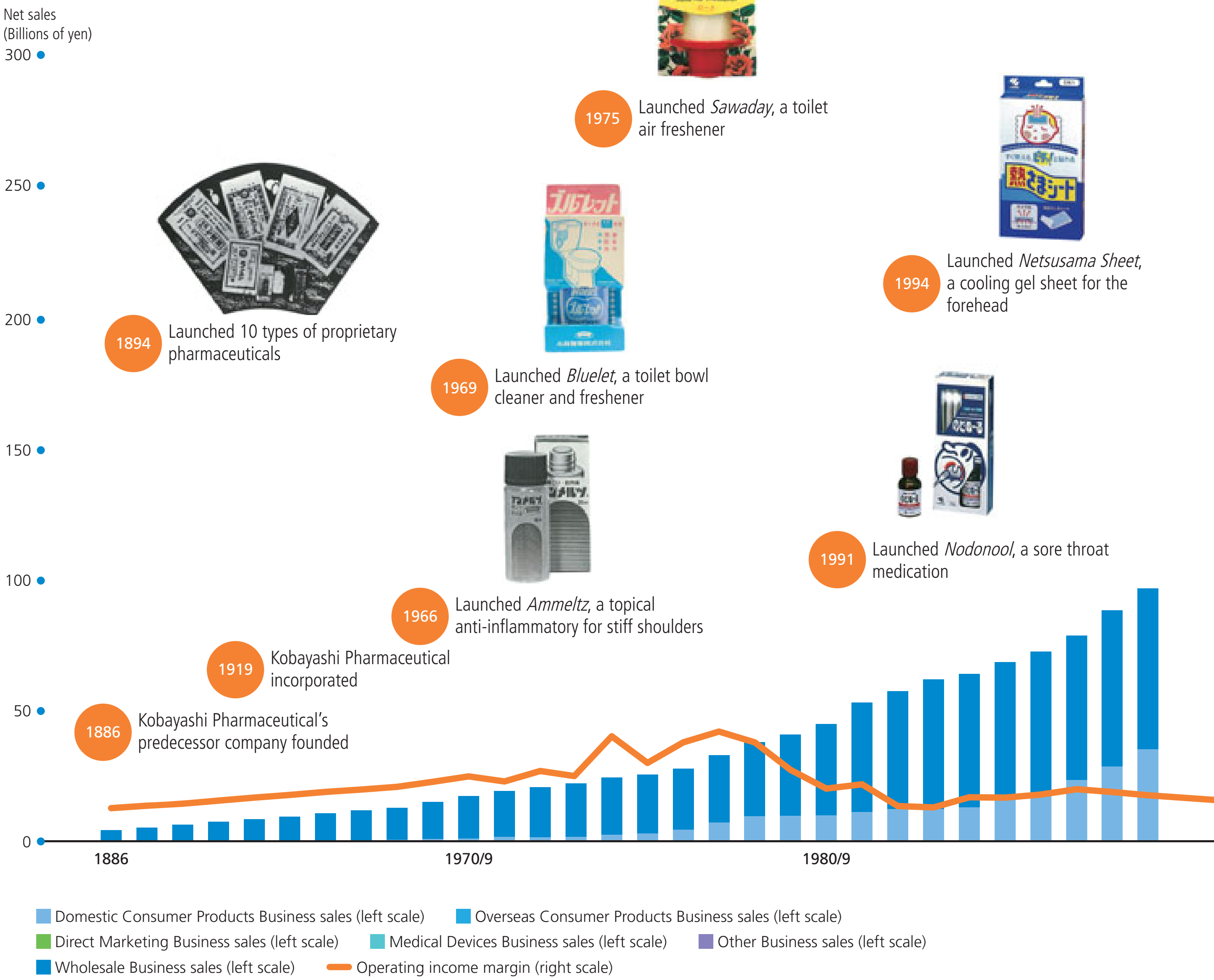
1886~

Delivering what customers wish for as a medicine wholesaler

1970~

Producing what customers wish for as a manufacturer

Net Sales and Operating Income Margin



1993~

Providing what customers wish for throughout Japan and around the world

2009~

Creating what customers wish for even faster by concentrating on manufacturing

1995 Launched *Shoshugen for Toilet*, a deodorizing air freshener

1995 Launched *Eyebon*, an eye wash

1997 Launched *BreathCare*, oral breath freshener capsules

1999 Made first full-scale foray into overseas markets

1999 Listed on the Osaka Securities Exchange

2000 Listed on the Tokyo Stock Exchange

2001 Made Kiribai Chemical Co., Ltd. a subsidiary

2005 Acquired exclusive sales rights for *Inochi no Haha A*, a women's health medicine

2006 Made HeatMax, Inc. (U.S.) a subsidiary

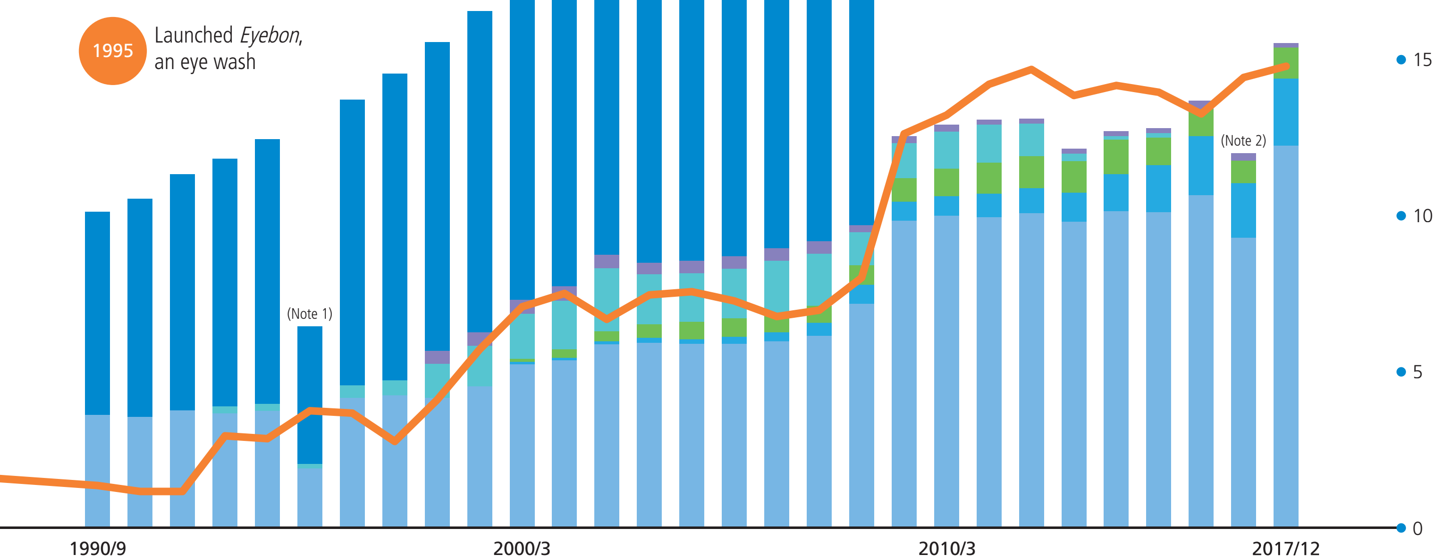
2008 Sold wholesale company Kobashou Co., Ltd.

2012 Sold medical device company Kobayashi Medical Co., Ltd.

2015 Dissolved Medicon, Inc. joint venture

2016 Made Perfecta Products, Inc. (U.S.) a subsidiary

2017 Concluded an exclusive distribution agreement for *Bioil*, a skincare product



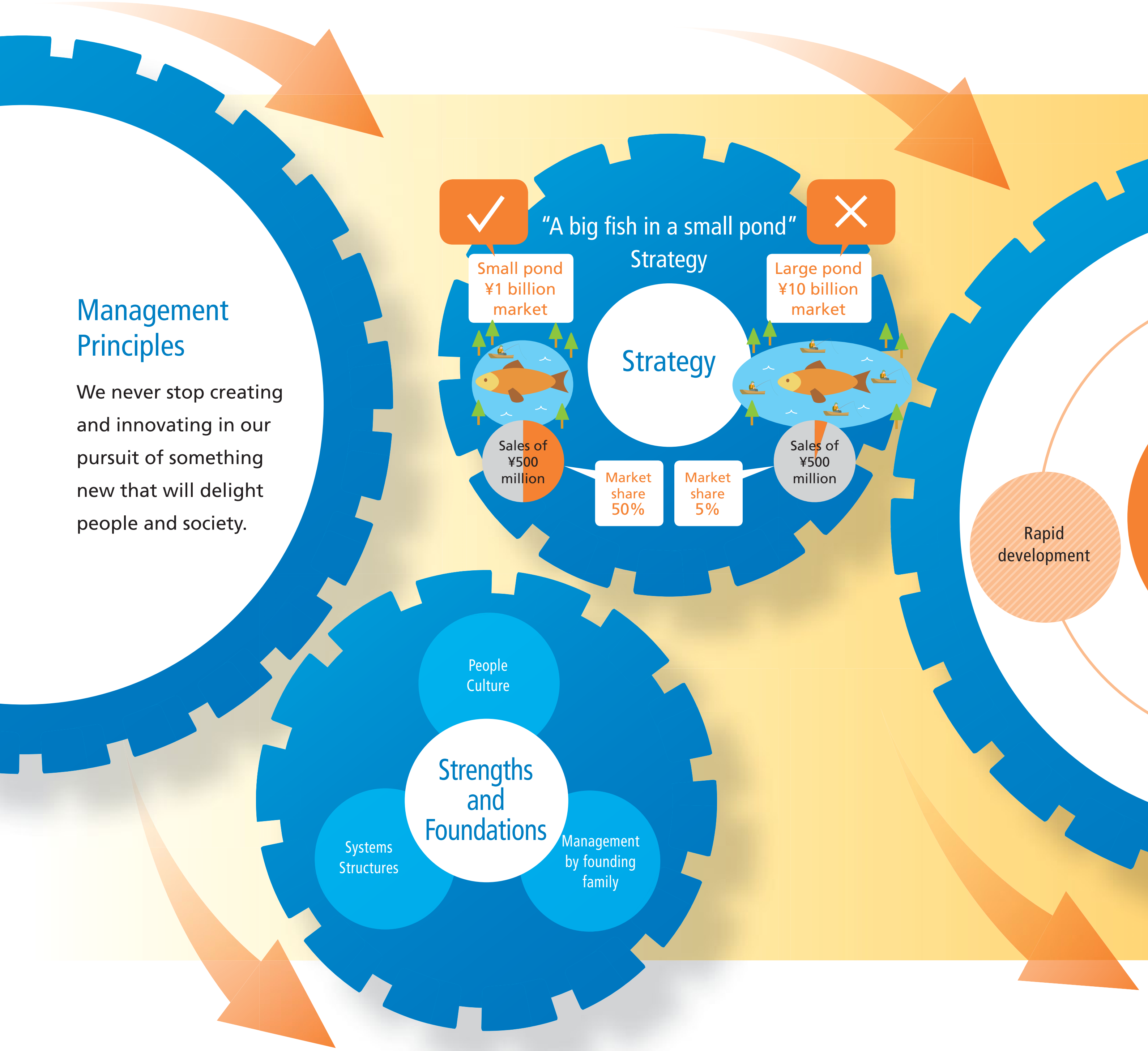
(Photos show product packaging at the time of launch.)

Notes: 1. Fiscal 1995/3 was a six-month transitional period due to a change in fiscal year-end.
2. Fiscal 2016/12 was a nine-month transitional period due to a change in fiscal year-end.

A business model that starts with our Management Principles and results in what customers wish for

Management Principles

We never stop creating and innovating in our pursuit of something new that will delight people and society.



Output

Healthcare Business

Household Products Business

Skincare Business

Body Warmer Business

Overseas Business

Direct Marketing Business

Target KPIs

Contribution ratio of new products
(first year, first four years)
10%, 25%

Operating income margin
14%
or higher

Return on equity (ROE)
10%
or higher

Medium-Term Management Plan (2017–2019)

Growth with Real Strength

Improve our ability to develop and cultivate new products to achieve "Growth with Real Strength" and become the leading company in the market for new products that solve customer problems.

1. Promote four growth businesses (Overseas, Direct Marketing, Skincare and Kampo)
2. Invest in growth for the future
3. Develop and cultivate products that create new markets
4. Become a company where employees can grow and develop

(See page 12 for more information.)

The results and market position we have achieved in providing what customers wish for

19
Straight fiscal periods of dividend increases

Total number of brands
155

Operating income margin
14.6%

20
Straight fiscal periods of profit growth

ROE
10.7%

Gross profit margin
60.9%

Contribution ratio of new products (first four years)
21.0%

(As of December 31, 2017)

Number of brands with top domestic market share

43

Number of idea proposals in FY2017

33,000

Brands sold for more than 10 years

85

Number of new products launched during FY2017

29

Contribution ratio of new products (first year)

5.4%

Worldwide units sold

400 million

External recognition (selection for ESG indices)

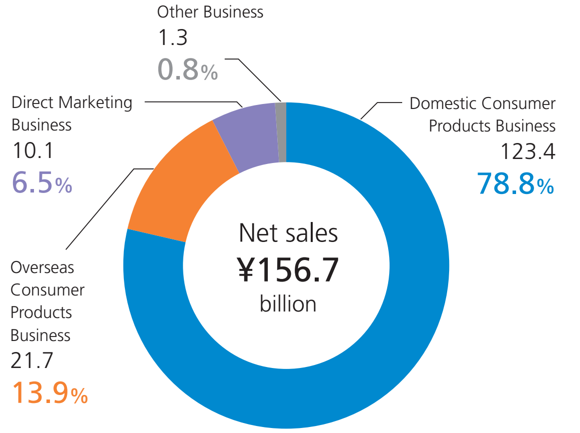
MSCI 2018 Constituent MSCI Japan ESG Select Leaders Index

MSCI 2018 Constituent MSCI Japan Empowering Women Index (WIN)

Highlights

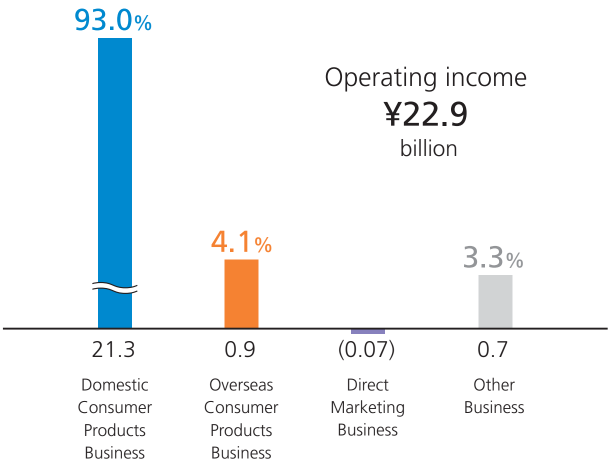
FY2017 Net Sales by Segment

(Billions of yen)



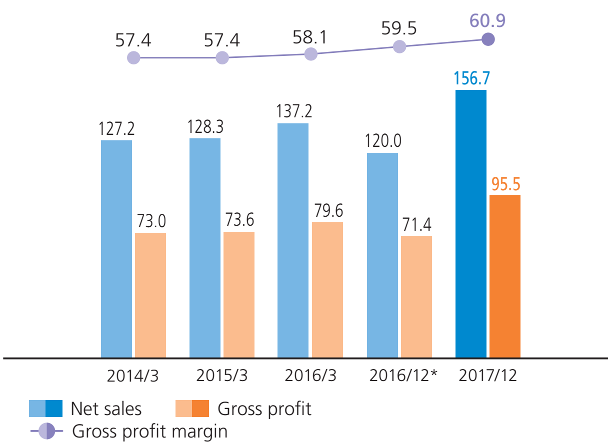
FY2017 Operating Income by Segment

(Billions of yen)



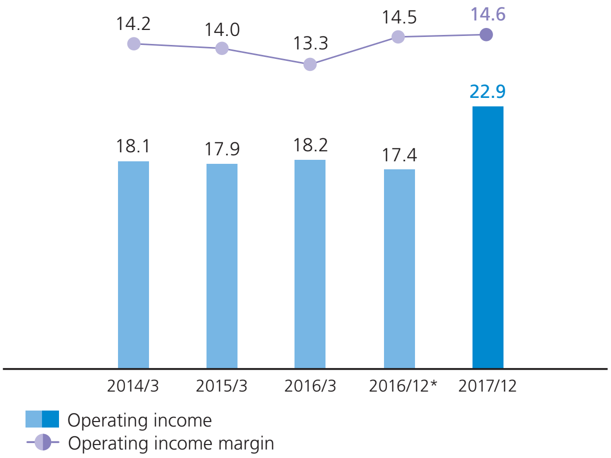
Net Sales / Gross Profit / Gross Profit Margin

(Billions of yen) (%)



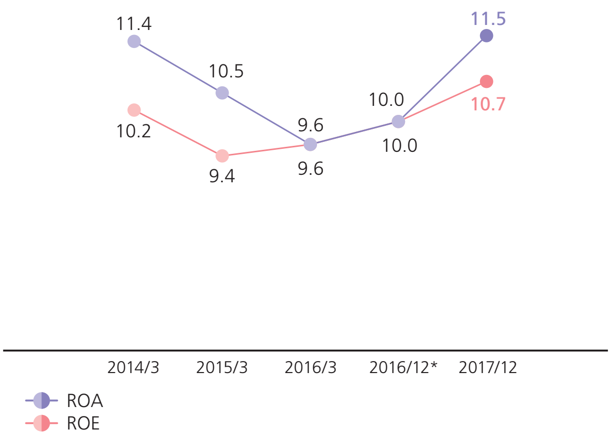
Operating Income / Operating Income Margin

(Billions of yen) (%)



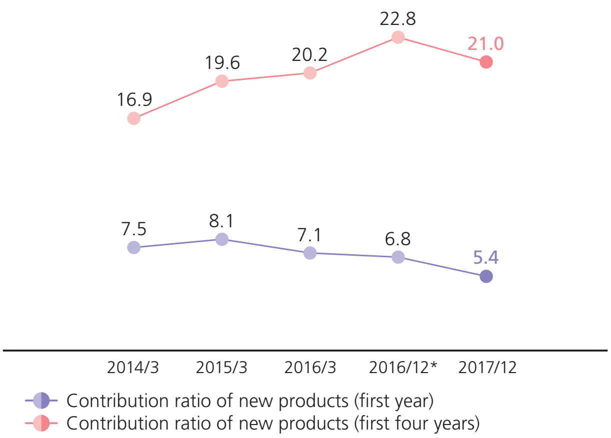
ROA / ROE

(%)

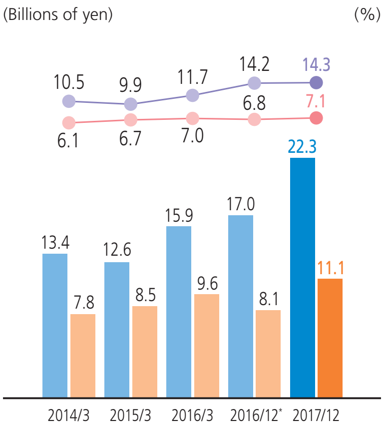


Contribution Ratio of New Products (First Year) / Contribution Ratio of New Products (First Four Years)

(%)

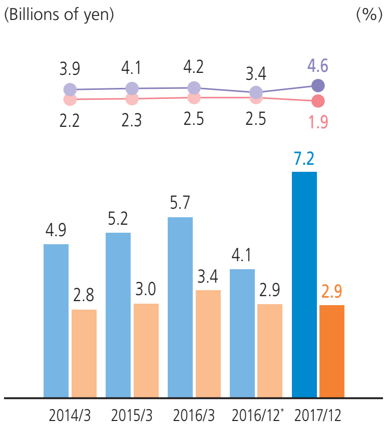


Advertising Expenses / Ratio of Advertising Expenses to Net Sales / Sales Promotion Expenses / Ratio of Sales Promotion Expenses to Net Sales



Advertising expenses
Sales promotion expenses
Ratio of advertising expenses to net sales
Ratio of sales promotion expenses to net sales

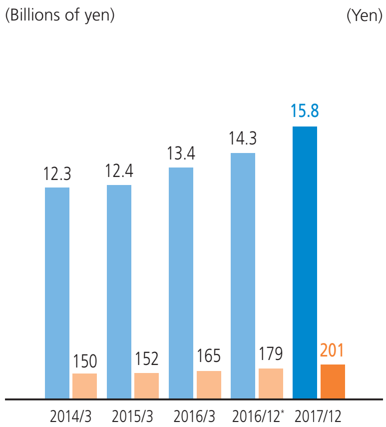
R&D Costs / Ratio of R&D Costs to Net Sales / Capital Expenditures(Note) / Ratio of Capital Expenditures to Net Sales



R&D costs
Capital expenditures
Ratio of R&D costs to net sales
Ratio of capital expenditures to net sales

Note: Capital expenditures (property, plant and equipment)

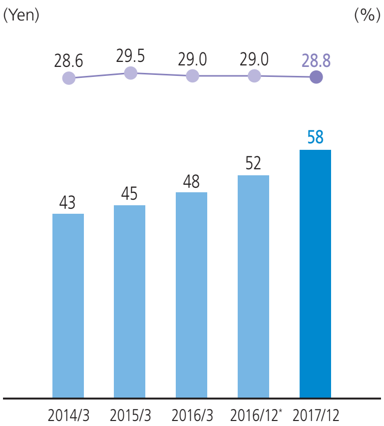
Profit Attributable to Owners of Parent / Net Income per Share(Note)



Profit attributable to owners of parent
Net income per share

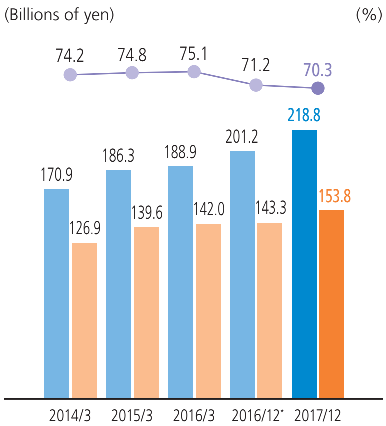
Note: Including impact of stock split

Cash Dividends per Share / Payout Ratio



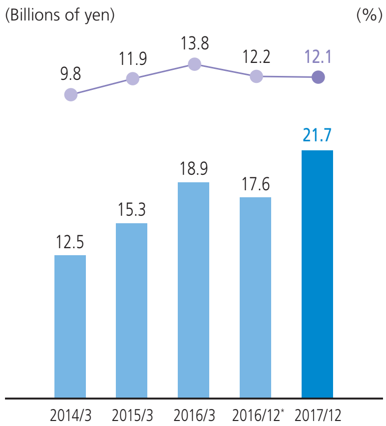
Cash dividends per share
Payout ratio

Total Assets / Net Assets / Equity Ratio



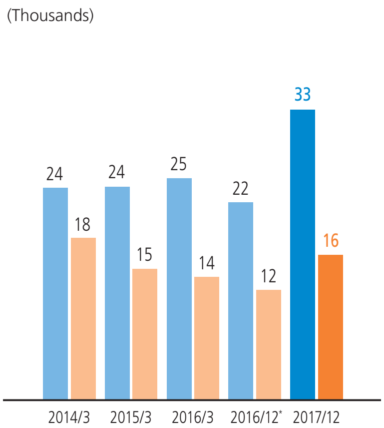
Total assets
Net assets
Equity ratio

Overseas Sales / Overseas Sales Ratio



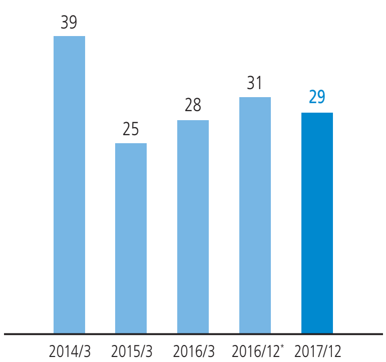
Overseas sales
Overseas sales ratio

Number of Idea Proposals / Number of Improvement Suggestions

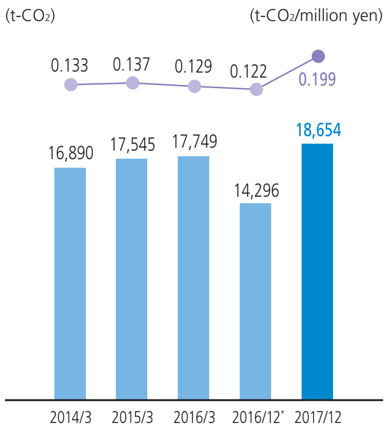


Number of idea proposals
Number of improvement suggestions

Number of New Products Launched during the Year



CO_2 Emissions Volume / CO_2 Emissions per Unit of Sales



CO_2 emissions volume
CO_2 emissions per unit of sales

* Year on year changes have been omitted, as fiscal 2016/12 was a nine-month transitional period due to a change in fiscal year-end.

Overview of the Medium-Term Management Plan for 2017–2019

Growth with Real Strength

Improve our ability to develop and cultivate new products to achieve "Growth with Real Strength" and become the leading company in the market for new products that solve customer problems.

Consolidated Financial Targets[1]

	FY2019 targets	Results for comparable period in 2016(Note)	Versus comparable period in 2016
Net sales	¥165.0 billion	¥144.8 billion	+14%
Operating income	¥23.0 billion	¥18.4 billion	+24%
Net income[2]	¥17.0 billion	¥15.0 billion	+13%
ROE[2]	10%	10%	—

1. Targets at the time the Medium-Term Management Plan was announced in November 2016
2. Profit attributable to owners of parent

Note: Fiscal 2016/12 was a nine-month transitional period due to a change in fiscal year-end. Results for the period from January through December 2016 are shown for comparison purposes only.

1 Promote four growth businesses

		FY2019 targets	Versus comparable period in 2016
Overseas Business	· Strengthen the OTC Pharmaceuticals Business, mainly in North America and China. · Cultivate products such as *Netsusama Sheet*, *Ammeltz* and body warmers.	¥27.0 billion	+50%
Direct Marketing Business	· Develop new high-profile products that will attract new customers. · Develop brands through a mix of sales at stores and via direct marketing.	¥12.0 billion	+26%
Skincare Business	· Develop a third major brand alongside *Keshimin* and *Eaude Muge*.	¥9.0 billion	+67%
Kampo Business	· Continue to pursue the development of products that are easier for customers to select, depending on their condition and symptoms.	¥12.5 billion	+13%

2 Investments in growth, cultivation of new products

M&A	· Overseas Business: Establish the foundation for OTC pharmaceutical sales in China and other parts of Asia. · Skincare Business: Develop a third major brand. · Domestic Business: Invest in OTC pharmaceuticals, health food products and other products.	Investment budget (2017–2019) ¥30 billion
R&D New businesses	· Established four key themes (immunity ingredients, fermentation technology, natural product science and new OTC pharmaceuticals). Launch new products based on innovative technologies from the Central R&D Laboratory.	New investment (2017–2019) ¥3 billion

3 Develop and cultivate products that create new markets

- Cultivate and establish the market for at least two new products every six months.
- Our most important strategy is to develop products that create new markets, in line with our brand slogan "You make a wish and we make it happen."

4 Become a company where employees can grow and develop

- We strive to be a company where employees can grow and develop through their work and also experience personal growth.
- Initiatives to visualize growth through "growth dialogues" that help supervisors to support employees' self-driven growth efforts.

We will ensure the achievement of our Medium-Term Management Plan "Growth with Real Strength" through a steady approach. By cultivating solid capabilities, we will meet the challenge of bringing our model for developing unique products to the world stage.

Akihiro Kobayashi

Representative Director,
President and Chief Operating Officer

President Kobayashi on Strategy

Can you tell us about Kobayashi Pharmaceutical's Management Principles and fundamental strategy?

The Kobayashi Pharmaceutical Group's Management Principles state: "We never stop creating and innovating in our pursuit of something new that will delight people and society." On the basis of these principles, we have developed many new products and achieved growth in categories that include pharmaceuticals, nutritional supplements, deodorizing air fresheners, household products, skincare products and oral care products. To continue this mission, we promote our corporate brand slogan, "You make a wish and we make it happen," inside and outside the Company, and we are constantly looking to the problems consumers face in order to find inspiration for ideas that can form solutions. We then turn these ideas into unique new products unlike those seen anywhere else. Many of the resulting products might be described as "niche" items, yet for the people who use them regularly, these products are irreplaceable and become a vital part of daily life. Our employees find pride and motivation in creating and bringing such products to the world.

Our fundamental strategy enlists a one-of-a-kind business model of "a big fish in a small pond." We do not attempt to compete in large markets ("large ponds") that have already matured. We instead discover small, unaddressed markets ("small ponds") and develop them. Consequently, we maintain exceptionally large market shares for many of our products, such as *Bluelet*, *Netsusama Sheet* and *Eyebon*.

As a result, Kobayashi Pharmaceutical has realized sales and profit growth and delivered earnings gains for 20 consecutive fiscal years since our stock listing. This has also been the source of our success in raising the dividend for 19 consecutive periods.

What is the future vision for Kobayashi Pharmaceutical, and how will the Company achieve it?

We are pursuing two areas. The first area is continuation and enhancement of the business model that underpins our existing strategy as expressed in "You make a wish and we make it happen." Our new product development is largely as follows: idea creation, assessment of market potential, prototyping, assessment of user satisfaction, mass production, launch and cultivation. For each stage, we meticulously apply the PDCA cycle to achieve ongoing improvement.

The second area is expansion of our ability to deliver what customers wish for on a global basis. In our view, globalization is more than merely the overseas sale of products conceived in Japan. We want to implement "You make a wish and we make it happen" in each country we operate in. In other words, we aim to discover the issues faced by people in these countries and turn ideas that provide a solution into reality. This will require that idea generation and product development be carried out by employees born and raised in each region. We will continue our endeavors in this regard so that 10 or 20 years from now, like in Japan, we can apply the same development of unique products in countries around the world.

Please explain the background and substance of the Medium-Term Management Plan for 2017–2019 "Growth with Real Strength."

In 2016, when formulating the plan, we had achieved consistent rises in profit, and investors perceived us as "a company capable of stably delivering profit." However, investors also felt that they "could not expect major growth." During the decade from 2007 through 2016, although sales increased in the final two years, growth had been scarce in domestic store sales[1] over the preceding eight years. For the ten-year period as a whole, our weak growth was undeniable.

While sales did grow in the final two years, a major factor was an opportune upswing in demand from inbound visitors to Japan. Based on a frank acknowledgment that our ability to deliver stable growth without being affected by the external environment was lacking, we targeted "Growth with Real Strength" as the theme of our Medium-Term Management Plan for 2017–2019.

We accepted that stable growth could not be attained simply by continuing along as we had previously, and we therefore adopted a policy of transforming how we work. Specifically, we laid out four goals: 1) Defining four growth businesses and clarifying investment priorities; 2) Investing to drive future growth; 3) Renouncing past approaches to new product development and switching to methods that support stable growth; and 4) Creating a framework by which employees can grow and develop at a faster pace.

1. Including Kiribai Chemical Co., Ltd. and excluding medical devices.

Promote four growth businesses

The first policy goal to promote four growth businesses calls for actively allocating resources to the Overseas, Direct Marketing, Skincare and Kampo businesses as growth drivers.

Overseas Business

Our Overseas Business is focusing on two main initiatives. The first initiative is to cultivate three product lines (body warmers, *Netsusama Sheet* and *Ammeltz*) sold globally. We aim to make inroads with these three products in each country's market. For example, to expand the body warmer market, we are mainly utilizing in-store sales promotion activities in the U.S. Meanwhile in China, against a backdrop of growing awareness of the Kobayashi Pharmaceutical brand, we are increasing the number of stores that stock our products, promoting e-commerce channels and using TV commercials and public transport advertisements.

Consolidated Results for FY2017

Achieved large increases in sales and profits year on year[2]

	Results for comparable period in 2016 (January 1–December 31, 2016)	FY2017 targets (Announced February 1, 2017)	FY2017 results (January 1–December 31, 2017)		
	(Billions of yen)	(Billions of yen)	(Billions of yen)	Percentage of net sales	YoY change
Net sales	144.8	150.0	156.7	—	+8.3%
Operating income	18.4	20.0	22.9	14.6%	+24.3%
Profit attributable to owners of parent	15.0	15.1	15.8	10.1%	+5.6%

2. Year on year comparison based on results for January–December 2016, as fiscal 2016/12 was a nine-month transitional period due to a change in fiscal year-end.

Key Points of Consolidated Results (Sales)

Factors behind change in sales (YoY comparison)

Positive factors

1) Expansion of Overseas Business (+¥4.0 billion)
2) Contribution of new products (+¥5.4 billion)
3) Increased sales of existing domestic products (+¥1.0 billion)
4) Increase in inbound demand (+¥2.0 billion)
5) Expansion of Direct Marketing Business (+¥0.6 billion)

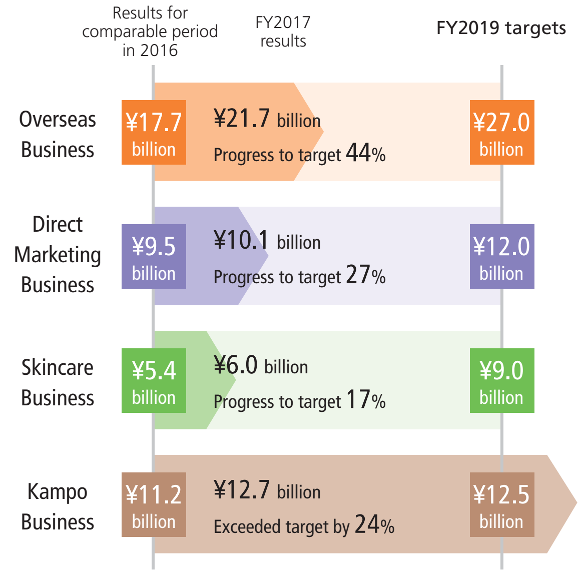
Negative factors

1) Decrease in sales of Other Business (–¥1.1 billion)

Note: Includes decrease in sales due to dissolution of joint venture in medical devices business (–¥1.4 billion)

+8.3% YoY

Results in Four Growth Businesses



(Percentages are calculated taking sales for the period January–December 2016 as a base, and the FY2019 target amount as 100%.)

The second initiative is to strengthen OTC pharmaceuticals, primarily in the U.S. and China. We have improved sales growth and profit margin by shifting emphasis from household products to healthcare (OTC pharmaceuticals and health foods) in Japan, and we also intend to strengthen the healthcare category and raise the percentage of sales accounted for by OTC pharmaceuticals in overseas markets. In particular, we have acquired OTC drug manufacturers with the aim of accelerating growth in the U.S. and China. We acquired Perfecta Products, Inc. in North America in September 2016, and Jiangsu Zhongdan Pharmaceutical Co., Ltd. in China in June 2018. We intend to develop the OTC pharmaceuticals business by leveraging drug approvals and sales channels held by these new Group members. As a business that offers the prospect of stable and firm growth, we seek to increase the percentage of sales accounted for by OTC pharmaceuticals in each country.

Direct Marketing Business

A key theme for the Direct Marketing Business in the medium-term management plan is the development of major new products leading to the acquisition of new customers. Sales are on a recovery track and grew at a healthy pace in 2016 through 2017. To continue this growth on a steady basis, we must develop unique new products (along the lines of *Edicare*, *Salacia 100* and *Hifmid*) and invest in advertising to build our customer base.

We are also pursuing brand cultivation that combines store sales and direct marketing sales. In 2017, we established *Salacia 100* as our first common brand across store and direct marketing channels, and began cross-divisional efforts to cultivate this product. The result was a healthy synergy effect, with the number of orders in the direct marketing channel boosted through increased TV advertising after store launch. Taking this example as a successful case study, we will apply the PDCA cycle with the aim of extending such initiatives to other products.

Skincare Business

While the skincare market is an intensely competitive environment with many players, we believe customers still face many hidden issues. We see room for substantial growth by offering ideas to solve those issues.

Our policy under the medium-term management plan envisions development of a third major brand beside *Keshimin* and *Eaude Muge*. We intend to strengthen these two brands and focus on cultivating *Madame Juju* at the same time as

Three Key Global Product Lines

HotHands (U.S.) *Netsusama Sheet* (China) *Ammeltz* (Thailand)

Acquisitions to Strengthen the Healthcare Category Overseas

Obtained rights for *Max Freeze* brand through the acquisition of Perfecta Products, Inc.

Signing ceremony for the acquisition of Jiangsu Zhongdan Pharmaceutical Co., Ltd.

New Products in the Direct Marketing Business

Edicare *Salacia 100* *Hifmid*

New Brands in the Skincare Business

Acquired exclusive marketing rights in Japan for *Bioil* through an alliance with Union-Swiss (Pty) Ltd.

Obtained rights for *Cinderella Time* brand through the acquisition of True Nature Co., Ltd.

pursuing alliances and M&A to establish a third major brand. In 2017, we acquired exclusive marketing rights in Japan for *Bioil* from South Africa-based Union-Swiss (Pty) Ltd. In July 2018, we acquired True Nature Co., Ltd., the manufacturer of *Cinderella Time*, a cleansing gel brand with growing popularity among specific demographics. Kobayashi Pharmaceutical plans to begin selling this product in spring 2019. Going forward, we will make market inroads through promotion of these brands together with our existing core brands, *Keshimin*, *Eaude Muge* and *Madame Juju*.

Kampo Business

Many Kampo medicines are highly effective against the complex symptoms of lifestyle diseases and menopause, which are difficult to attribute to any one cause, and we believe that this is an area with great potential for resolving issues facing many customers. However, Kampo preparations are often distributed under their generic names, making it difficult for consumers to find and select the product that meets their needs. In response, Kobayashi Pharmaceutical has been developing new products with easy-to-understand naming, packaging and advertising to help customers understand who the medicine is for and what kinds of problems it can address. This strategy has produced successes such as *Naishitol* (for obesity), *Chikunain* (for sinusitis), and *Komure Care* (for muscle cramps).

To further strengthen these initiatives, in line with the medium-term management plan, we reorganized our divisions and established a dedicated Kampo and herbal medicine[3] unit in the fiscal year ended December 31, 2017, and we are pursuing concentrated development and brand cultivation. As a result, new product development has accelerated. We also achieved significant growth over the previous year in existing products, such as *Inochi no Haha A*, a woman's health medicine. We will continue to develop Kampo medicines that are customer-oriented and will seek greater overall customer satisfaction by emphasizing not only effect and efficacy but also easy-to-take forms, container

Kampo Medicines with Easy-to-Understand Naming and Packaging

Naishitol

Chikunain

Komure Care

packaging designs, the quality of herbal medicine ingredients and attractive prices.

3. Herbal medicines may contain natural organic or inorganic active ingredients that are not of plant origin, such as animal or mineral materials.

Invest in growth for the future

In order to realize future growth, we are defining new investment areas as well as actively investing in medium-to-long-term research themes and M&A.

In the past, Kobayashi Pharmaceutical lacked substantial experience in product development based on innovative technologies, such as from materials research and new effect discovery. We have selected four priority areas (immunity ingredients, fermentation technology, natural product science and pharmaceuticals reclassified as OTC) and aim to develop major new products from a medium-to-long-term perspective as part of the management plan. We are streamlining development of products from innovative technologies by applying our accumulated expertise in assessing market potential to prioritize themes and clarify resource allocations. Our efforts should not be confined to in-house development. We aim to promptly deliver products that have greater novelty and robust efficacy by strengthening collaboration with external partners.

Joint research with Makino Botanical Garden in Kochi Prefecture on new materials is ongoing, and we entered the field of rice mold (monascus purpureus) through an acquisition in 2016. Additionally, in 2017, we began offering joint research courses on dementia with the University of Tokyo, and on peripheral blood vessels with Osaka University. We also cultivated sales channels for functional foods to medical institutions, and worked on pharmaceuticals that have been reclassified as OTC.

Our M&A focus areas under the medium-term management plan are establishing a platform for OTC sales in overseas markets (North America, China and the rest of Asia), acquiring skincare brands (establishing a third major brand), and strengthening domestic consumer products (namely OTC pharmaceuticals and health foods). We are targeting the signing of at least eight contracts, including alliances, in the four years 2016 through 2019, which cover the duration of the medium-term management plan. As of July 2018, we have already executed on seven such arrangements. We established a special M&A unit 14 years ago to seamlessly handle the process from acquisition search, to drafting of acquisition plans, risk assessment, due diligence and the post-acquisition integration process. This approach has increased the flexibility with which we are able to implement M&As, and has generated a number of successes. We will continue to pursue speed-conscious M&As that lead to sales growth.

We are targeting a global rollout of OTC pharmaceuticals and plan major capital investment totaling about ¥30 billion over the next five or so years. We will construct two new plants with the goals of strengthening our manufacturing capacity to address growing demand, establishing PIC/S-compliant production, and improving productivity through streamlining as a response to hiring shortages. We have also begun investing in intellectual property as a precursor to stronger brand expansion overseas. Additionally, we are acquiring land and preparing for construction of a new research institute in order to resolve capacity shortfall at our Central R&D Laboratory. This series of investments is on a larger scale than ever for the Company. Nevertheless, we are advancing in a planned manner and building a foundation for future growth.

Envisioned Investments

Invest in growth for the future

Medium-Term Management Plan for 2017–2019 Invest in growth for the future Announced November 2016		Investment budget (2017–2019)
	M&A	¥30 billion
	R&D, new businesses	¥3 billion

+

Expected large-scale investments in anticipation of global expansion of OTC pharmaceuticals

Challenges	Responses	Maximum investment budget (over the next 4 to 7 years)
Capacity to boost production to prepare for increase in demand	New factory construction	¥30 billion
Manufacturing in line with global standards (PIC/S[4])		
Overseas brand development, management of global risks	Trademark management in each country, security measures, etc.	
Current capacity shortage at Central R&D Laboratory	Relocation of Central R&D Laboratory	

Note: These plans are still in the early stages of consideration, and have not been formally decided.

4. Pharmaceutical Inspection Convention and Pharmaceutical Inspection Co-operation Scheme

Develop and cultivate products that create new markets

The concept behind "Growth with Real Strength," the theme for the three years of our medium-term plan, calls for us to transform into a company capable of stable domestic growth despite Japan's shrinking population. We will accomplish this through the further improvement of development and cultivation capabilities for new products that enable them to take hold in the market.

Previously, we placed priority on speed when developing new products, seeking to move swiftly through the stages of idea creation, assessment of market potential, prototyping, assessment of user satisfaction, mass production, launch and cultivation.

However, growth in domestic store sales remains weak and we concluded that it would not be possible to overcome these conditions by applying the same methods responsible for past successes. The medium-term management plan mandates that we renounce all aspects of our current approach to development and seek to continuously improve the quality of development by generating ideas and implementing the PDCA cycle.

For example, we faced an issue that although we were developing and launching many new products, a large portion was failing to gain market traction. This happened because launching numerous products on a six-month cycle split the attention of cultivation capabilities and meant that each product did not receive the necessary support. The medium-term management plan shifts the emphasis onto narrowing the number of new products, and ensuring the thorough cultivation of each product after launch. Specifically, we have been taking

New Product Cultivation Successes

Dusmock *Oshiria* *Bluelet Stampy*

Cultivating New Products

Three-arrow strategy: Cultivating products through a series of three sales promotion surges during the six months after launch steps to only develop products with strong prospects for cultivation after launch, such as by carefully assessing market potential in the initial stage of development and applying more stringent launch criteria for new products.

Furthermore, in post-launch cultivation, we implement a "three-arrow strategy" of promotion surges in the first six months, as well as a system for rapid implementation of the PDCA cycle for product cultivation based on monitoring of cultivation status by sales divisions, marketing divisions and the executive team. We have already achieved a number of successes, including *Dusmock* (for ameliorating persistent coughing and bronchitis), *Oshiria* (a cream for rectal irritation) and *Bluelet Stampy* (a toilet bowl cleaner and freshener with added anti-bacterial action).

Such wide-ranging improvements have resulted in the steady and tangible accretion of development and cultivation capabilities. We will continue to focus our efforts, and broaden the application of related expertise to the Overseas Business.

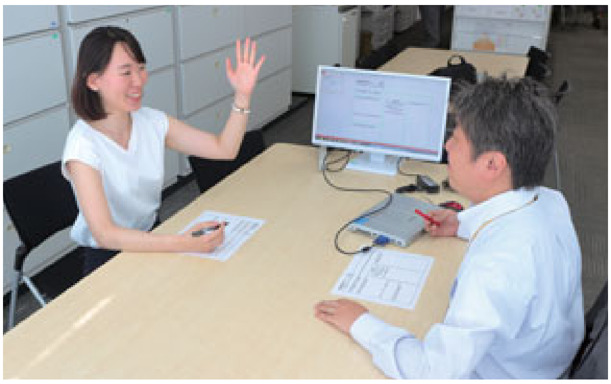
Become a company where employees can grow and develop

The critical success factor for promoting the four growth businesses, investing in growth for the future, and continuing to increase corporate value, is the steady deployment of talented personnel to such frontier fields. This will require us to accelerate the speed with which we foster human resource growth.

As with our business model for realizing "You make a wish and we make it happen," we seek to establish a unique model for cultivating human resources. One specific initiative is our regular "growth dialogues," opportunities for discussion between employees and supervisors. A dialogue sheet is used to help visualize career goals and ideas for growth, and support is provided for each individual in his or her development. Communication that provides immediate recognition of growth is a key motivator for further growth aspirations.

Ten years from now, we aim to achieve a model for the cultivation of human resources where "You make a wish and we make it happen" applies just as equally when discussing ideas for coworker growth as when we set ourselves to resolving customer problems.

○ Growth Dialogues



Employees brainstorm ideas for career growth with supervisors

How would you assess the Company's progress one year into the medium-term management plan?

In the fiscal year ended December 31, 2017, the inaugural year of the plan, we made an excellent start, including a dramatic increase in sales and profit year on year. We also achieved steady results by clarifying our investment priorities, as seen in the ¥6.7 billion increase in sales for the four growth businesses – Overseas, Skincare, Direct Marketing and Kampo.

Sales expanded on growth in the Overseas Business, new product contributions and healthy inbound demand. Net profit attributable to owners of parent reached an all-time high, and we posted increased profit for the 20th consecutive fiscal year. The new product contribution ratio declined to 5.4 percent because activities for creating new markets in domestic store sales emphasized market potential and applied stricter new launch criteria. Nevertheless, the four-year contribution ratio, which represents the share of sales accounted for by products launched in the past four years, was 21.0 percent in the fiscal year ended December 31, 2017, up from 15.4 percent in the fiscal year ended March 31, 2012. This improvement was attributable to careful selection of new products for release, and emphasis on cultivation after launch. We believe this indicates an improvement in our ability to ensure new products take hold in the market, and affirms the validity of our approach.

Additionally, continuing growth in inbound demand is lifting our confidence that our products have the support of people from around the world. We see potential for expanding into global markets and intend to further strengthen investment in the Overseas Business.

We are committed to attaining the goals of the medium-term management plan. In the next plan beginning in 2020, we will deploy our enhanced development and cultivation capabilities to overseas markets, as well as launch major new products in the areas receiving investment and reliably cultivate them. By doing this, we expect to sustain stronger growth than previously achieved.

What is the Company doing to ensure ongoing improvement in corporate value?

Advancing management from an ESG perspective

We have defined action themes and established a framework for applying the PDCA cycle based on advancing management from the perspective of the environment, society and governance (ESG).

Key environment themes are reducing energy consumption and designing products with consideration for the environment. In 2011, we defined our own set of standards, known as the "product development eco indicators," to support environmentally friendly design, and we have since

Inochi no Haha A Simultaneously Realizes Customer, Economic and Social Value

Customer Value
Alleviation of unpleasant symptoms associated with menopause

Economic (Financial) Value
Sales and profit from *Inochi no Haha*

Social (Non-Financial) Value
- Enhances quality of life for women and empowers them
- Lowers medical costs

revised constituent items and improved application methods in order to further reduce environmental impact. We hope to finish establishing a framework during the period covered by the medium-term management plan and proceed to setting long-term goals that include CO_2 emission management at overseas plants, as well as carry out other activities to lessen environmental impact throughout the value chain, including procurement, usage, disposal and returns.

With respect to society, we emphasize the motivation, diversity and growth of employees, who are vital to the functioning of our business model, and the further development of trust from customers, business partners and other stakeholders. We want to develop unique initiatives, such as supporting employee growth through the "growth dialogues" detailed previously, and creating social value as illustrated through the example below featuring the *Inochi no Haha* brand.

In corporate governance, we have proactively deployed new mechanisms and systems since 2008, such as selecting and increasing the number of outside directors, introducing various committees and assessing the effectiveness of the Board of Directors. Over the past year, we bolstered discussions of business strategy, ESG issues and risk management.

We intend to advance management from an ESG perspective through further dialogue with stakeholders and work toward sustainably achieving continued increases in profit and dividends.

Realizing a fusion of customer, economic and social value

I believe our products resolve more than customer problems; they contribute to the development of solutions to underlying world issues and social problems.

For example, our product *Inochi no Haha A* is a Kampo medicine that can relieve symptoms due to disruptions in hormonal balance associated with menopause, such as sudden sweating, grogginess and tension. In the past, there was no easy solution, so when we offered this product along with a straightforward TV advertising slogan that let customers know menopausal symptoms could be treated with medicine, the reception was enthusiastic and positive. The feedback from users not only indicated that it improved their various symptoms, but also included unexpected comments such as: "My anxiety and worries are gone," "Now I can live with a cheerful and positive outlook," and "I can focus my energy on my job again." In other words, it became evident that *Inochi no Haha A* is a product that offers value beyond improvement of menopausal symptoms (customer value), in that it also helps to empower women (social value).

By identifying ways for our products to create this type of social value, we hope to promote solutions to larger issues in society through our approach of resolving customer problems.

We do not pursue large markets that are already established. Instead, we develop and supply new products to niche markets that have gone undetected. Even though the market size of each product may be smaller, these niche markets supply items that become essential for the customers that use them. Without these products, customers would have no other choice but to endure uncomfortable symptoms or inconvenience. This results in the formation of a strong bond between us and our customers. The world has high expectations of us for continuing to identify and deliver new products. This role is our unique value and one we must continue to uphold.

Closing comments

On behalf of the Kobayashi Pharmaceutical Group, I would like to express our sincerest appreciation to shareholders, investors and other stakeholders for their steadfast support. Through living up to our brand slogan, "You make a wish and we make it happen," we will sustainably enhance our corporate value by resolving issues faced by customers and society. You can rest assured that the Kobayashi Pharmaceutical Group still has plenty more to offer.

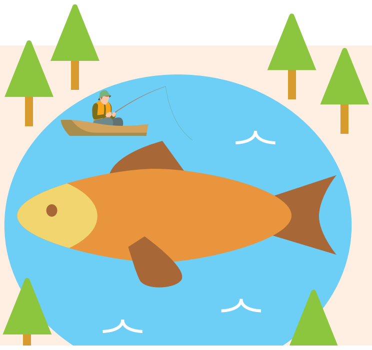
Idea & Speed

Our Business Model and Development of Unique Products

01 | Kobayashi Pharmaceutical Group’s Business Activities

So far, we have created new markets by launching niche products that answer the needs of society. To sustain our growth, we will need to strengthen our business model as presented below.

1 A big fish in a small pond



Find an undiscovered pond

Fish in it by ourselves

Grow the pond so it is big enough for large fish

Small pond—Sales of ¥0.5 billion in a ¥1 billion market

✓ There are few competitors in small ponds, so we can secure large market share (50%) and high profit margins.

Large pond—Sales of ¥0.5 billion in a ¥10 billion market

✗ Competition is fierce in large, crowded ponds, so it is difficult to expand market share (5%) and raise profit margins.

2 Development of unique products

Generating ideas to address needs and turning them into products

In our approach to development, everything starts from discovering a need that we think people wish could be filled. We then develop ideas generated from that, with an emphasis on speed.

To make sure that the wish can come true, we have established a structure for developing it into the ideal form and quickly delivering it to customers.

3 Easy-to-understand marketing

The new products we create are often unfamiliar to consumers because of their novelty.

Without knowing what a product is for, people are unlikely to buy it, so it is imperative to communicate product features simply and clearly. We therefore focus on conveying a consistent message in naming, packaging, advertising, sales promotion, sales displays and product marketing to make the product easy to understand.

In recent years, our marketing approach has helped drive demand among foreign visitors to Japan by overcoming written linguistic barriers and enabling understanding of product features from other information. We believe this approach holds currency all over the world, not just in Asia.

02 | Development of Unique Products: The Source of Our Competitiveness

Our niche products are the result of our unique approach to development inspired by our brand slogan, "You make a wish and we make it happen." This is the source of our competitiveness.

Flexible, imaginative thinking by employees and a free and open corporate culture that supports such creativity are critical to that approach. To maintain and develop this individual creativity, we have established various systems and structures to prevent the encroachment of bureaucracy and authoritarianism that could dampen it, and constantly strive to foster a free and open corporate culture.

03 | Systems, Structures and Corporate Culture That Support Development of Unique Products

Systems for Producing Ideas

Idea Presentation

Staff involved in product development are given the opportunity to pitch their new product ideas directly to the president once a month, which is a great source of motivation. Moreover, the involvement of the president from the initial stages of product development significantly speeds up decision-making on development and shortens time to market.

Product developers apply their individual perspectives in looking for new ideas, actively collect information, and identify key issues. This stage of development is a muddy process of trial and error that requires significant effort.

The driving force of product development that opens untapped markets is the way our development team members constantly ask themselves what would delight customers and persevere through the obstacles they encounter.

Idea Proposal System

Our idea proposal system allows any employee to submit an idea for a new product. In FY2017, a total of 33,769 ideas were proposed, averaging 11 per employee.

To come up with such proposals, employees look at how lifestyles are changing and what new needs are emerging. Rather than relying excessively on survey data, they are encouraged to go out into the real world to see things with their own eyes, and gather information from the standpoint of consumers. In collecting information, they discover needs in day-to-day shopping and conversations with friends and

Employees present their ideas

Naishitol 85, which originated from the idea proposal system

family members. The best suggestions are conceived by keeping eyes and ears open in the course of daily life.

The idea proposal system has been in place for more than 35 years since its origins in 1982. As a result, our employees have acquired the habit of thinking about the needs of society and the signs of change, and have a keen awareness of development. This is one factor behind our unique corporate culture that encourages employees to embrace challenge.

Company-Wide Idea Contest

Since 2014, we have held a yearly company-wide idea contest in which all employees can enter their new product ideas. On August 22, the anniversary of the Company's incorporation, all employees gather to present ideas to each other. This event is characteristic of Kobayashi Pharmaceutical.

The best ideas from each department are selected and finally presented in front of the president and other top executives. The winning idea is then given actual consideration for development and commercialization.


Company-wide idea contest (top left: President Akihiro Kobayashi)

Systems to Foster a Free and Open Corporate Culture

Equality at Work: Policy on Forms of Address

The Kobayashi Pharmaceutical Group emphasizes equality at work. We strive for a workplace culture where anyone, whether freshly hired or a seasoned veteran, is free to express their opinion on an equal footing, regardless of position.

In 1995, we introduced a policy on forms of address, abandoning the practice of referring to people by their job title. All employees are uniformly called by their name to reinforce this attitude of equality.

Reward and Recognition: e-Appreciation

At Kobayashi Pharmaceutical, we encourage praise and recognition of success rather than dwelling on failure. This has helped to foster a culture that prizes the independence and effort of every employee.

Under the e-Appreciation program, the president personally sends an email to thank employees who have taken up a challenge on their own initiative and generated positive results. A single email directly from the president may offer great encouragement and motivate employees to tackle the next challenge. These emails are also published in the Group internal newsletter.

04 | Leadership by Top Management

Kobayashi Pharmaceutical has a management structure built around the founding family, which enables speed-oriented management, strong employee loyalty, bold management decisions, and management with a long-term perspective.

In product development in particular, the president not only oversees naming and package design decisions, but also has final approval on price-setting and all other matters. This hands-on leadership helps to keep product strategy in line with our business model – in other words, it supports smooth internal operations by enabling consistency in management.

Human Resources Strategy

Human Resources Strategy

It is commonly said that "A company is its people." We believe that our human resources are essential for the Kobayashi Pharmaceutical's sustained growth, and are our most important asset.

Hiring and nurturing human resources able to develop and provide products that create new markets through our "a big fish in a small pond" business model is our most important management task.

01 | The Kind of People We Seek

Below, we summarize the kind of people we look for. These requirements are closely aligned to the attributes needed to achieve our Management Principles and business model.

By bringing together people like this at our company, we aim for "management with full employee participation," encouraging all employees to think like managers.

Four Employee Requirements

Independence	Thinks and makes decisions independently, without being bound by precedent
Pioneer spirit	Takes on new challenges without fear of failure
Relationship-building skills	Encourages colleagues and builds good relationships
Ability to accomplish objectives and persevere	Shows determination in the face of adversity

Ten Attributes We Look for in Employees

Kobayashi Pharmaceutical has a list of ten attributes that it looks for in prospective employees. Combined, these attributes are expressed in the four employee requirements.

Ten Attributes We Look for in Employees

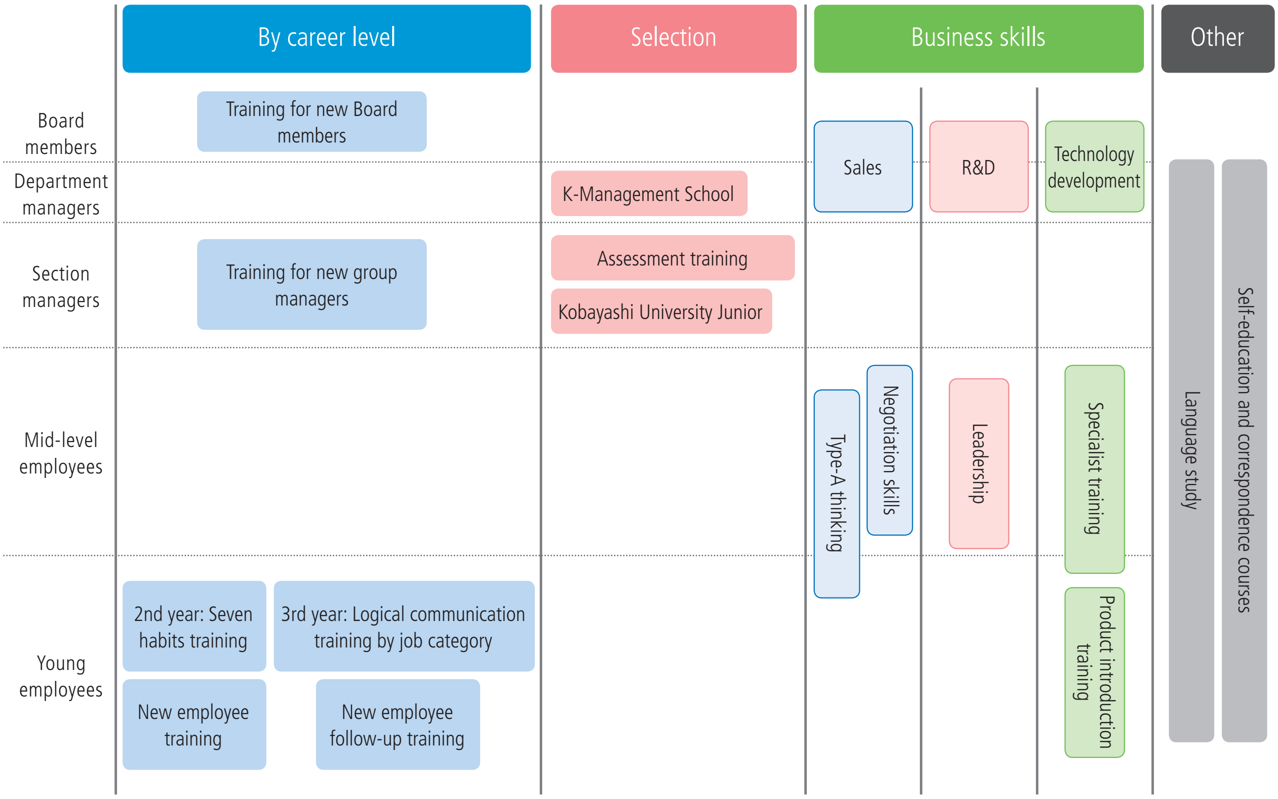
1. Likes new things
2. Hates to lose
3. Assertive
4. Communicates frankly
5. Perseveres
6. Energetic
7. Devoted to work
8. Not afraid of challenges or failure
9. Offers something unusual
10. Pleasant and likeable

02 | Approach to Human Resource Development

We believe that employee growth leads to the Company's growth, and therefore devote significant effort to human resource development.

A training system that enables employees to grow and develop, and expand their potential, is therefore an absolute necessity.

Training System



Selection Education

Kobayashi Pharmaceutical uses a selection education program called "Kobayashi University" to polish management acumen from an early stage and cultivate future executive candidates. Chairman of the Board and CEO Kazumasa Kobayashi is the president of Kobayashi University, which consists of a junior course mainly for the section manager class, and two K-Management School courses mainly for the department manager class. In the K-Management School courses, the chairman and other executives do the teaching, and engage with the students intensively. Through management meeting role-playing and other techniques, students learn how to view things and make decisions as a manager, and above all, learn the DNA of the Kobayashi Pharmaceutical Group.

K-Management School (rear left: Chairman Kazumasa Kobayashi)

On-the-Job Training

Based on our belief that the key to the early development of employees is experience on the front lines, we emphasize human resource development through on-the-job training (OJT) for young employees.

The new product contribution ratio (first year and first four years) is one of our important management indicators, and new product development is the source of our growth. We have thereby introduced our own unique approaches in OJT related to new product development.

Employees involved in product development are given the opportunity to present new product ideas to the company president once a month (see "Idea Presentation" on page 21). Being able to present their ideas directly to the president is a great source of motivation for young employees. Even after their ideas are accepted and proceed to the product development stage, they continue frequent communication with the president through monthly meetings of the Development Committee, again chaired by the president. This provides a major growth opportunity, as they also work closely with their colleagues, supervisors, and related departments, in addition to the president, through these processes.

Explanations are given in the Development Committee (right: President Akihiro Kobayashi)

Our unique Idea Proposal System is another important tool for human resource development. All employees are given the duty of submitting a product idea or a business improvement idea once a month (some young employees submit more than 100 ideas in a year). Through this system, employees get into the habit of thinking about the signs of change and needs in the world every day, and hone their ability to generate new product ideas. Making the most of such OJT opportunities requires a corporate culture where everyone's will is respected, regardless of age or position. Therefore, we have instituted a system to promote a spirit of equality at work (see "Equality at Work: Policy on Forms of Address" on page 22).

03 | Diversity

The presence of employees with diverse backgrounds and perspectives, including age, gender and nationality, is essential in developing new products that create new markets. Two people looking at the same thing see it differently depending on their standpoint and perspective. By being an organization that attracts such people and which looks at things from a wide variety of angles, we can realize product development and advertising based on understanding of various customer needs.

Empowering women in the workplace is another important management issue at Kobayashi Pharmaceutical. We are expanding the percentage of management positions held by women (9.1% as of January 31, 2018), and will continue this focus.

A meeting gathering employees of various nationalities

Development Stories

Development Story 1

The story behind the creation of long-selling products that are recognized by Guinness World Records®

1

Toilet bowl cleaner and freshener

Bluelet

Product Description

- Keeps the toilet bowl clean by coating it with a substance that prevents adhesion of dirt
- Washes away dirt with every flush
- A deodorizing fragrance keeps the bathroom smelling fresh

Guinness World Records presentation ceremony

1969
Bluelet
(when it was launched)

1986
Basin-mounted type debuts

2001
Liquid type launched

Making the bathroom a clean and comfortable space

Bluelet, a toilet bowl cleaner and freshener launched in 1969, has been sold continuously for nearly half a century. Kazumasa Kobayashi (the current chairman), then in his third year with the Company, took inspiration from the home in which he stayed while studying in the United States. The bathroom included a bathtub, sink and toilet, with tiles on the walls. When flushed, the toilet ran with pleasantly fragranced blue water, and the bathroom was a bright, clean and comfortable space. Toilets in Japan at the time were often thought of as "dirty, dark and smelly," but Kazumasa had a hunch that the need to make the bathroom a more pleasant space would grow as flush toilets became commonplace. On this basis began the development of a toilet bowl cleaner and freshener that ran blue. The goal was for a fixed amount of cleaner to be released into the water with every flush, providing a stable color and fragrance. He also wanted it to have the same color and fragrance under any conditions – regardless of water temperature variation by region or season, or frequency of use depending on family size.

A product that continues to evolve with toilets

Four years after the start of development, the difficult hurdles had been cleared, and a product that was the first of its kind in Japan was ready at last. But the product was launched in adverse market conditions, as only about 20 percent of Japanese homes had flush toilets at the time. In the years that followed, Japan's high economic growth phase brought dramatic changes in people's lifestyles. With the advancement of women in society, there was strong interest in making housework more efficient, and Kazumasa was confident in the potential and expansion of the market for a toilet bowl cleaner and freshener that could simplify cleaning the toilet and make it smell better. Kobayashi Pharmaceutical tenaciously developed the market for *Bluelet* with television, newspaper and magazine advertising ahead of other companies, a word-of-mouth strategy using consumer testers, and sales promotions at drug stores and supermarkets. Since the product had a high repeat purchase rate, sales climbed steadily. *Bluelet*, which evolved from solid form to a liquid in 2001, has continued to grow steadily in an expanding market, and in 2014 – the 45th anniversary of its launch – it was recognized by Guinness World Records as the world's best-selling[1] product of its kind (sales in 2013 were approximately ¥13.0 billion[2]). In recent years, tankless toilets that take up less space and save water are gaining popularity, and we are now focused on developing a new tankless-compatible version of *Bluelet.*

1. About *Bluelet*'s Guinness World Record
   Record name: Largest in-cistern device toilet care brand by annual revenue – current; Period covered: January–December 2013
2. Sales estimate by an international market research organization (converted at ¥97.65 to US$1, the average rate in 2013)

Development Story 2

2017
Guinness World Record edition

2007
Shoshugen Charcoal Fragrance

1995
Shoshugen for Toilet
(when it was launched)

2

Deodorizing air freshener

Shoshugen

Product Description

- Large filter eliminates unpleasant odors
- Fragrance intensity can be adjusted by raising the filter
- Large capacity provides a long-lasting effect

Guinness World Records presentation ceremony

A product development idea discovered overseas

The deodorizing air freshener *Shoshugen* is a long-selling product line that has met consumer needs with a variety of fragrances for 23 years since the launch of *Shoshugen for Toilet* in 1995. It is positioned as one of our top brands, and in 2017, sales of the liquid-type deodorizing air freshener were recognized as number one[3] in the world by Guinness World Records (sales in 2016 were approximately ¥13.1 billion[4]). The inspiration for the development of *Shoshugen for Toilet* also came from Kazumasa Kobayashi. On his international market research trips each year, Kazumasa made sure to visit local stores, and one time in Europe, he noticed large-capacity deodorizers lining the shelves. He was confident that the product would sell in Japan, where it was unprecedented. The key to strong sales would be creating an air freshener that had a high volume capacity and long-lasting performance. However, the idea encountered nothing but resistance from development team members. The reaction from distributors was sharply divided: some thought the pull-up filter lacked design sense and wouldn't catch on in Japan; others were convinced it was the answer to consumer dissatisfaction with product longevity.

"It may not be pretty but it works!"—market creation with a focus on effectiveness

In consumer testing before the development of *Shoshugen for Toilet*, only 8 percent of participants said they liked the design, while 66 percent disliked it. On the other hand, on the question of "deodorizing effect compared with existing products," 62 percent responded that it was superior, and 10 percent said it was not. In other words, it was clear that the biggest selling point was not the appearance, but that the product had a large capacity and worked well. Conveying that in a straightforward way led to stock shortages soon after the product launch.

A television commercial that communicated that selling point with a simple and clear message – "It may not be pretty but it works!" – became a touchstone of our distinctive promotional strategy.

Since its debut, *Shoshugen for Toilet* has undergone numerous redesigns, but its unique pull-up filter has remained constant. Product development has expanded the brand range with versions such as *Oheya no Shoshugen* for living spaces, and we have actively made improvements in step with changes in consumer needs regarding fragrances.

3. About *Shoshugen*'s Guinness World Record
Record name: Largest liquid air freshener brand – retail RSP, current
Record holder: *Oheya no Shoshugen* series, *Shoshugen for Toilet* series; Period covered: January–December 2016
4. Sales estimate by an international market research organization (converted at ¥106.79 to US$1, the average rate in 2016).

Development Stories

Development Story 3

The story behind the creation of Japan's first medicated skincare product

3

Class 2 OTC drug

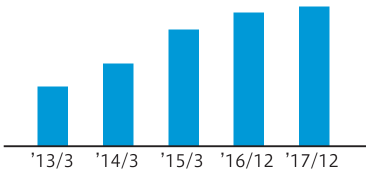
Attonon

Product Description

- Three active ingredients repair scars and make them less noticeable
  - Heparinoid promotes regeneration of normal skin by stimulating turnover
  - Allantoin promotes repair of damaged skin tissue
  - Glycyrrhizinate dipotassium alleviates residual scar inflammation

Medicated skincare sales

(Billions of yen)



Launched in March 2011

Attonon
(Product name: *Attonon*)
Class 2 OTC drug

Ninocure
(Product name: *Ninocure*)
Class 3 OTC drug

2011 2013

A female employee finds a "customer wish"

Attonon, a medicated skincare product that improves the appearance of scars, came into being because of an accident that happened to a female employee. While riding her bicycle one day, she fell and injured both knees.

Since she had only grazed her skin, she assumed her knees would heal quickly and did not treat them, but was concerned when the scars remained. She felt that there must be many women with similar concerns, and conducted a survey on women's attitudes to scars. The results showed that some 30 percent of women from their twenties to fifties had scars acquired within the previous three years. Moreover, even though virtually all of the women were concerned about and wanted to improve the appearance of their scars, over 60 percent had taken no action. In the United States, the market for treating scars such as pregnancy stretch marks and acne scars was worth roughly ¥23 billion, but in Japan there was no clear market. Confident in this latent demand, Kobayashi Pharmaceutical set out to develop a medication to repair scars and make them less noticeable.

Focusing on the active ingredient and ease of use

Redness and protrusion in scars are caused by collagen overproduction that occurs when a wound does not heal well because of purulence and poor blood circulation around the wound. As the main ingredient, we therefore used a heparinoid that improves blood circulation in the subcutaneous tissue and promotes skin metabolism. A particular focus was ease of use. While ensuring the active ingredient did its work, we explored how to give the product a texture that women in their twenties to fifties, the target segment, would want to use every day.

The first in the series was a gel-type that was easier to apply without stickiness, and permeated rapidly and dried completely, allowing users to get dressed and leave the home or go to bed soon after application. Since then, we have added new varieties, including a cream-type and concealer-type, to provide products that fit women's needs and lifestyles, and offer a product lineup that women could choose from to suit their preferences.

Building the new category of medicated skincare products

We had developed *Attonon* with the confidence that potential demand existed, but there were concerns about the launch. In survey data from consumer testers, several mentioned that they had no concept of improving a scar, and that there

Saiki
(Product name: *Saiki a*)
Class 2 OTC drug

Senacure
(Product name: *Senacure*)
Class 2 OTC drug

Curerare
(Product name: *Curerare a*)
Class 2 OTC drug

Kurocure
(Product name: *Kurocure b*)
Class 3 OTC drug

2015 | 2016 | 2017

were no competing products to compare effects with. How to convey the product's benefits to customers posed a problem. Our solution was to prominently display "For scars and burns" on the packaging, along with usage illustrations. TV commercials showed clips of relatable everyday scenes where someone is bothered by a visible scar – for example, knees when sitting on a train, or an arm showing when wearing a T-shirt.

In 2011, sales in a limited area were followed by a nationwide rollout. Today, annual sales have exceeded the ¥1 billion mark. Since the launch of *Attonon*, we have introduced a series of medicated skincare products – pharmaceutical products to resolve skin problems for which cosmetics or other products prove insufficient, and to restore the natural beauty of bare skin – and we continue to focus on expanding the new market we created.

Value Creation Activities

Domestic Consumer Products Business

Eyebon Liquid Bluelet Keshimin Cream

With a portfolio of about 150 brands in four categories – healthcare products, household products, skincare products and body warmers – this is our core business, accounting for roughly 80 percent of total sales and a major portion of our profits. Many of these products are purchased by foreign visitors to Japan, which has helped this business maintain a high growth rate, with sales increasing 7.3 percent and operating income up 19.1 percent year on year.

Net Sales (Billions of yen)

123.4

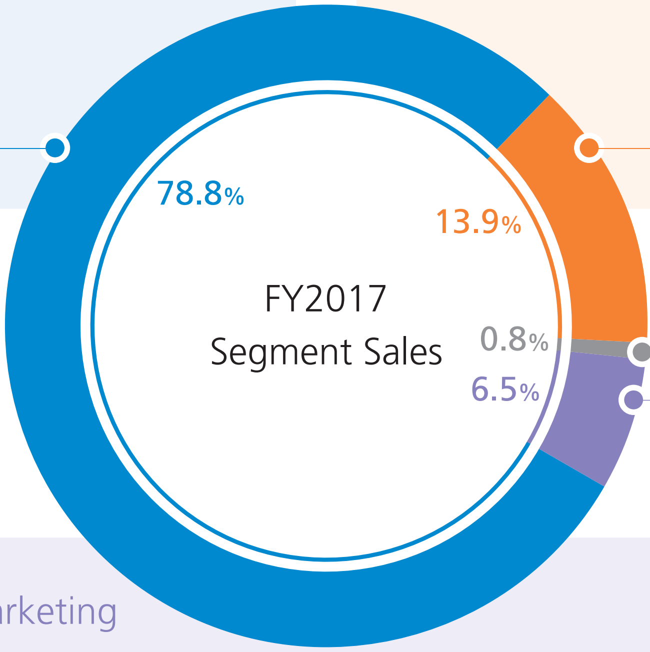
Overseas Consumer Products Business

Binbaotie (Netsusama Sheet) Clearwipe (Fuki Fuki)

This business sells body warmers, cooling gel sheets and other products in three main markets: the United States, China and Southeast Asia. It posted the highest growth rate of our three core business segments, as sales increased 22.8 percent and operating income climbed 202.4 percent year on year. This business now accounts for 13.9 percent of our net sales.

Net Sales (Billions of yen)

21.7



Other Business (Billions of yen)

1.3

Direct Marketing Business

Hifmid Edicare

Net Sales (Billions of yen)

10.1

This business involves the sale of nutritional supplements, skincare products and other items by phone and online. Up until two fiscal periods ago, sales had been on a downward trend, but aggressive advertising investment and the introduction of a regular delivery service have helped drive a V-shaped recovery, with sales rising 6.9 percent year on year.

Domestic Consumer Products Business

Opportunities	Risks	Strengths
• Market growth driven by expanding needs for Kampo and herbal medicines with Japan's aging population • Expansion of inbound demand resulting from government-led measures to increase foreign visitors to Japan – 28,691,000 people visited Japan in 2017 (up 19% year on year) (Source: Japan National Tourism Organization) – The Japanese government's target is 40 million visitors in 2020 and 60 million in 2030 (announced by Japan Tourism Agency on March 30, 2016) • Increase in foreign visitors coinciding with the 2020 Tokyo Olympics and Paralympics	• Decrease in consumer confidence due to increasing social security expenses caused by Japan's low birthrate and aging population • Decrease in foreign visitors to Japan, and the resulting decline in inbound demand, due to regional tensions with neighboring countries • Possibility of restrictions on development and sales under laws and regulations related to OTC pharmaceuticals, quasi-pharmaceuticals, cosmetics and other products	• Product development that launches around 30 new products per year • Ability to stimulate demand by creating niche markets and little competition from rival products • High likelihood of becoming products sought by inbound tourists because of the novelty of niche products and easy-to-understand packaging

Review of FY2017

The fiscal year ended December 31, 2017 (FY2017), the inaugural year of the Medium-Term Management Plan for 2017–2019, was a pivotal year for achieving the plan's financial targets in Domestic Business, which accounts for about 80 percent of total sales, as the targets were ambitiously based on 2016 figures, when sales grew substantially. The strong performance of new products, the growth of existing products due to heavy advertising investment, and demand from foreign visitors to Japan drove a 7.3 percent increase in sales year on year to ¥123.4 billion. This was accompanied by a 19.1 percent increase in operating income to ¥21.3 billion, achieving our targets for sales and profit growth. We will continue to focus on meeting targets in this core business.

Strategy for FY2018

In the fiscal year ending December 31, 2018 (FY2018), which is the second year of the medium-term management plan, we will continue to improve our ability to develop and cultivate new products to achieve "Growth with Real Strength." In addition, we will raise growth efficiency by sharpening our focus on priority-led development and sharing of successful practices across the Company. By refining controllable activities such as establishment of new products and cultivation of existing products, rather than focusing on the external factor of demand from foreign visitors to Japan, we will ensure the successful achievement of the medium-term management plan.

	Results of Domestic Consumer Products Business (Domestic Store Sales + Kiribai Chemical Co., Ltd.)	
	(Billions of yen)	YoY change*
Net sales	123.4	+7.3%
Operating income	21.3	+19.1%

* Year on year comparison based on results for January–December 2016

Value Creation Case Study | Creating a New Market with Medicated Skincare Products

Markets already existed for OTC drugs that treat symptoms such as pain and irritation, and skincare products to keep skin looking healthy and beautiful. However, between those two markets, Kobayashi Pharmaceutical saw a potential market for OTC medications to treat mild skin conditions such as small scars and rashes that cause minor or no pain or irritation. By rolling out skincare products such as *Attonon*, which helps improve the appearance of scars, *Ninocure,* a treatment for skin rashes on upper arms, and *Kurocure*, a remedy for dark and rough spots on elbows and knees, we have succeeded in creating a whole new category: medicated skincare products.

Attonon EX Gel

	FY2017 results (January–December 2017)	Comparable period in 2016* (January–December 2016)		
	(Billions of yen)	(Billions of yen)	Difference (Billions of yen)	YoY change
Healthcare	58.1	53.4	4.7	+8.7%
Household Products	52.3	50.3	2.0	+4.0%

* Calculated for the same period in the previous year, January–December 2016

Healthcare

Net sales ¥**58.1** billion

Sales grew strongly in FY2017, increasing 8.7 percent year on year to ¥58.1 billion. Three key factors drove this performance. The first was strong sales of new products in the medicated skincare products category, such as *Kurocure*, a remedy for dark and rough spots on elbows and knees. The second was an increase in sales of existing products in the Kampo category, including *Inochi no Haha A*, a women's health medicine, on the back of aggressive investment in advertising. The third was the effect of demand from foreign visitors to Japan for products such as *Eyebon*, an eye wash solution with corneal healing and protective ingredients. Needs in the healthcare category are projected to grow further in step with Japan's demographic aging. In this high-margin business, we will aim for further expansion by focusing on medicated skincare products and Kampo, one of our four targeted growth businesses.

Naishitol Z

Eyebon

Household Products

Net sales ¥**52.3** billion

Sales in FY2017 were solid, increasing 4.0 percent year on year to ¥52.3 billion. Sales of existing products benefited from heavy advertising investment for products with high per-unit prices such as *Sawaday Kaoru Stick Aroma*, a home fragrance that uses carefully selected aromatic oils, as well as long-selling products such as *Sarasaty* panty liners and *Bluelet* toilet bowl cleaner and freshener. In new products, the new market-creating product *Nightmin Nasal Respiration Tape*, which is applied over the mouth before sleeping to promote breathing through the nose, performed well, reaching its initial-year sales target in half a year. We will target further business expansion by implementing a cycle of expanding existing markets through the creation of new markets and trends for products with high per-unit prices.

Shoshugen for Toilet

Liquid Bluelet

	FY2017 results (January–December 2017)	Comparable period in 2016* (January–December 2016)		
	(Billions of yen)	(Billions of yen)	Difference (Billions of yen)	YoY change
Skincare	6.0	5.4	0.6	+12.3%
Body Warmers	6.9	5.8	1.1	+18.6%

* Calculated for the same period in the previous year, January–December 2016

Skincare

Net sales ¥6.0 billion

The Skincare Business, one of the four growth businesses in the medium-term management plan, posted double-digit growth in FY2017, with sales of ¥6.0 billion, a 12.3 percent increase year on year. Products in this business performed well, including *Keshimin*, a mainstay brand of specially formulated skincare cream for spots, and recently acquired long-selling skincare creams *Eaude Muge* and *Madame Juju*. At the same time, products such as *Keshimin Cream EX*, a high-value-added premium prescription cream for spots, and *Bioil*, a skincare oil for which we have an exclusive distribution agreement, also contributed to sales. We will continue to expand this business by strengthening core brands and acquiring brands through mergers and acquisitions.

Keshimin Cream

Eaude Muge

Body Warmers

Net sales ¥6.9 billion

Sales in FY2017 increased 18.6 percent year on year to ¥6.9 billion. This was partly attributable to the rebound following a mild winter in FY2016, but the main factor was new hit product *Kiribai Kairo Magma*, which maintains a temperature 10°C higher on average compared with existing products developed for outdoor winter use. To stimulate the domestic body warmer market as the leading manufacturer, we will continue new product development through novel approaches such as imagining different usage scenarios.

Overseas Consumer Products Business

Opportunities

- The everyday use of body warmers is not yet rooted in the U.S., so there is room for expansion
- Solid expansion of the Chinese economy with the increase in the middle income demographic

Risks

- Changes in financial figures due to conversion into yen of items denominated in local currencies, including sales, expenses, assets and liabilities of overseas consolidated subsidiaries if there has been a significant change in exchange rates at the time of conversion
- Changes in regulations by national governments or economic conditions, etc.
- Weak sales of body warmers and other seasonal products due to mild winter conditions

Strengths

- Number-one share in the U.S. body warmer market
- High name recognition of Kobayashi Pharmaceutical in China resulting from popularity of products among inbound visitors to Japan

Review of FY2017

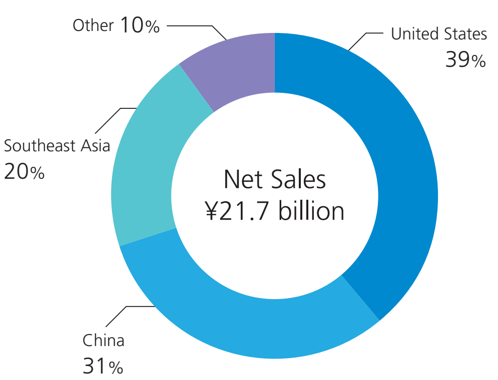
After sales declined in the fiscal period ended December 31, 2016 due to the effects of mild winter conditions and foreign exchange rates, this business grew steadily in FY2017 with sales of ¥21.7 billion, a 22.8 percent increase year on year, and operating income of ¥0.9 billion, a 202.4 percent increase. Growth attributable to exchange rates was approximately ¥0.5 billion, but the main factor was that sales increased substantially in the China market for *Netsusama Sheet*, a cooling gel sheet for the forehead and rated as one of the "12 must-buy" products among Chinese tourists.[1] Many of our brands have a strong reputation among Chinese tourists visiting Japan, which has raised awareness of the Kobayashi Pharmaceutical name in China, and resulted in greater distribution and exposure in stores. We will work to develop more "products from Japan" via import and cross-border e-commerce channels to establish new brands alongside body warmers and *Netsusama Sheet*.

1. Source: Sohu, a Chinese social media network. Among the "12 must-buy" pharmaceutical products for Chinese tourists visiting Japan, five are Kobayashi Pharmaceutical products.

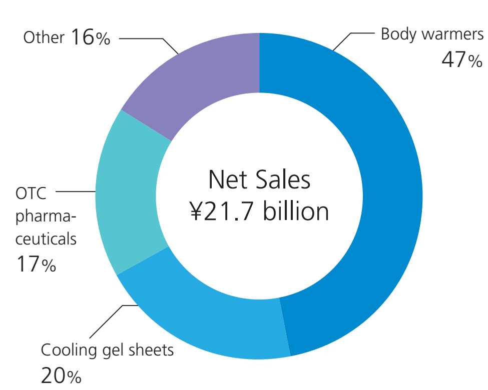
	Overseas Consumer Products Business	
	(Billions of yen)	YoY change[2]
Net sales	21.7	+22.8%
Operating income	0.9	+202.4%

2. Comparison with the same period in the previous year, January–December 2016

Sales by Region



Sales by Product



Direct Marketing Business

Opportunities

- Emergent trend of high health and beauty consciousness in the young consumer segment and energization of the health food market
- Some companies have achieved ¥10 billion in sales five years from the start of business, and the business overall has high growth potential

Risks

- Weak sales due to loss of trust in the event of personal information leaks
- Large impact on business in the event of adverse effect on health due to high proportion of sales of food and cosmetics compared to other businesses

Strengths

- Efficiency of advertising investment and profitability improvement with introduction of regular delivery service
- Differentiation from competitors due to direct marketing of OTC pharmaceuticals

Review of FY2017

The Direct Marketing Business, one of the four growth businesses, posted sales of ¥10.1 billion in FY2017, an increase of 6.9 percent year on year. With the recovery in sales, the operating loss narrowed to ¥70 million from ¥300 million. The two main factors were sales growth driven by aggressive advertising investment and the introduction of a regular delivery service through which customers can sign up for product deliveries at regular intervals. By introducing the regular delivery service, we cut costs and improved profitability by increasing the customer repeat rate. In addition to acquiring new customers through active advertising investment, we will carry out activities to promote sign-ups for the regular delivery service. This will create a positive cycle and help to ensure growth.

Strategy for FY2018

We will continue our strategy of expanding sales by generating profits with the regular delivery service, and investing those profits in advertising to acquire new customers. In FY2018, we will carry out efficient marketing through joint promotion with in-store sales of products with high per unit prices, such as *Salacia*, and drive further sales growth by considering efficacy-focused advertising for pharmaceutical products.

	Direct Marketing Business	
	(Billions of yen)	YoY change*
Net sales	10.1	+6.9%
Operating income (loss)	–0.07	Results in comparable period in 2016 —

* Comparison with the same period in the previous year, January–December 2016

Direct marketing website

Basic Approach

The Kobayashi Pharmaceutical Group established the Kobayashi Environmental Statement and the Environmental Action Guidelines in December 2001 to further enhance environmental conservation activities based on its Management Principles. We strive to increase awareness about environmental conservation by sharing and promoting understanding of the Kobayashi Environmental Statement and the Environmental Action Guidelines throughout the Group.

◆ Kobayashi Environmental Statement

Committed to preserving the environment, the Kobayashi Pharmaceutical Group makes effective use of limited natural resources and energy while reducing waste materials and substances that have an environmental impact.

◆ Environmental Action Guidelines

(1) Legal Compliance and Implementation of Targets

We comply with laws, regulations and agreements related to environment conservation in our business fields. In addition, we set and implement environmental targets and voluntary standards.

(2) Reduction of Waste and Improvement of Recycling

In every stage of our business operations, we actively recycle waste that is renewable or reusable to achieve a quantitative reduction in waste disposal.

(3) Conservation of Resources and Energy

To effectively utilize limited natural resources, we promote the efficient use of energy and active use of renewable resources.

(4) Eco-Friendly Products and Services

In conducting our business activities, we consider the substances we use and how we use them in order to provide products and services that have less impact on the environment.

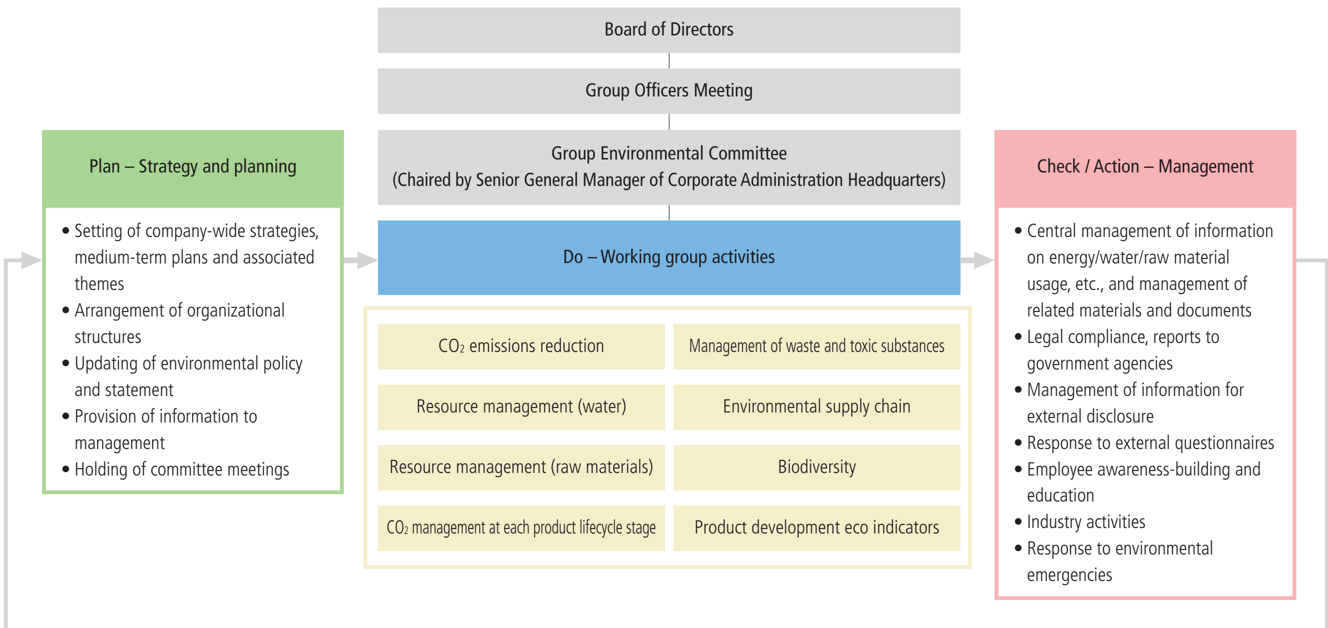
(5) Sharing of Action Guidelines and Enhancement of Environmental Awareness

We share these guidelines with all Kobayashi Group employees, and work to raise their environmental awareness through educational activities.

◆ Environmental Management System

The Group Environmental Committee utilizes a structure that enlists the commitment of all department managers related to product development, as shown in the chart below. Working groups for specific themes have been set up under the Committee. The General Affairs Department and Management Planning Department work together to strengthen the PDCA cycle and provide support for the working groups.

○ Environmental Management System



◆ Medium-Term Environmental Impact Reduction Targets for FY2020

The Kobayashi Pharmaceutical Group is taking steps to minimize the environmental impact from its business operations. In particular, we are placing priority on greenhouse gas reduction and waste reduction, and have set medium-term targets for FY2020.

We are also taking proactive measures for chemical substance management and resource conservation.

Themes	Relevant departments	FY2017 targets	Action plans implemented in FY2017	FY2017 results	FY2020 medium-term targets
Energy conservation CO_2 reduction	Manufacturing	Emissions per unit of sales 16.0% reduction vs. fiscal 2005/3 (0.098 t-CO_2/million yen)	· Upgrade of compressors · Installation of rooftop sunshades · Suspension of humidification of pharmaceutical facilities in summer · Updating to energy-saving equipment (air conditioning, LED lighting)	Emissions per unit of sales 16.8% reduction vs. fiscal 2005/3 (0.097 t-CO_2/million yen)	Emissions per unit of sales[1] 20% reduction vs. fiscal 2005/3 (Fiscal 2005/3: 0.162 t-CO_2/million yen) (FY2020: 0.129 t-CO_2/million yen)
	Offices	Total emissions (including from sales vehicles) 27.5% reduction vs. fiscal 2005/3 (3,533 t-CO_2)	· Implementation of summer dress code · Encouraging employees to leave early · Control of air-conditioning settings · Encouraging environmentally friendly driving · Conversion to LED lighting · Control of regular energy use	Total emissions (including sales vehicles) 28.8% reduction vs. fiscal 2005/3 (3,475 t-CO_2)	
Waste reduction	Manufacturing	—	· In-house recycling of irregularly occurring waste · Separation and sale of irregularly occurring waste and production losses	Increase in volume of waste generated	—
Recycling	Manufacturing	Recycling rate of 99.5% or higher across all businesses	· Reduction of production losses, and separation and collection of waste materials	98.7% recycling rate	99.5% or higher
Chemical substance management	Manufacturing	Maintain emissions of substances subject to the PRTR Act below 100 kg at all factories	· Switch to alternative raw materials	Emissions of substances subject to the PRTR Act exceeded 100 kg at one or more factories	Emissions of substances subject to the PRTR Act below 100 kg at all factories
Resource conservation	Manufacturing	Expansion of eco-friendly products	· Research on thinning and structure of containers and packaging	Made containers and packaging for major products thinner and simpler	Expansion of eco-friendly products
Green procurement and purchasing	Manufacturing	Strengthening of relationships with partners	· Examination of survey items and study of survey methods	Supported energy conservation efforts of partners	Strengthening of relationships with partners

1. We began setting medium-term targets for emissions per unit of sales starting with FY2020.

◆ Environment-Conscious Product Development

Packaging Redesign for *Itoyoji*

Previously, the packaging for *Itoyoji* dental floss picks comprised many materials and pieces, which made it laborious to open. By eliminating the special container and integrating a floss-pick container with the packaging, we improved the specifications to enable easy access to the picks simply by peeling back the rear of the packaging.

Packaging pieces were reduced from four to two, and the steps between purchase and use were shortened from three to one. This has resulted in a lighter burden on both users and the environment.

We will continue to proactively reduce the weight of materials and containers while making products easier to use and enhancing their functionality.

Packaging before change

Packaging after change

Packaging Redesign of *Chewable BreathCare*

The previous design of a transparent plastic blister pack on a cardboard mount was changed to newly developed film-type packaging. This cut packaging pieces from seven to five, and reduced the steps from purchase to consumption from six to four. Based on an overall evaluation of aspects such as the lighter burden on the environment and users, the packaging was declared a WorldStar Winner 2015 in the WorldStar Competition[2] sponsored by the World Packaging Organisation.

Packaging before change

Packaging after change

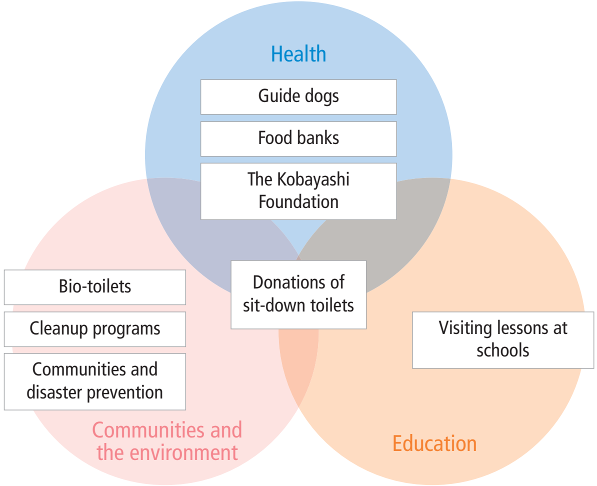
2. The WorldStar Competition is an internationally authoritative packaging contest aimed at promoting the development and dissemination of outstanding package designs and packaging technologies around the world. Only products that have already won awards in individual countries qualify for entry. The packaging and container of *Chewable BreathCare* won an award in the food packaging category in the Japan Packaging Contest sponsored by the Japan Packaging Institute, and thus qualified for entry in the WorldStar Competition. In the year it won the award, there were a total of 264 entries from 37 countries.

WPO WORLD PACKAGING ORGANISATION
WORLDSTAR WINNER 2015

01 CSR

Basic Approach

The Kobayashi Pharmaceutical Group actively contributes to society through its business activities, taking the same approach expressed in our slogan, “You make a wish and we make it happen.” Specifically, targeting societal issues under themes such as “health,” “education,” and “communities and the environment,” we collaborate and cooperate with a wide range of stakeholders, including NPOs, local communities and governments, to bring more comfort to daily life as only the Kobayashi Pharmaceutical Group can.



◆ The Kobayashi Foundation

Establishment

The Kobayashi Foundation (“the Foundation”) was established in 2017 as one of the projects to mark Kobayashi Pharmaceutical’s 100th fiscal period since incorporation.

In the past we have carried out a variety of social contribution activities, however, establishing the Foundation created a structure for conducting more specialized activities on a stable basis without affecting our business operations. The Foundation funds its activities with dividends on the shares of Kobayashi Pharmaceutical stock that it holds.

In December 2017, the Foundation received authorization for incorporation as a public interest corporation from the Prime Minister of Japan.

Activities

Societal issues today are extremely diverse, and solving them requires flexible support that is carefully tailored to address the problems people face.

The Foundation’s purpose is to provide support for children who have disabilities or illnesses, as well as their families – in short, to identify their wishes and address them. By soliciting applications from a wide range of people working in this field, and supporting their activities, the Foundation aims to contribute to bringing greater delight to society as a whole.

In November 2017, the Foundation invited applications in the assistance category and awards category, and after consideration by a selection committee consisting of outside experts, assistance and award recipients were decided for a total of 14 projects out of 29 applications. Representatives of the recipients came together for a presentation ceremony in Osaka in March 2018.

◆ Donation of Sit-Down Toilets to Elementary Schools

While restroom facilities in homes and commercial facilities in Japan continue to improve, many of the toilet fixtures in public elementary schools were installed decades ago, and most are squat toilets. An increasing number of children are reluctant to use the restrooms at school because they are unaccustomed to or have never used a squat toilet.

In response, since 2010, we have been donating sit-down toilets to elementary schools to upgrade their restroom facilities and teach children about gastrointestinal health.

In addition to improvement of the restroom environment, including conversion to sit-down toilets, this program also includes a special lesson on the importance of staying regular and the right ways to use a toilet.

Every year in March and April, we post an announcement on our website soliciting elementary schools that wish to improve their restrooms, and select the recipients. In FY2017, following a rigorous selection process, we selected 20 schools to which we donated sit-down toilets, achieving our running target of 100 schools by the 100th fiscal period.

02 Product Development from the Viewpoint of Customers

Basic Approach

In product development, we look at the product through the eyes of customers to focus on ensuring not only safety, but also immediate understanding of benefits, ease of use, and minimal waste disposal.

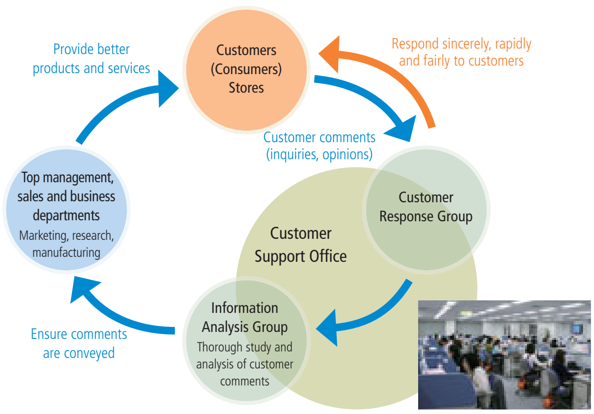
We also leverage feedback from customers to continuously improve our products and services so that customers can be glad they chose Kobayashi Pharmaceutical.

◆ Reflecting Customer Feedback in Our Products

The Customer Support Office takes every comment from customers seriously, and quickly relays their valued opinions to the appropriate departments and to top management. Besides sharing customer feedback within the Company, the mission of the Customer Support Office also includes thoroughly analyzing feedback and conducting activities that lead to improvement of products and services.

In the case of *Tough Grip* denture stabilizer, customer feedback indicated that the product features and instructions for use on the box were hard to understand because there was too much text. Based on that comment, we put pictures on the side of the box to aid understanding.

System of Communication with Customers



Example Improvement from Customer Comment

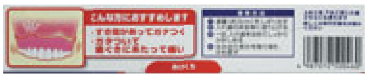
Tough Grip (replaced words with pictures)

Customer Comment
"The product features and instructions written on the box are hard to understand because there's too much text."

▼

Put pictures on the side of the box to aid understanding

Before improvement



After improvement

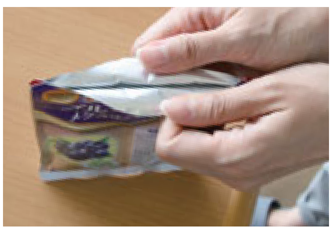
◆ Aiming for More User-Friendly Products

In Japan, trends include acceleration of the aging population and support and empowerment for people with disabilities, and society as a whole is becoming more barrier-free. This also extends to products, which are increasingly being designed to make them usable by all, a concept called "universal design." Aluminum pouches containing nutritional supplements had the problem of being hard for seniors to open. After testing more than 60 alternatives, we finally came up with an opening with a subtle bulge cut that met our preconditions: the top seal could be torn off neatly with little effort; the flaps are easy to grasp; and the more times the product is opened, the easier it is to open. As a result, we succeeded in bringing greater comfort of customers.

We will continue to explore product design through the eyes of customers.

Improvement of Opening

Before improvement
Flaps shallow and therefore difficult to open



After improvement
Flaps cut into a bulge make it easier to open

Aluminum pouch designed for seniors

Good Design Award 2015

Governance

Basic Policy

We believe it is important to balance an environment that supports a healthy risk appetite with adequate oversight of management in order to achieve sustainable growth.

We have established a management structure centered on the founding family to enable speedy management, strong employee loyalty, bold management decisions and management with a long-term perspective. On the other hand, there is also a risk that this may give rise to self-serving management, so robust corporate governance is essential, and we have introduced a range of systems and structures.

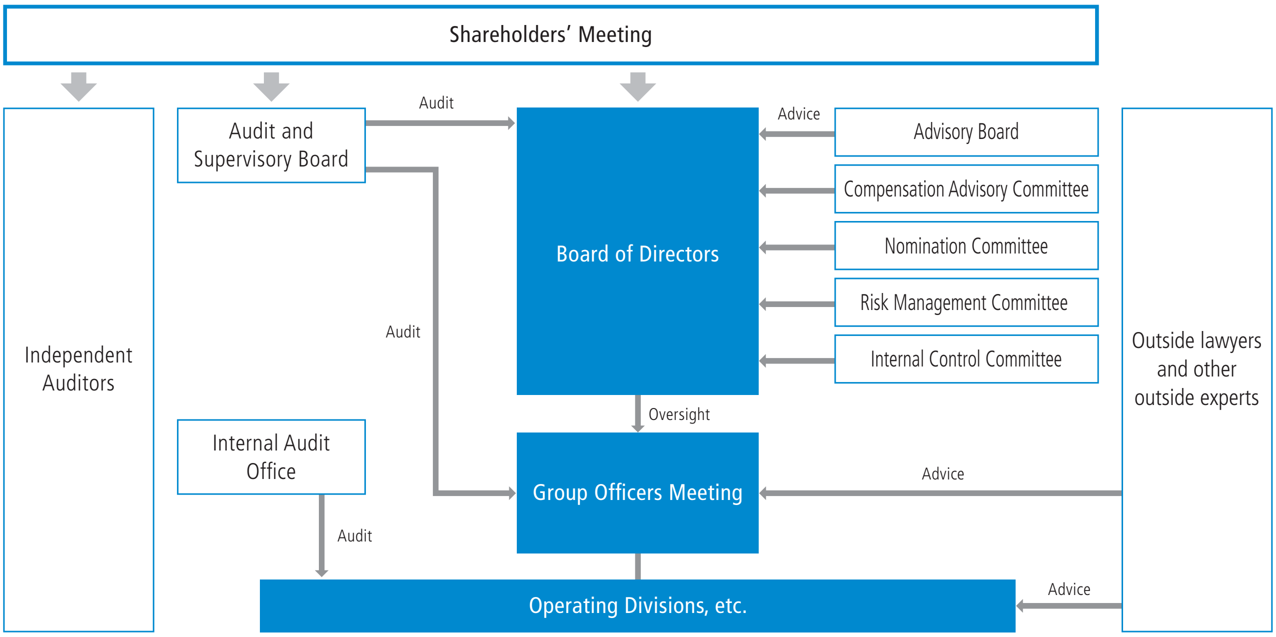
In addition, we have an exceptionally open and transparent corporate culture in which employees can voice their opinions to anyone. For example, we proactively give frontline employees opportunities to express their candid opinions directly to top management. Based on our recognition that corporate governance objectives cannot be achieved by enhancing systems and structures alone, we believe that maintaining and developing this corporate culture is also an effective means of corporate governance.

Management Structure

Responsibility for the execution of management resides with executive officers, led by the president and COO, while management oversight functions are performed by the Board of Directors, chaired by the chairman and CEO. We have appointed three independent outside directors among the eight directors, and optimize the number of directors from the standpoint of energizing the Board of Directors.

To ensure the fairness of the decision-making process for appointment and compensation of directors and other officers, we have established a Nomination Committee and Compensation Advisory Committee. We have also set up an Advisory Board consisting mainly of independent outside directors and representative directors to provide a structure for obtaining necessary advice on major management issues.

Corporate Governance Structure



Bringing in Outside Perspectives

When appointing independent outside directors, the most important criterion is whether they can clearly express their views to internal directors and executive officers. Independent outside directors actively speak up and engage in lively discussions at Board of Directors meetings.

In this way, an open atmosphere is fostered at Board of Directors meetings, and votes on proposals that are the subject of heated debate are often divided.

To incorporate more diverse perspectives into management, two of the officers we have appointed are women (one outside director and one outside Audit and Supervisory Board member).

Selection and Compensation of Officers

Candidates are selected based on consideration of the right person for the right job in each business unit in the case of executive officers to incorporate a wide range of knowledge and insight throughout the Company's operations. Candidates are appointed or designated as candidates after discussion by the Nomination Committee (consisting of outside experts, independent outside directors, the president and responsible executives) and the Board of Directors.

Decisions on Audit and Supervisory Board candidates are made after the Board of Directors has obtained the approval of the Audit and Supervisory Board on persons who have the requisite knowledge and insight to perform audit work (persons who have an accounting or legal background in the case of outside Audit and Supervisory Board members).

Compensation of directors and executive officers is linked to the Company's financial results for a given fiscal year and their performance of their designated duties in order to increase their incentive to achieve results in their areas of responsibility.

The appropriateness of the amount of compensation based on that assessment is discussed by the Compensation Advisory Committee, which consists of independent outside directors, outside experts, representative directors of the Company, and others. The results of that discussion are then placed on the agenda of the Board of Directors meeting.

Total Amount of Compensation by Position, Types of Compensation and Number of Officers Receiving Each Type of Compensation

Officer title	Total amount of compensation (Millions of yen)	Total amount of compensation by type (Millions of yen)				Number of officers
		Basic compensation	Stock options	Bonuses	Retirement bonuses	
Directors (excluding outside directors)	680	680	—	—	—	6
Audit and Supervisory Board members (excluding outside members)	42	42	—	—	—	3
Outside officers	79	79	—	—	—	5

Notes: 1. Directors of the Company do not receive payment of salaries as employees other than the above payment amounts.
2. The upper limit on total compensation for directors was set at ¥900 million per year (including ¥100 million for outside directors) at the 97th General Shareholders' Meeting held on June 26, 2015.
3. The upper limit on total compensation for Audit and Supervisory Board members was set at ¥80 million per year at the 91st General Shareholders' Meeting held on June 26, 2009.

Total Amount of Compensation of Officers Receiving Compensation of More Than ¥100 Million

Name	Position	Total amount of compensation by type (Millions of yen)				Total compensation (Millions of yen)
		Basic compensation	Stock options	Bonuses	Retirement bonuses	
Kazumasa Kobayashi	Chairman and CEO	281	—	—	—	281
Yutaka Kobayashi	Vice Chairman of the Board	182	—	—	—	182

Assessment of the Effectiveness of the Board of Directors

We believe that vigorous discussion by the Board of Directors is vital to corporate governance, and thus to the sustainable growth of a company. An assessment of the effectiveness of the Board of Directors was conducted from November through December of 2017.

For the assessment, a questionnaire and individual interviews on the operation, discussion points and functions of the Board of Directors were conducted for all directors and Audit and Supervisory Board members, and problems and future issues concerning the Board of Directors were identified.

Based on the results of that questionnaire, the Board of Directors Assessment Meeting, which consists of all outside officers (three independent outside directors and two outside Audit and Supervisory Board members), was held. Feedback was provided to the Board of Directors on the assessment results determined at that meeting, and will be used to further improve the Board's oversight and decision-making functions.

Issues identified by the assessment are as outlined below.

Issues

- Stimulation of information exchange and sharing of awareness between outside officers
- Further clarification of risk information in Board meeting documents
- Further allocation of time for discussion on management strategy, including the medium-term management plan, ESG and other matters
- Enhancement of progress reports and reviews on important matters concerning business execution
- Strengthening of feedback of investor views to the Board of Directors
- Development of training options with outside directors in mind

Internal Controls and Compliance

The Kobayashi Pharmaceutical Group is building internal frameworks to ensure that operations are conducted and financial statements prepared in compliance with the Companies Act and the Financial Instruments and Exchange Act of Japan, and to adhere to relevant laws and regulations. In addition, we conduct a variety of training programs to ensure that all Board members, executive officers and employees comply with laws and regulations as well as follow a strict code of corporate conduct and ethics.

We have established the Internal Control Committee, which meets twice each year. This committee oversees the Kobayashi Pharmaceutical Group's internal control system and compliance framework, while also consulting with outside attorney advisors. Based on its work, the committee issues the Board of Directors with recommendations and advice on measures concerning internal controls and compliance.

We provide training on compliance issues to Board members, executive officers and employees, with a focus on continued learning, in order to enhance compliance awareness and understanding.

We raise awareness in the in-house newsletter and, since July 2011, we provide monthly e-learning via the Group intranet for all employees.

e-Learning Themes in FY2017 (100th Fiscal Period)

Jan.	Compliance
Feb.	Information security 1
Mar.	Disaster safety
Apr.	Information security 2
May	Information security 3
Jun.	Employee Q&A
Jul.	Sexual harassment
Aug.	Information security 4
Sep.	Pharmaceutical sales and side-effect information
Oct.	Power harassment
Nov.	Act against Unjustifiable Premiums and Misleading Representations in relation to the Internet
Dec.	Understanding assessment test

Risk Management Framework

We incorporate opinions of outside experts not only into the Group Officers Meeting, but also into meetings of other committees such as the Internal Control Committee, in defining the business risks each year and conducting and auditing action plans.

In FY2017, we focused on two main themes: information security measures and reduction of long work hours. To ensure the steady execution of risk management for these themes, progress on action plans was reported to the Internal Control Committee, which provided feedback. As a result, we implement measures such as training to ensure that checks are integrated into daily business activities.

In July 2017, we established the Risk Management Committee chaired by the president. The committee's purpose is to prevent the manifestation of management risks in the Kobayashi Pharmaceutical Group, and to minimize the impact if risks do materialize.

Whistleblower System

The Kobayashi Pharmaceutical Group has established the Employee Consulting Center both internally and externally (in a law office, including for overseas employees) as a special hotline for employees to anonymously report compliance violations or ask general questions on compliance issues.

To ensure that this whistleblower system works effectively, we regularly conduct employee training and raise awareness about the Employee Consulting Center through the in-house newsletter, steps which have led to an increase in willingness to seek advice.

Communication with Shareholders and Investors

We recognize that shareholders are important stakeholders, and we emphasize constructive dialogue with them for the Company's sustainable growth.

We believe it is important to deepen understanding about the views and standpoints of both the Company and shareholders, and to take appropriate action based on those views and standpoints.

We respond to shareholder requests for dialogue as necessary. Our policies for dialogue with shareholders are as follows.

- We actively engage in dialogue with shareholders to contribute to the Company's sustainable growth.
- Dialogue with shareholders is conducted by the IR Department, the IR officer or, if necessary, top management, depending on the attributes of the shareholder(s), the timing of the dialogue, the Company's business resources and other factors.
- In dialogue with shareholders, feedback is provided to the Board of Directors on shareholders' views conducive to the Company's sustainable growth.

Shareholder Events in FY2017

General Shareholders' Meeting (held in March 2018)	
Attendance	494
Vote participation rate	89.8%
Meetings with institutional investors and analysts	
	219
Dialogue with individual investors	
Number of times held	2
Participants	92

Message from an Outside Director

Haruo Tsuji, Outside Director

The Role of Outside Directors

The role of an outside director is to oversee a company's business execution and decision-making from a highly independent standpoint and objective point of view – in essence, to serve as a watchdog. I have 12 years of practical experience as the president of a major consumer electronics manufacturer, and have access to the latest information needed to manage the Company through my personal contacts in various industries. Along with my practical experience and the information I obtain, I try to reflect the point of view of customers in the opinions I express in Board of Directors meetings. In that sense, the opinions I voice represent those of various stakeholders. I also regularly visit factories and other sites in Japan and overseas to monitor conditions in frontline operations, and include their perspective in my comments at Board meetings.

A company always needs to grow. While encouraging transparent and vigorous discussion, I also actively support proposals that will lead to the Company's growth, and if a proposal has potential risks, I point them out and request countermeasures and improvements. In this way, I am committed to eliciting the best possible results.

Corporate Governance Initiatives

The Company has voluntarily established a Nomination Committee and Compensation Advisory Committee, which help to ensure transparency in the appointment of directors and executive officers and in the compensation-setting process.

However, the existence of these committees is meaningless unless they act as an effective check on top management. This requires a corporate culture in which not only outside directors but also employees are empowered to say "no" when a problem arises, or when a decision by senior management is wrong. To fulfill my role as an outside director, I place priority on communication with frontline employees, and from my communications with them, I get the sense that this kind of culture is being fostered within the Company.

This is a family-managed company. Family management has both positive and negative aspects. On the positive side, speed and cost-consciousness are generally strong. At this point, I believe that the positive aspects are prevalent.

Operation and Assessment of the Board of Directors

When proposals are being discussed at Board of Directors meetings, the Chairman of the Board conducts the proceedings while conscientiously asking those in attendance for their input. My assessment is that our Board meetings have a free and open atmosphere that provides a good base for outside directors to voice their opinions candidly. Discussions at Board meetings are not perfunctory, but have real substance, and sometimes the votes on resolutions are divided.

Assessment of the Board of Directors is performed mainly by the Board of Directors Secretariat, which administers questionnaires and interviews to all directors and corporate auditors. The Board of Directors Assessment Meeting, composed of the outside directors and corporate auditors, uses the results to identify issues, on the basis of which the Board of Directors makes a final decision.

Issues for the Future

Recently, greater emphasis has been placed on ESG initiatives for the sustainable growth of corporate value. I too concur that such initiatives will be essential for the Company's growth. In addition, the Company needs to do more to promote diversity. This will require the Company to clearly identify the issues that should be addressed, and then prioritize and steadily implement appropriate measures. I intend to monitor that process through Board of Directors meetings and other meetings to make sure it is being handled appropriately.

It is also important to not lose sight of the main role of a company, which for manufacturers in particular is to develop products that will keep customers interested. That does not mean simply creating exactly what customers say they want; it means anticipating and providing products that will surprise and excite them.

To do so, the Company will have to invest in information technology such as the Internet of things, artificial intelligence and big data to increase its productivity and competitiveness. Employees themselves must always look at things through the eyes of customers and have the ability to respond to change. It is said that "A company is its people." Cultivating such employees is important, not only in Japan, but at the global level. That is a vital intangible asset that will lead to the Company's sustainable growth.

Management Team (As of March 31, 2018)

1 Chairman of the Board and Chief Executive Officer
Kazumasa Kobayashi

Mar. 1962	Joined the Company
Nov. 1966	Director
Nov. 1970	Executive Director
Dec. 1976	Representative Director and President
Jun. 2004	Chairman of the Board and Chief Executive Officer (current)

2 Vice Chairman of the Board
Yutaka Kobayashi

Mar. 1968	Joined the Company
Dec. 1976	Director and General Manager of Overseas Business
Dec. 1982	Executive Director
Dec. 1985	Senior Executive Director and Senior General Manager of Trade Business Division
Dec. 1992	Director and Vice President
Jun. 1999	Representative Director and Vice President
Jun. 2004	Representative Director and President
Jun. 2013	Vice Chairman of the Board (current)

3 Representative Director, President and Chief Operating Officer
Akihiro Kobayashi

Mar. 1998	Joined the Company
Jun. 2001	Executive Officer and Manufacturing Company President
Jun. 2004	Director, International Sales Company President and Marketing Office Manager
Jun. 2007	Executive Director
Mar. 2009	Senior Executive Director and Senior General Manager of Product Business Division
Jun. 2013	Representative Director, President and Chief Operating Officer (current)

4 Senior Executive Director
Satoshi Yamane

Mar. 1983	Joined the Company
Mar. 2004	Executive Officer, Board of Directors Office Manager and Growth Strategy Office Manager
Jun. 2006	Director and Senior General Manager of Corporate Administration Headquarters (current)
Jun. 2011	Executive Director
Jun. 2016	Senior Executive Director (current)

5 Executive Director
Susumu Horiuchi

Mar. 1979	Joined the Company
Mar. 2006	Executive Officer and Manager of Sales Management Division
Mar. 2009	Senior Executive Officer and Senior General Manager of Sales Division (current)
Jun. 2014	Director
Jun. 2016	Executive Director (current)

6 Outside Director
Haruo Tsuji

Mar. 1955	Joined Hayakawa Electric Industry Co., Ltd. (now Sharp Corporation)
Jun. 1986	Director and President
Jun. 1998	Advisor
Jun. 2008	Outside Director of the Company (current)

7 Outside Director
Kunio Ito

Apr. 1992	Professor, Faculty of Commerce and Management, Hitotsubashi University
Aug. 2002	Dean of the Graduate School of Commerce and Management, Hitotsubashi University
Dec. 2004	Vice President of Hitotsubashi University
Dec. 2006	Professor, Graduate School of Commerce and Management, Hitotsubashi University
Jun. 2007	Member of the Independent Committee of the Company
Jun. 2013	Outside Director of the Company (current)
Jan. 2015	Director, Center for CFO Education and Research, Hitotsubashi University (current)
Apr. 2015	Adjunct Professor, Graduate School of Commerce and Management, Hitotsubashi University (current)

8 Outside Director
Kaori Sasaki

Jul. 1987	Representative Director and President, UNICUL International, Inc. (current)
Mar. 2000	President & CEO, ewoman, Inc. (current)
Jun. 2016	Outside Director of the Company (current)

9 Full-time Audit and Supervisory Board Member
Hiroshi Goto

Mar. 1979	Joined the Company
Jun. 2011	Audit and Supervisory Board Member (current)

10 Full-time Audit and Supervisory Board Member
Kazuhiro Shiratsuchi

Mar. 1982	Joined the Company
Mar. 2017	Audit and Supervisory Board Member (current)

11 Outside Audit and Supervisory Board Member
Ryuji Sakai

Partner, Nagashima Ohno & Tsunematsu

Jun. 2005	Outside Audit and Supervisory Board Member of the Company (current)

12 Outside Audit and Supervisory Board Member
Yoko Hatta

Auditor, International Christian University

Jun. 2015	Outside Audit and Supervisory Board Member of the Company (current)


Board of Directors


Board of Directors Assessment Meeting

11-Year Summary

	2008/3	2009/3	2010/3	2011/3
For the fiscal period	(Millions of yen)			
Net sales	228,826	125,693	129,184	130,824
Cost of sales	147,638	57,013	57,295	56,184
Gross profit	81,187	68,679	71,888	74,640
Selling, general and administrative expenses	62,611	52,861	54,847	56,019
Operating income	18,576	15,818	17,041	18,620
Profit before income taxes	15,800	16,270	14,553	13,178
Profit attributable to owners of parent	8,504	8,853	9,249	9,335
Cash flows from operating activities	12,192	12,849	15,319	13,168
Free cash flow[1]	5,767	11,467	10,618	4,789
Depreciation and amortization	2,489	2,873	2,996	2,932
Capital expenditures[2]	2,895	3,468	3,562	2,346
Research and development costs	2,813	3,361	3,962	4,069
At period-end	(Millions of yen)			
Current assets	66,069	73,172	85,208	88,837
Property, plant and equipment, net	56,340	52,037	46,763	45,518
Current liabilities	37,940	39,834	39,024	34,525
Long-term liabilities	7,286	9,011	8,344	8,488
Net assets	77,182	76,364	84,603	91,342
Total assets	122,409	125,210	131,972	134,356
Working capital[3]	28,129	33,338	46,184	54,312
Interest-bearing debt	726	644	1,708	25
Per-share data[4]	(Yen)			
Net income	102.81	107.95	112.94	113.99
Cash dividends	27.00	29.00	31.00	33.00
Payout ratio (%)	26.3	26.9	27.4	28.9
Cash flows[5]	143.4	151.1	180.2	154.9
Net assets	931.62	930.57	1,030.90	1,113.21
Financial ratios	(%)			
Gross profit margin	35.5	54.6	55.6	57.1
Operating income margin	8.1	12.6	13.2	14.2
Net margin	3.7	7.0	7.2	7.1
Current ratio	174.1	183.7	218.3	257.3
Return on assets (ROA)	10.9	12.4	13.3	14.3
Return on equity (ROE)	11.2	11.5	11.5	10.6
Equity ratio	63.0	60.9	64.0	67.9
Debt-equity ratio (times)[6]	0.01	0.01	0.02	0.0003
Price-earnings ratio (PER) (times)[7]	18.7	15.1	17.0	16.9

1. Cash flows from operating activities + Cash flows from investing activities
2. Increase in property, plant and equipment and intangible assets as shown in Segment Information in the Notes to Consolidated Financial Statements.
3. Current assets – Current liabilities
4. Including impact of stock split
5. Cash flows from operating activities ÷ Number of shares issued
6. Interest-bearing debt ÷ Shareholders' equity
7. Current share price ÷ Earnings per share

2012/3	2013/3	2014/3	2015/3	2016/3	2016/12 (Note)	2017/12
			(Millions of yen)			
131,166	121,532	127,293	128,344	137,211	120,051	**156,761**
54,635	51,732	54,193	54,718	57,518	48,638	**61,238**
76,531	69,799	73,099	73,626	79,693	71,412	**95,522**
57,233	52,895	54,977	55,708	61,432	54,003	**72,596**
19,298	16,903	18,122	17,917	18,260	17,409	**22,925**
19,822	18,853	19,666	20,056	18,755	19,802	**22,572**
11,726	12,176	12,307	12,448	13,466	14,321	**15,863**
17,250	9,242	13,513	15,445	14,329	16,097	**22,350**
14,320	(17,362)	6,553	10,904	3,396	15,577	**29,390**
2,727	2,622	2,677	2,641	2,587	2,112	**2,926**
2,212	3,173	4,003	3,655	4,317	6,269	**3,360**
4,385	4,544	4,930	5,289	5,788	4,121	**7,239**
			(Millions of yen)			
102,538	94,353	105,614	115,990	120,347	128,646	**142,346**
45,352	62,753	65,304	70,340	68,650	72,587	**76,484**
37,791	34,477	34,216	35,890	36,481	46,975	**54,274**
8,220	7,757	9,749	10,829	10,492	10,938	**10,744**
101,879	114,872	126,953	139,611	142,023	143,320	**153,811**
147,890	157,106	170,919	186,331	188,997	201,234	**218,831**
64,747	59,876	71,398	80,100	83,865	81,670	**88,072**
5	4	6	40	181	192	**194**
			(Yen)			
143.18	148.69	150.28	152.73	165.56	179.12	**201.31**
39.00	41.00	43.00	45.00	48.00	52.00	**58.00**
27.2	27.6	28.6	29.5	29.0	29.0	**28.8**
202.9	108.7	158.9	181.6	168.5	189.3	**272.4**
1,242.04	1,402.64	1,549.16	1,711.77	1,766.06	1,818.10	**1,947.82**
			(%)			
58.3	57.4	57.4	57.4	58.1	59.5	**60.9**
14.7	13.9	14.2	14.0	13.3	14.5	**14.6**
8.9	10.0	9.7	9.7	9.8	11.9	**10.1**
271.3	273.7	308.7	323.2	329.9	273.9	**262.3**
14.2	12.2	11.4	10.5	9.6	10.0	**11.5**
12.2	11.2	10.2	9.4	9.6	10.0	**10.7**
68.8	73.1	74.2	74.8	75.1	71.2	**70.3**
0.00005	0.00004	0.00005	0.00029	0.00127	0.00134	**0.00126**
14.5	15.3	19.8	28.2	29.8	27.9	**36.4**

Note: The Company changed its fiscal year-end to December 31 from March 31 effective from fiscal 2016/3.
Consequently, fiscal 2016/12 is a transitional period comprising the nine months from April 1, 2016 to December 31, 2016.

Management's Discussion and Analysis

Consolidated Results

◆ Net Sales

For the fiscal year ended December 31, 2017 (FY2017), sales were strong due to factors including the launch of 29 new products, robust demand for existing products, and firm demand from foreign visitors to Japan in the Domestic Consumer Products Business (Domestic Business), as well as growth in the e-commerce market. As a result, net sales were ¥156.7 billion, an increase of 8.3 percent year on year.*

◆ Gross Profit

OTC pharmaceuticals, food products and other items that generate high gross profit accounted for a higher percentage of domestic sales in FY2017. As a result, gross profit was ¥95.5 billion and the gross profit margin increased to 60.9 percent.

◆ Operating Income

The Group invested heavily in advertising in the Domestic Consumer Products Business, the Overseas Consumer Products Business and the Direct Marketing Business. As a result, advertising expenses were ¥22.3 billion, and the advertising expenses to net sales ratio increased 0.1 percentage points to 14.3 percent. Sales promotion expenses were ¥11.1 billion, and the promotion expenses to net sales ratio increased 0.3 points to 7.1 percent. Due to these factors, selling, general and administrative expenses were ¥72.5 billion, but because gross profit also increased, operating income was ¥22.9 billion, an increase of 24.3 percent year on year,* and the operating income margin rose 0.1 points to 14.6 percent.

◆ Profit Attributable to Owners of Parent

Other income, which included compensation income, was ¥0.1 billion, and other expenses, which included impairment loss, totaled ¥1.7 billion, resulting in profit before income taxes of ¥22.5 billion. As a result, profit attributable to owners of parent increased 5.6 percent year on year* to ¥15.8 billion, a record high. This also marked the 20th consecutive fiscal period of bottom-line growth. Net income per share increased ¥22.19 year on year to ¥201.31.

* Comparison with the same period in the previous year, January–December 2016

Reportable Segment Business Results

The Kobayashi Pharmaceutical Group classifies its business activities into four segments: Domestic Consumer Products Business, Overseas Consumers Products Business, Direct Marketing Business, and Other Business. Net sales by segment also include inter-segment sales and transfers, which amounted to ¥12.6 billion in FY2017.

◆ Domestic Consumer Products Business

In this business segment during FY2017, we launched 11 new products in spring and 18 in autumn, which contributed to sales. These included *Kurocure*, a remedy for dark and rough spots on elbows and knees; *Hishimore*, a medication for improving dry skin; *Nightmin Nasal Respiration Tape*, which is applied over the mouth before sleeping to promote breathing through the nose; *Sawaday Kaoru Stick Aroma*, a home fragrance that uses carefully selected aromatic oils; *Keshimin Cream EX*, a premium prescription cream for spots; and *Bioil*, a skincare oil.

Existing products also made strong contributions to sales, including *Eyebon*, an eye wash solution with corneal healing and protective ingredients, *Bisrat Gold*, an obesity therapeutic drug, *Inochi no Haha A*, a women's health medicine, *Chikunain*, a sinusitis medicine, and *Dusmock*, a Kampo medicine that ameliorates persistent coughing and bronchitis, in the healthcare category; *Sarasaty*, a panty liner, and *Bluelet*, a toilet bowl cleaner and freshener, in the household products category; and *Keshimin*, a skincare product for spots, and *Madame Juju*, a skincare cream, in the skincare category.

As a result, sales in the Domestic Consumer Products Business totaled ¥129.8 billion and operating income was ¥21.3 billion.

Sales include inter-segment sales and transfers, which amounted to ¥6.3 billion in FY2017.

Contribution Ratio of New Products

We calculate the contribution ratio of new products using two indices, one based on sales in the first fiscal year on the market and the other based on sales for the first four years on the market. In FY2017, we launched 29 new products. However, the first-year contribution ratio of new products declined 1.4 percentage points year on year to 5.4 percent, partly reflecting sales growth for existing products and expansion of demand from foreign visitors to Japan, while the four-year contribution ratio of new products fell 1.8 percentage points year on year to 21.0 percent.

◆ Overseas Consumer Products Business

In this business segment, we sell products such as body warmers, *Netsusama Sheet*, a cooling gel sheet for the forehead, and *Ammeltz*, a topical anti-inflammatory, mainly in the United States, China and Southeast Asia. During FY2017, we focused on growing sales by investing aggressively in advertising and sales promotion.

As a result, sales in the Overseas Consumer Products Business totaled ¥22.8 billion, and operating income was ¥0.9 billion.

Sales include inter-segment sales and transfers, which amounted to ¥1.0 billion in FY2017.

◆ Direct Marketing Business

In this business segment, we conduct mail-order sales of nutritional supplements, skincare products and other items. In FY2017, we worked to attract new customers and encourage existing customers to make regular purchases by implementing sales promotion activities centered on advertising and direct mail.

As a result, sales in the Direct Marketing Business totaled ¥10.1 billion and operating loss was ¥75 million.

There are no inter-segment sales and transfers in this segment.

◆ Other Business

Businesses in this segment include the transportation business, the manufacture and distribution of plastic containers, insurance agency operations, real estate management, and advertising planning and production. Each company in this segment conducts business on a financially independent basis, and revised the delivery price of materials and services provided as necessary.

As a result, sales in Other Business totaled ¥6.5 billion and operating income was ¥0.7 billion.

Sales include inter-segment sales and transfers, which amounted to ¥5.2 billion in FY2017.

Net Sales by Segment

(Billions of yen)

	2017/12	Comparable period in 2016[1] (January–December 2016)	YoY change (%)
1. Domestic Consumer Products Business			
Sales to third parties	123.4	115.0	+7.3%
Inter-segment sales and transfers	6.3	—	—
Total	129.8	—	—
2. Overseas Consumer Products Business			
Sales to third parties	21.7	17.7	+22.8%
Inter-segment sales and transfers	1.0	—	—
Total	22.8	—	—
3. Direct Marketing Business			
Sales to third parties	10.1	9.5	+6.9%
4. Other Business			
Sales to third parties	1.3	—	—
Inter-segment sales and transfers	5.2	—	—
Total	6.5	—	—

Operating Income (Loss) by Segment

(Billions of yen)

	2017/12 (January–December 2017)	Comparable period in 2016[1] (January–December 2016)	YoY change (%)
1. Domestic Consumer Products Business	21.3	16.4	+19.1%
2. Overseas Consumer Products Business	0.9	0.7	+202.4%
3. Direct Marketing Business	(0.07)	(0.3)	—
4. Other Business	0.7	0.3	—

1. Results for the comparable period are calculated for January–December 2016. Figures are unaudited and provided for reference purposes only.

Consolidated Balance Sheet

December 31, 2017

	Millions of yen		Thousands of U.S. dollars (Note 1)
	December 31, 2017	December 31, 2016	**December 31, 2017**
Assets			
Current assets:			
Cash and time deposits *(Notes 3, 15 and 17)*	**¥ 64,991**	¥ 58,173	**$ 575,142**
Trade notes and accounts receivable *(Notes 4 and 17)*	**50,032**	47,046	**442,761**
Securities *(Notes 3, 6 and 17)*	**8,300**	5,500	**73,451**
Inventories:			
Commodities and finished goods	**9,790**	9,222	**86,637**
Work in process	**693**	752	**6,133**
Raw materials and supplies	**2,807**	2,833	**24,841**
Total inventories	**13,290**	12,807	**117,611**
Deferred income taxes *(Note 13)*	**3,222**	2,899	**28,513**
Other current assets	**2,547**	2,267	**22,540**
Allowance for doubtful accounts	**(35)**	(45)	**(310)**
Total current assets	**142,347**	128,647	**1,259,708**
Property, plant and equipment:			
Buildings and structures *(Note 7)*	**20,960**	20,536	**185,487**
Machinery, equipment and vehicles *(Note 7)*	**11,794**	10,684	**104,372**
Tools, furniture and fixtures *(Note 7)*	**6,489**	6,257	**57,425**
Land	**3,576**	3,553	**31,646**
Construction in progress	**562**	389	**4,973**
Leased assets *(Note 10)*	**817**	815	**7,230**
Total property, plant and equipment	**44,198**	42,234	**391,133**
Accumulated depreciation	**(25,951)**	(24,400)	**(229,655)**
Property, plant and equipment, net	**18,247**	17,834	**161,478**
Investments and other assets:			
Investments in securities *(Notes 6 and 17)*:			
Unconsolidated subsidiaries and affiliate	**425**	375	**3,761**
Other	**46,372**	39,906	**410,372**
Total investments in securities	**46,797**	40,281	**414,133**
Deferred income taxes *(Note 13)*	**539**	383	**4,770**
Goodwill *(Notes 7 and 21)*	**2,626**	4,730	**23,239**
Software	**906**	963	**8,018**
Other intangible assets *(Notes 7 and 21)*	**1,266**	1,531	**11,204**
Investment properties, net *(Note 8)*	**2,981**	2,968	**26,381**
Other assets *(Notes 15 and 17)*	**3,506**	4,162	**31,025**
Allowance for doubtful accounts	**(384)**	(265)	**(3,398)**
Total investments and other assets	**58,237**	54,753	**515,372**
Total assets *(Note 21)*	**¥ 218,831**	¥ 201,234	**$ 1,936,558**

	Millions of yen		Thousands of U.S. dollars (Note 1)
	December 31, 2017	December 31, 2016	**December 31, 2017**
Liabilities and Net Assets			
Current liabilities:			
Short-term loans *(Notes 9 and 17)*	**¥ 194**	¥ 192	**$ 1,717**
Trade notes and accounts payable *(Notes 4and 17)*	**8,279**	8,169	**73,265**
Electronically recorded obligations-operating *(Note 17)*	**9,222**	7,850	**81,611**
Current portion of lease obligations *(Notes 10 and 17)*	**56**	57	**496**
Income taxes payable *(Notes 13 and 17)*	**4,654**	3,357	**41,186**
Other accounts payable *(Note 17)*	**24,447**	20,192	**216,345**
Provision for sales returns	**1,794**	1,410	**15,876**
Accrued bonuses	**2,250**	1,147	**19,912**
Asset retirement obligations *(Note 12)*	**38**	38	**336**
Other current liabilities *(Notes 13 and 17)*	**3,341**	4,564	**29,566**
Total current liabilities	**54,275**	46,976	**480,310**
Long-term liabilities:			
Lease obligations *(Notes 10 and 17)*	**528**	581	**4,673**
Deferred income taxes *(Note 13)*	**5,224**	3,842	**46,230**
Liability for retirement benefits *(Note 11)*	**2,805**	4,337	**24,823**
Provision for retirement benefits for directors and audit & supervisory board members	**37**	34	**327**
Asset retirement obligations *(Note 12)*	**81**	80	**717**
Other long-term liabilities	**2,070**	2,064	**18,319**
Total long-term liabilities	**10,745**	10,938	**95,089**
Total liabilities	**65,020**	57,914	**575,399**
Contingent liabilities *(Note 15)*			
Net Assets			
Shareholders' equity *(Note 14)*:			
Common stock:			
Authorized – 340,200,000 at December 31, 2017 and 340,200,000 at December 31, 2016			
Issued – 82,050,000 shares at December 31, 2017 and 85,050,000 shares at December 31, 2016	**3,450**	3,450	**30,531**
Capital surplus	**4,184**	4,959	**37,027**
Retained earnings	**146,758**	147,901	**1,298,743**
Treasury stock, at cost	**(12,260)**	(21,088)	**(108,496)**
Total shareholders' equity	**142,132**	135,222	**1,257,805**
Accumulated other comprehensive income:			
Unrealized holding gain on securities *(Note 6)*	**13,267**	9,481	**117,407**
Deferred gain on hedges *(Note 18)*	**9**	40	**80**
Translation adjustments	**404**	681	**3,575**
Retirement benefit liability adjustments *(Note 11)*	**(2,038)**	(2,171)	**(18,035)**
Total accumulated other comprehensive income	**11,642**	8,031	**103,027**
Stock acquisition rights	**37**	67	**327**
Total net assets	**153,811**	143,320	**1,361,159**
Total liabilities and net assets	**¥ 218,831**	¥ 201,234	**$ 1,936,558**

See accompanying notes to consolidated financial statements

Consolidated Statement of Income

Twelve months ended December 31, 2017

	Millions of yen		*Thousands of U.S. dollars (Note 1)*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Net sales *(Note 21)*	**¥ 156,761**	¥ 120,052	**$ 1,387,265**
Cost of sales	**61,239**	48,639	**541,938**
Gross profit	**95,522**	71,413	**845,327**
Selling, general and administrative expenses:			
Sales promotions	**11,107**	8,159	**98,292**
Freight and storage	**5,872**	4,521	**51,965**
Advertising	**22,362**	17,049	**197,894**
Provision for allowance for doubtful accounts	**27**	32	**239**
Salaries and bonuses	**10,106**	8,019	**89,434**
Net pension cost *(Note 11)*	**813**	545	**7,195**
Provision for retirement benefits for directors and audit and supervisory board members	**10**	2	**88**
Taxes and dues other than income taxes	**601**	454	**5,319**
Depreciation and amortization *(Note 21)*	**741**	526	**6,558**
Amortization of goodwill *(Note 21)*	**593**	513	**5,248**
Office rent and other rental charges	**1,461**	1,130	**12,929**
External service fees	**5,504**	4,069	**48,708**
Research and development costs	**7,240**	4,122	**64,071**
Other	**6,159**	4,862	**54,502**
Total selling, general and administrative expenses	**72,596**	54,003	**642,442**
Operating income	**22,926**	17,410	**202,885**
Other income (expenses):			
Interest and dividend income *(Note 21)*	**658**	540	**5,823**
Interest expense *(Note 21)*	**(39)**	(22)	**(345)**
Sales discounts	**(750)**	(583)	**(6,637)**
Foreign currency exchange (loss) gain, net	**(211)**	50	**(1,867)**
Loss on disposal or sales of property, plant and equipment, net	**(96)**	(114)	**(850)**
Loss on impairment of fixed assets *(Notes 7 and 21)*	**(1,544)**	(1,342)	**(13,664)**
Gain on sales of investment in an affiliate	**–**	8	**–**
Gain on sales of investments in securities *(Note 6)*	**4**	1,796	**35**
Loss on business transfer	**–**	(10)	**–**
Compensation income	**1,500**	1,900	**13,274**
Other, net	**125**	169	**1,107**
Profit before income taxes	**22,573**	19,802	**199,761**
Income taxes *(Note 13)*:			
Current	**7,602**	5,223	**67,274**
Deferred	**(893)**	322	**(7,902)**
	6,709	5,545	**59,372**
Profit	**15,864**	14,257	**140,389**
Profit (loss) attributable to:			
Non-controlling interests	**–**	(65)	**–**
Owners of parent *(Note 19)*	**¥ 15,864**	¥ 14,322	**$ 140,389**

See accompanying notes to consolidated financial statements

Consolidated Statement of Comprehensive Income

Twelve months ended December 31, 2017

	Millions of yen		*Thousands of U.S. dollars (Note 1)*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Profit	**¥ 15,864**	¥ 14,257	**$ 140,389**
Other comprehensive income (loss) *(Note 20)*:			
Unrealized holding gain on securities	**3,786**	619	**33,504**
Deferred (loss) gain on hedges	**(31)**	79	**(274)**
Translation adjustments	**(277)**	(998)	**(2,451)**
Retirement benefit liability adjustments	**133**	(843)	**1,177**
Total other comprehensive income (loss)	**3,611**	(1,143)	**31,956**
Comprehensive income	**¥ 19,475**	¥ 13,114	**$ 172,345**
Comprehensive income (loss) attributable to:			
Owners of parent	**¥ 19,475**	¥ 13,189	**$ 172,345**
Non-controlling interests	**–**	(75)	**–**

See accompanying notes to consolidated financial statements

Consolidated Statement of Changes in Net Assets

Twelve months ended December 31, 2017

	Numbers of shares issued (Thousands)	Common stock	Capital surplus	Retained earnings	Treasury stock at cost	Unrealized holding gain on securities	Deferred gain on hedges	Translation adjustments	Retirement benefit liability adjustments	Stock acquisition rights	Non-controlling interests	Total net assets
		Millions of yen										
Balance at April 1, 2016	42,525	¥ 3,450	¥ 4,954	¥ 137,486	¥ (13,180)	¥ 8,862	¥ (39)	¥ 1,668	¥ (1,328)	¥ 75	¥ 75	¥ 142,023
Profit attributable to owners of parent for the period		–	–	14,322	–	–	–	–	–	–	–	14,322
Cash dividends		–	–	(3,925)	–	–	–	–	–	–	–	(3,925)
Change in scope of consolidation		–	–	18	–	–	–	–	–	–	–	18
Purchase of treasury stock		–	–	–	(8,003)	–	–	–	–	–	–	(8,003)
Disposal of treasury stock		–	5	–	95	–	–	–	–	–	–	100
Other changes		–	–	–	–	619	79	(987)	(843)	(8)	(75)	(1,215)
Balance at January 1, 2017	85,050 *	¥ 3,450	¥ 4,959	¥ 147,901	¥ (21,088)	¥ 9,481	¥ 40	¥ 681	¥ (2,171)	¥ 67	–	¥ 143,320
Profit attributable to owners of parent for the period	–	–	–	**15,864**	–	–	–	–	–	–	–	**15,864**
Cash dividends	–	–	–	**(4,337)**	–	–	–	–	–	–	–	**(4,337)**
Purchase of treasury stock	–	–	–	–	**(5,000)**	–	–	–	–	–	–	**(5,000)**
Disposal of treasury stock	–	–	**(3,335)**	–	**3,718**	–	–	–	–	–	–	**383**
Retirement of treasury shares	**(3,000)**	–	**(10,110)**	–	**10,110**	–	–	–	–	–	–	–
Transfer from retained earnings to capital surplus	–	–	**12,670**	**(12,670)**	–	–	–	–	–	–	–	–
Other changes	–	–	–	–	–	**3,786**	**(31)**	**(277)**	**133**	**(30)**	–	**3,581**
Balance at December 31, 2017	**82,050**	**¥ 3,450**	**¥ 4,184**	**¥ 146,758**	**¥ (12,260)**	**¥13,267**	**¥ 9**	**¥ 404**	**¥ (2,038)**	**¥ 37**	**–**	**¥ 153,811**

* The Company carried out a two-for-one split of common stock on July 1, 2016.

See accompanying notes to consolidated financial statements

	Thousands of U.S. dollars (Note 1)										
	Common stock	Capital surplus	Retained earnings	Treasury stock at cost	Unrealized holding gain on securities	Deferred gain on hedges	Translation adjustments	Retirement benefit liability adjustments	Stock acquisition rights	Non-controlling interests	Total net assets
Balance at January 1, 2017	$ 30,531	$ 43,885	$ 1,308,859	$ (186,620)	$ 83,903	$ 354	$ 6,026	$(19,212)	$ 593	–	$ 1,268,319
Profit attributable to owners of parent for the period	–	–	140,389	–	–	–	–	–	–	–	140,389
Cash dividends	–	–	(38,381)	–	–	–	–	–	–	–	(38,381)
Purchase of treasury stock	–	–	–	(44,248)	–	–	–	–	–	–	(44,248)
Disposal of treasury stock	–	(29,513)	–	32,903	–	–	–	–	–	–	3,390
Retirement of treasury shares	–	(89,469)	–	89,469	–	–	–	–	–	–	–
Transfer from retained earnings to capital surplus	–	112,124	(112,124)	–	–	–	–	–	–	–	–
Other changes	–	–	–	–	33,504	(274)	(2,451)	1,177	(266)	–	31,690
Balance at December 31, 2017	$ 30,531	$ 37,027	$ 1,298,743	$ (108,496)	$117,407	$ 80	$ 3,575	$ (18,035)	$ 327	–	$ 1,361,159

See accompanying notes to consolidated financial statements

Consolidated Statement of Cash Flows

Twelve months ended December 31, 2017

	Millions of yen		*Thousands of U.S. dollars (Note 1)*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Cash flows from operating activities:			
Profit before income taxes	**¥ 22,573**	¥ 19,802	**$ 199,761**
Adjustments for:			
Depreciation and amortization	**3,520**	2,626	**31,150**
Loss on impairment of fixed assets	**1,544**	1,342	**13,664**
Increase in allowance for doubtful accounts	**106**	102	**938**
Decrease in liability for retirement benefits	**(1,743)**	(1,583)	**(15,425)**
Interest and dividend income	**(658)**	(540)	**(5,823)**
Interest expense	**39**	22	**345**
Gain on sales of investment in an affiliate	**–**	(8)	**–**
Gain on sales of investments in securities	**(4)**	(1,796)	**(35)**
Loss on disposal or sales of property, plant and equipment	**96**	114	**850**
Changes in operating assets and liabilities:			
Increase in trade notes and accounts receivable	**(2,970)**	(11,045)	**(26,283)**
(Increase) decrease in inventories	**(526)**	1,148	**(4,655)**
Increase in trade notes and accounts payable	**1,500**	2,328	**13,274**
Increase in other accounts payable	**4,058**	5,955	**35,912**
Increase in consumption taxes payable	**143**	347	**1,265**
Other, net	**313**	481	**2,770**
Subtotal	**27,991**	19,295	**247,708**
Interest and dividends received	**676**	528	**5,982**
Interest paid	**(28)**	(22)	**(248)**
Income taxes paid	**(6,288)**	(3,703)	**(55,646)**
Net cash provided by operating activities	**¥ 22,351**	¥ 16,098	**$ 197,796**

Consolidated Statement of Cash Flows (continued)

Twelve months ended December 31, 2017

	Millions of yen		*Thousands of U.S. dollars (Note 1)*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Cash flows from investing activities:			
Payments for time deposits	**¥ (52,456)**	¥ (63,870)	**$ (464,212)**
Proceeds from time deposits	**63,220**	69,021	**559,469**
Payments for purchases of property, plant and equipment	**(2,841)**	(2,851)	**(25,142)**
Proceeds from sales of property, plant and equipment	**3**	6	**27**
Payments for purchases of intangible assets	**(365)**	(636)	**(3,230)**
Payments for purchases of investments in securities	**(1,065)**	(19)	**(9,425)**
Proceeds from sales of investments in securities	**715**	316	**6,327**
(Increase) decrease in other assets, net	**(83)**	33	**(735)**
Proceeds from sales of investment in an affiliate	**–**	19	**–**
Payments for purchase of shares of subsidiaries resulting in change in scope of consolidation	**–**	(2,470)	**–**
Other, net	**(88)**	(69)	**(778)**
Net cash provided by (used in) investing activities	**7,040**	(520)	**62,301**
Cash flows from financing activities:			
Increase (decrease) in short-term loans, net	**(47)**	11	**(416)**
Dividends paid	**(4,343)**	(3,920)	**(38,434)**
Purchase of treasury stock	**(5,068)**	(8,054)	**(44,850)**
Proceeds from disposal of treasury stock	**352**	92	**3,116**
Decrease in lease obligations	**(57)**	(52)	**(504)**
Net cash used in financing activities	**(9,163)**	(11,923)	**(81,088)**
Effect of exchange rate changes on cash and cash equivalents	**137**	(760)	**1,212**
Net increase in cash and cash equivalents	**20,365**	2,895	**180,221**
Cash and cash equivalents at the beginning of the period	**28,323**	25,428	**250,646**
Increase in cash and cash equivalents from newly consolidated subsidiary	**–**	0	**–**
Cash and cash equivalents at the end of the period *(Note 3)*	**¥ 48,688**	¥ 28,323	**$ 430,867**

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

December 31, 2017

1. Basis of Presentation of Consolidated Financial Statements

The accompanying consolidated financial statements of KOBAYASHI PHARMACEUTICAL CO., LTD. (the “Company”) and its consolidated subsidiaries (collectively, the “Group”) have been prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Financial Instruments and Exchange Act of Japan.

In preparing the accompanying consolidated financial statements, certain reclassifications and rearrangements 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 are presented solely for convenience and are translated, as a matter of arithmetic computation only, at ¥113.00 = U.S.$1.00, the approximate exchange rate in effect on December 31, 2017. 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 any significant companies controlled directly or indirectly by the Company. All significant intercompany transactions and accounts have been eliminated in consolidation.

Goodwill is 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.

Among the consolidated subsidiaries, the fiscal year end for Kiribai Chemical Co., Ltd. is June 30 and the results of this subsidiary are, therefore, consolidated using financial statements based on a provisional settlement as of December 31.

(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.

2. Summary of Significant Accounting Policies (continued)

(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 consolidated 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 non-controlling 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 profit, but are presented as “Translation adjustments” and “Non-controlling interests” in the consolidated financial statements.

(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 accumulated other comprehensive income. Cost of securities sold is determined by the moving average method. Non-marketable securities classified as other securities are stated at cost determined by the moving average method.

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.

2. Summary of Significant Accounting Policies (continued)

(f) Inventories

Commodities and raw materials are stated principally at the lower of cost, determined by the moving average method, or net selling value. Finished goods, work in process and supplies are principally stated at the lower of cost, determined by the average method, or net selling value.

(g) Property, plant and equipment (excluding leased assets)

Property, plant and equipment are stated at cost. The Company and its domestic consolidated 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 consolidated subsidiaries calculate depreciation by the straight-line method.

(h) Intangible assets (excluding leased assets)

Intangible assets, such as customer relationships and trademarks, are amortized by the straight-line method over two to fourteen years.

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 five years.

(i) Leased assets

Leased assets under finance lease transactions which do not transfer ownership to the lessee are capitalized and depreciated over the respective lease terms by the straight-line method assuming a nil residual value.

(j) Allowance for doubtful accounts

The Company and its domestic consolidated 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. Overseas consolidated subsidiaries provide an allowance for doubtful accounts based on estimate of uncollectible amounts with the current status.

2. Summary of Significant Accounting Policies (continued)

(k) Provision for sales returns

The Company and certain consolidated subsidiaries provide a provision for sales returns at the estimated amount in order to cover possible future losses on the return of products.

(l) Accrued bonuses

The Company and certain consolidated subsidiaries provide accrued bonuses for the future payment of employees' bonuses based on the estimated amount of bonus payments.

(m) Liability for retirement benefits

The liability for retirement benefits for employees of the Company and a domestic consolidated subsidiary represents the projected benefit obligation in excess of the fair value of the pension plan assets. The estimated benefit is attributed to each period by the benefit formula method over the estimated years of service of the eligible employees.

Certain domestic consolidated subsidiaries have adopted a simplified method of calculation. Under this simplified method, the liability for retirement benefits for employees is stated at 100% of the amount which would be required to be paid if all eligible employees voluntarily retired at the balance sheet date (the "simplified method").

Prior service cost is being amortized by the straight-line method over ten years, which is shorter than the average remaining years of service of the eligible employees.

Actuarial differences are amortized in the year following the year in which the differences are recognized by the straight-line method over ten years, which is shorter than the average remaining years of service of eligible employees.

2. Summary of Significant Accounting Policies (continued)

(n) Provision for retirement benefits for directors and audit and supervisory board members

Directors and audit and supervisory board members of certain domestic consolidated subsidiaries (collectively, “officers”) are customarily entitled, subject to shareholders’ approval, to lump-sum payments under an unfunded retirement allowances plan. Provision for retirement benefits for officers have been made at an estimated amount based on the consolidated subsidiaries’ internal regulations.

The Company decided to abolish the retirement allowances plan for officers at the Board of Directors meeting held on February 12, 2009. At the annual general shareholders’ meeting held on June 26, 2009, a proposal was then subsequently approved to provide retirement allowances for these officers when they retire.

(o) Income taxes

Deferred income taxes have been recognized with respect to the differences between financial reporting and the tax bases of the assets and liabilities. Deferred income taxes are measured at the rates expected to apply to the period when each asset or liability is realized, based on the tax rates that will be in effect as of the balance sheet date or are to be subsequently effective.

(p) Research and development costs

Research and development costs are charged to income when incurred.

(q) Distribution of retained earnings

Under the Companies Act, the distribution of retained earnings with respect to a given financial period can be made by resolution of the Board of Directors meeting held subsequent to the close of the financial period. The accounts for that period do not, therefore, reflect such appropriations (see Note 24 (a)).

2. Summary of Significant Accounting Policies (continued)

(r) 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, net of the applicable income taxes, is deferred as a separate component of accumulated other comprehensive income. When forward foreign exchange contracts or currency options meet certain criteria, receivables and payables covered by the contract are translated at the contracted rates ("allocation method").

The Company evaluates the effectiveness of 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 hedges.

3. Cash and Cash Equivalents

Reconciliations between the balances of cash and time deposits in the accompanying consolidated balance sheet as of December 31, 2017 and 2016 and the balances of cash and cash equivalents in the accompanying consolidated statement of cash flows for the twelve months and nine months then ended, respectively, were as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Cash and time deposits	**¥ 64,991**	¥ 58,173	**$ 575,142**
Time deposits over three months	**(24,603)**	(35,350)	**(217,726)**
Securities maturing within three months	**8,300**	5,500	**73,451**
Cash and cash equivalents	**¥ 48,688**	¥ 28,323	**$ 430,867**

4. Trade Notes Receivable and Trade Notes Payable

Although the balance sheet date for the twelve months ended December 31, 2017 fell on a bank holiday, trade notes receivable of ¥0 million ($0 thousand) and trade notes payable of ¥436 million ($3,858 thousand) were accounted for as settled on that date and were excluded from the respective balances in the consolidated balance sheet at December 31, 2017.

5. Inventories

Loss on devaluation of inventories included in cost of sales for the twelve months ended December 31, 2017 and nine months ended December 31, 2016 amounted to ¥1,992 million ($17,268 thousand) and ¥1,558 million, respectively.

6. Securities and Investments in Securities

(a) Securities classified as “Other securities” as of December 31, 2017 and 2016 were summarized as follows:

(1) Securities whose carrying value exceeds their acquisition cost

	Millions of yen					
	December 31, 2017			December 31, 2016		
	Acquisition cost	Carrying value	Unrealized gain	Acquisition cost	Carrying value	Unrealized gain
Equity securities	**¥ 7,185**	**¥ 25,574**	**¥18,389**	¥ 7,160	¥ 19,901	¥12,741
Debt securities	**19,222**	**19,757**	**535**	19,266	19,960	694
	¥ 26,407	**¥ 45,331**	**¥18,924**	¥ 26,426	¥ 39,861	¥13,435

	Thousands of U.S. dollars		
	December 31, 2017		
	Acquisition cost	Carrying value	Unrealized gain
Equity securities	**$ 63,584**	**$226,318**	**$162,734**
Debt securities	**170,106**	**174,841**	**4,735**
	$233,690	**$401,159**	**$167,469**

(2) Securities whose acquisition cost exceeds their carrying value

	Millions of yen					
	December 31, 2017			December 31, 2016		
	Acquisition cost	Carrying value	Unrealized loss	Acquisition cost	Carrying value	Unrealized loss
Equity securities	**¥ 9**	**¥ 8**	**¥ (1)**	¥ 9	¥ 8	¥ (1)
Other	**9,332**	**9,300**	**(32)**	5,500	5,500	–
	¥ 9,341	**¥ 9,308**	**¥(33)**	¥ 5,509	¥ 5,508	¥ (1)

	Thousands of U.S. dollars		
	December 31, 2017		
	Acquisition cost	Carrying value	Unrealized loss
Equity securities	**$ 80**	**$ 71**	**$ (9)**
Other	**82,584**	**82,301**	**(283)**
	$ 82,664	**$ 82,372**	**$(292)**

6. Securities and Investments in Securities (continued)

(a) Securities classified as "Other securities" as of December 31, 2017 and 2016 were summarized as follows: (continued)

(3) Securities whose market value is not determinable

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Unlisted equity securities	**¥ 32**	¥ 37	**$ 283**

(b) Proceeds from sales, and gross realized gain on other securities with fair value

	Millions of yen			
	Twelve months ended December 31, 2017		Nine months ended December 31, 2016	
	Proceeds from sales	Gross realized gain	Proceeds from sales	Gross realized gain
Equity securities	**¥ 4**	**¥ 4**	¥ 1,960	¥ 1,796
	¥ 4	**¥ 4**	¥ 1,960	¥ 1,796

	Thousands of U.S. dollars	
	Twelve months ended December 31, 2017	
	Proceeds from sales	Gross realized gain
Equity securities	**$ 35**	**$ 35**
	$ 35	**$ 35**

7. Loss on Impairment of Fixed Assets

The Company and its consolidated subsidiaries group their property, plant and equipment and intangible assets for business use in each business segment unit and these are defined as the smallest identifiable group of assets generating cash inflows. The head office building, central laboratories and certain other assets are grouped as one common asset group. Idle assets which are not anticipated to be utilized in the future are classified as individual cash-generating units.

For the twelve months ended December 31, 2017, the carrying values of production facilities, which are not anticipated to be utilized in the future or whose corresponding economic environment in which the Company operates was changed, have been reduced to their respective recoverable amounts and loss on impairment of fixed assets was recognized in the consolidated statement of income.

The recoverable amounts of assets are based on the higher amount of net selling value or value in use. For the twelve months ended December 31, 2017, the carrying values of production facilities such as buildings and goodwill in Osaka were reduced to zero because future cash flow was not expected. As profitability decreased significantly, the carrying values of other intangible assets and goodwill for the Company's business in the U.S. were reduced to their respective recoverable amounts and loss on impairment of fixed assets was recognized in the consolidated statement of income.

The recoverable amount of production facilities such as buildings and other in the U.S. was measured at value in use based on estimated future cash flows discounted at rate of 14.3%.

For the nine months ended December 31, 2016, the carrying values of production facilities, which are not anticipated to be utilized in the future or whose corresponding economic environment in which the Company operates was changed, have been reduced to their respective recoverable amounts and loss on impairment of fixed assets was recognized in the consolidated statement of income.

The recoverable amounts of assets are based on the higher amount of net selling value or value in use. For the nine months ended December 31, 2016, the carrying values of production facilities such as machinery, equipment and other in Osaka and other and other intangible assets in Osaka were reduced to zero because future cash flow was not expected. The carrying value of goodwill for the Company's business in the U.S. was reduced zero because excess earnings power based on future business operations was not expected.

The recoverable amount of production facilities such as machinery, equipment and other in China was measured at value in use based on estimated future cash flows discounted at rate of 5.3%.

7. Loss on Impairment of Fixed Assets (continued)

Loss on impairment of fixed assets for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 was summarized as follows:

Twelve months ended December 31, 2017

Location	Description	Classification	*Millions of yen*	*Thousands of U.S. dollars*
Osaka and other	Production facilities	Buildings and other	**¥ 111**	**$ 982**
Osaka	Other	Goodwill	**227**	**2,009**
U.S.A.	Other	Other intangible assets	**70**	**619**
U.S.A.	Other	Goodwill	**1,136**	**10,054**
			¥ 1,544	**$ 13,664**

Nine months ended December 31, 2016

Location	Description	Classification	*Millions of yen*
Osaka and other	Production facilities	Machinery, equipment and other	¥ 59
Osaka	Other	Other intangible assets	275
China	Production facilities	Machinery, equipment and other	842
U.S.A.	Other	Goodwill	166
			¥ 1,342

8. Investment Properties

The Company and certain consolidated subsidiaries own rental properties (including land) in Osaka prefecture and other areas.

Rental income from these properties amounted to ¥297 million ($2,628 thousand) and ¥222 million, and rental cost amounted to ¥79 million ($699 thousand) and ¥59 million for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016, respectively.

The carrying value on the consolidated balance sheet as of December 31, 2017 and December 31, 2016, and corresponding fair value of those properties were as follows:

Millions of yen			
Carrying value			Fair value
January 1, 2017	Net change	December 31, 2017	December 31, 2017
¥ 3,859	**¥ 14**	**¥ 3,873**	**¥ 5,056**

Millions of yen			
Carrying value			Fair value
April 1, 2016	Net change	December 31, 2016	December 31, 2016
¥ 3,883	¥ (24)	¥ 3,859	¥ 4,874

Thousands of U.S. dollars			
Carrying value			Fair value
January 1, 2017	Net change	December 31, 2017	December 31, 2017
$ 34,150	**$ 124**	**$ 34,274**	**$ 44,743**

The carrying value represents the acquisition cost less accumulated depreciation and cumulative impairment loss.

The significant components of net change in carrying value for the twelve months ended December 31, 2017 were due to the increases related to the acquisition of land and other properties in the amount of ¥44 million ($389 thousand) and depreciation in the amount of ¥30 million ($265 thousand), and for the changes for the nine months ended December 31, 2016 were due to the decrease related to depreciation in the amount of ¥24 million and sales of buildings in the amount of ¥0 million.

The fair value of the main properties is estimated based on a real estate appraisal report issued by independent real estate appraisers.

9. Short-Term Loans

The average interest rates on short-term bank loans as of December 31, 2017 and 2016 were 0.02% and 0.10%, respectively.

In order to achieve more efficient and flexible financing, the Company and certain consolidated subsidiaries have concluded line-of-credit agreements with certain financial institutions. The status of these as of December 31, 2017 and 2016 were summarized as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Lines-of-credit	**¥ 16,676**	¥ 16,659	**$ 147,575**
Credit used	**(4)**	(4)	**(35)**
Available credit	**¥ 16,672**	¥ 16,655	**$ 147,540**

10. Lease Transactions

(a) Finance lease transactions

The Group principally leases office facilities, consisting of buildings, which are used in the consumer products business.

Lease obligations related to finance lease transactions as of December 31, 2017 and 2016 were summarized as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Finance lease obligations due in installments from 2019 through 2030	**¥ 584**	¥ 638	**$ 5,169**
Less current portion	**(56)**	(57)	**(496)**
	¥ 528	¥ 581	**$ 4,673**

10. Lease Transactions (continued)

(a) Finance lease transactions (continued)

The aggregate annual maturities of finance lease obligations subsequent to December 31, 2017 were summarized as follows:

Year ending December 31,	*Millions of yen*	*Thousands of U.S. dollars*
2018	**¥ 56**	**$ 496**
2019	**54**	**478**
2020	**52**	**460**
2021	**51**	**451**
2022	**51**	**451**
2023 and thereafter	**320**	**2,833**
Total	**¥ 584**	**$ 5,169**

(b) Operating lease transactions

Future minimum lease payments (including the interest portion thereon) subsequent to December 31, 2017 for non-cancelable operating leases were summarized as follows:

Year ending December 31,	*Millions of yen*	*Thousands of U.S. dollars*
2018	**¥ 236**	**$ 2,088**
2019 and thereafter	**940**	**8,319**
Total	**¥ 1,176**	**$ 10,407**

11. Retirement Benefits for Employees

(a) Outline of retirement benefits for employees

Pension plans of the Company and certain consolidated subsidiary include defined benefit corporate pension plans, retirement benefit plans and defined contribution pension plans. The retirement benefit plans provide for lump-sum payments to eligible employees who terminate their services determined by reference to current rate of pay, length of service and the conditions under which termination occurs. Certain consolidated subsidiaries calculate the liability for retirement benefits based on the simplified method.

11. Retirement Benefits for Employees (continued)

(b) Defined benefit plans

(1) The changes in the retirement benefit obligation are outlined as follows (except for plans for which the simplified method is applied):

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Retirement benefit obligation at beginning of period	**¥ 11,699**	¥ 10,410	**$ 103,531**
Service cost	**580**	413	**5,133**
Interest cost	**36**	25	**318**
Actuarial differences	**168**	1,369	**1,487**
Benefits paid	**(499)**	(518)	**(4,416)**
Retirement benefit obligation at end of period	**¥ 11,984**	¥ 11,699	**$ 106,053**

(2) The changes in plan assets at fair value are outlined as follows:

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Plan assets at fair value at beginning of period	**¥ 8,117**	¥ 6,644	**$ 71,832**
Expected return on plan assets	**122**	100	**1,080**
Actuarial differences	**(39)**	(50)	**(345)**
Contributions paid by the employer	**2,203**	1,886	**19,496**
Benefits paid	**(451)**	(459)	**(3,991)**
Other	**(5)**	(4)	**(45)**
Plan assets at fair value at end of period	**¥ 9,947**	¥ 8,117	**$ 88,027**

11. Retirement Benefits for Employees (continued)

(b) Defined benefit plans (continued)

(3) The change in liability for retirement benefits calculated by the simplified method is outlined as follows:

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Liability for retirement benefits at beginning of period	**¥ 755**	¥ 712	**$ 6,681**
Retirement benefit expenses	**158**	126	**1,398**
Benefits paid	**(145)**	(83)	**(1,283)**
Liability for retirement benefits at end of period	**¥ 768**	¥ 755	**$ 6,796**

(4) Reconciliations of the ending balance of the retirement benefit obligation and plan assets at fair value to liability for retirement benefits recognized in the consolidated balance sheet are outlined as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Funded retirement benefit obligation	**¥ 11,919**	¥ 11,604	**$105,478**
Plan assets at fair value	**(9,947)**	(8,117)	**(88,027)**
	1,972	3,487	**17,451**
Unfunded retirement benefit obligation	**833**	850	**7,372**
Net amount of liabilities recognized in the consolidated balance sheet	**2,805**	4,337	**24,823**
Liability for retirement benefits	**2,805**	4,337	**24,823**
Net amount of liabilities recognized in the consolidated balance sheet	**¥ 2,805**	¥ 4,337	**$ 24,823**

11. Retirement Benefits for Employees (continued)

2. Defined benefit plans (continued)

(b) Defined benefit plans (continued)

(5) The components of retirement benefit expenses are outlined as follows:

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Service cost	**¥ 580**	¥ 413	**$ 5,133**
Interest cost	**37**	25	**327**
Expected return on plan assets	**(122)**	(100)	**(1,080)**
Amortization of actuarial differences	**443**	237	**3,920**
Amortization of prior service cost	**(40)**	(29)	**(354)**
Retirement benefit expenses calculated by the simplified method	**158**	126	**1,399**
Retirement benefit expenses	**¥1,056**	¥ 672	**$ 9,345**

(6) The balance of retirement benefit liability adjustments recognized in other comprehensive income (loss) (before tax effect) for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 is outlined as follows:

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Actuarial differences	**¥ 232**	¥ (1,186)	**$ 2,053**
Prior service cost	**(40)**	(29)	**(354)**
Total	**¥ 192**	¥ (1,215)	**$ 1,699**

11. Retirement Benefits for Employees (continued)

(b) Defined benefit plans (continued)

(7) The balance of retirement benefit liability adjustments recognized in accumulated other comprehensive income (before tax effect) as of December 31, 2017 and 2016 is outlined as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Unrecognized actuarial differences	**¥ 3,237**	¥ 3,469	**$ 28,646**
Unrecognized prior service cost	**(299)**	(339)	**(2,646)**
Total	**¥ 2,938**	¥ 3,130	**$ 26,000**

(8) The plan assets by major category consist of the following:

	December 31, 2017	December 31, 2016
Bonds	**21%**	22%
General accounts	**79**	78
Other	**0**	0
Total	**100%**	100%

The expected long-term rate of return on plan assets is determined as a result of consideration of both the portfolio allocation at present and in the future, and long-term expected rate of return from multiple plan assets.

(9) The assumptions used in accounting for the defined corporate benefit plans were as follows:

	Twelve months ended December 31, 2017	Nine months ended December 31, 2016
Discount rates	**0.1% - 0.3%**	0.1% - 0.3%
Expected long-term rate of return on plan assets	**1.5%**	2.0%

11. Retirement Benefits for Employees (continued)

(c) The contributions by the Company and certain consolidated subsidiaries to the defined contribution plans for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 were as follows:

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Contributions to defined contribution pension plans	**¥ 183**	¥ 130	**$ 1,619**

12. Asset Retirement Obligations

Asset retirement obligations are the result of legal obligations for the removal of leasehold improvements and the restoration of premises to their original conditions upon termination of leases.

Asset retirement obligations are measured based on the estimated useful life of 10 years and the discount rate of a 10-year Japanese government bond at the commencement of the lease contract.

Changes in the balance of asset retirement obligations for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 were as follows:

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Asset retirement obligations at beginning of period	**¥ 118**	¥ 111	**$ 1,044**
Liabilities incurred for leased buildings	**–**	6	**–**
Decrease due to settlement of asset retirement liabilities	**–**	–	**–**
Accretion expense	**2**	1	**18**
Asset retirement obligations at end of period	**¥ 120**	¥ 118	**$ 1,062**

13. Income Taxes

The Company and its domestic subsidiaries are subject to several taxes based on income which, in the aggregate, resulted in a statutory tax rate of approximately 30.81% for the nine months ended December 31, 2016. The overseas subsidiaries are subject to the income taxes of their respective countries of domicile.

A reconciliation of the difference between the statutory tax rate and the effective tax rate in the accompanying consolidated statement of income for the nine months ended December 31, 2016 was as follows:

	Nine months ended December 31, 2016
Statutory tax rate	30.81 %
Tax loss carryforwards of consolidated subsidiaries	0.56
Valuation allowances	1.22
Utilization of tax loss carryforwards	(0.62)
Tax credits on research and development costs and other	(2.79)
Expenses not deductible for tax purposes	0.45
Nontaxable dividend income	(0.11)
Other	(1.52)
Effective tax rate	28.00 %

A reconciliation of the statutory tax rate and the effective tax rate for the twelve months ended December 31, 2017 has been omitted as the difference was less than 5% of the statutory tax rate.

13. Income Taxes (continued)

The tax effects of the temporary differences which gave rise to a significant portion of the deferred tax assets and liabilities as of December 31, 2017 and 2016 were as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Deferred tax assets:			
Liability for retirement benefits	**¥ 880**	¥ 1,342	**$ 7,788**
Tax loss carryforwards	**716**	736	**6,336**
Accrued bonuses	**665**	332	**5,885**
Provision for retirement benefits for directors and audit and supervisory board members	**11**	10	**97**
Accrued expenses	**2,050**	1,777	**18,142**
Accrued enterprise taxes	**261**	147	**2,310**
Unrealized intercompany profits	**218**	207	**1,929**
Loss on impairment of fixed assets	**934**	891	**8,265**
Loss on disposal or write-offs of inventories	**67**	355	**593**
Allowance for doubtful accounts	**127**	149	**1,124**
Other	**1,164**	1,098	**10,300**
Gross deferred tax assets	**7,093**	7,044	**62,769**
Valuation allowance	**(2,370)**	(2,377)	**(20,973)**
Total deferred tax assets	**4,723**	4,667	**41,796**
Deferred tax liabilities:			
Unrealized holding gain on securities	**(5,624)**	(3,953)	**(49,770)**
Forward foreign currency exchange contracts	**(4)**	(18)	**(35)**
Gain on sales of investment securities	**(437)**	(944)	**(3,867)**
Other	**(268)**	(556)	**(2,372)**
Total deferred tax liabilities	**(6,333)**	(5,471)	**(56,044)**
Net deferred tax liabilities	**¥(1,610)**	¥ (804)	**$(14,248)**

13. Income Taxes (continued)

Net deferred tax assets in the above table were analyzed as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Current assets – deferred income taxes	**¥ 3,222**	¥ 2,899	**$ 28,513**
Investments and other assets – deferred income taxes	**539**	383	**4,770**
Current liabilities – deferred income taxes	**(147)**	(244)	**(1,301)**
Long-term liabilities – deferred income taxes	**(5,224)**	(3,842)	**(46,230)**
	¥ (1,610)	¥ (804)	**$ (14,248)**

14. Shareholders' Equity

The Companies Act of Japan (the "Act") 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 meeting 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 ($3,008 thousand) as of December 31, 2017 and 2016.

Stock-based compensation plan

As of December 31, 2017 the Company had one stock option plan: the 2013 stock option plan. The 2013 stock option plan (the 2013 plan) was approved at the annual general meeting of the shareholders of the Company held on June 27, 2013. The 2013 plan provides for granting options to purchase 905,200 shares of common stock, adjusted in accordance with the two-for-one common stock split, to directors and certain key employees of the Company, and directors and certain key employees of certain consolidated subsidiaries. The exercise price was ¥2,876 ($25.45) per share as of December 31, 2017. This exercise price is subject to adjustment in certain cases which include stock splits. The options became exercisable on July 1, 2015 and expire on June 30, 2018. There were no stock option expenses for the twelve months ended December 31, 2017, and for the nine months ended December 31, 2016, respectively. Gain on reversal of stock acquisition rights recorded for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 amounted to ¥0 million ($0 thousand) and ¥0 million, respectively.

14. Shareholders' Equity (continued)

Stock-based compensation plan (continued)

Information regarding stock option activity for the Company's stock options was as follows:

	The 2013 plan
Number of stock options (Unvested):	
Outstanding as of December 31, 2016	–
Granted	–
Forfeited	–
Vested	–
Outstanding as of December 31, 2017	–
Number of stock options (Vested):	
Outstanding as of December 31, 2016	272,600
Vested	–
Exercised	122,400
Forfeited	800
Outstanding as of December 31, 2017	149,400

	Yen	*U.S. dollars*
Exercise price	¥ 2,876	$ 25.45
Average price at exercise	¥ 6,265	$ 55.44
Fair value of options as of the grant date	¥ 247	$ 2.19

The number of stock options and prices were adjusted as a result of the two-for-one common stock split, effective July 1, 2016.

Because it is difficult to reasonably estimate the number of stock options that will be forfeited, the estimation reflects the actual number of forfeited.

14. Shareholders' Equity (continued)

Common stock and treasury stock

Movements in shares of common stock in issue and treasury stock for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 were summarized as follows:

	Number of shares			
	Twelve months ended December 31, 2017			
	January 1, 2017	Increase	Decrease	December 31, 2017
Common stock	**85,050,000**	**–**	**3,000,000**	**82,050,000**
Treasury stock	**6,257,437**	**817,900**	**3,972,400**	**3,102,937**

Notes:
1. The decrease of 3,000,000 shares in common stock was due to retirement of treasury stock approved by the Board of Directors
2. The increase of 817,900 shares in treasury stock was purchases of treasury stock of 817,900 shares approved by the Board of Directors.
3. The decrease of 3,972,400 shares in treasury stock was due to the exercise of 122,400 shares under the 2013 stock option plan, retirement of treasury stock of 3,000,000 shares approved by the Board of Directors and the disposal of treasury stock of 850,000 shares approved by the shareholders' meeting.

	Number of shares			
	Nine months ended December 31, 2016			
	April 1, 2016	Increase	Decrease	December 31, 2016
Common stock	42,525,000	42,525,000	–	85,050,000
Treasury stock	2,358,313	3,927,524	28,400	6,257,437

Notes:
1. The Company implemented a two-for-one common stock split, effective July 1, 2016.
2. The increase of 42,525,000 shares in common stock was due to the two-for-one common stock split, effective July 1, 2016.
3. The increase of 3,927,524 shares in treasury stock was due to the two-for-one common stock split of 2,354,713 shares, effective July 1, 2016, purchases of treasury stock of 1,572,100 shares approved by the Board of Directors and purchases of less than one voting unit of 711 shares for the nine months ended December 31, 2016.
4. The decrease in treasury stock was due to the exercise of 28,400 shares under the 2013 stock option plan.

15. Contingent Liabilities, Guarantees and Pledged Assets

As of December 31, 2017 and 2016, the Company was committed to providing debt guarantees as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Bank loans of small and medium-sized enterprises in areas affected by the Great East Japan Earthquake	**¥ 25**	¥ 33	**$ 221**

A summary of the assets pledged as collateral as of December 31, 2017 and 2016, was as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Time deposits	**¥ 43**	¥ 50	**$ 381**
Security deposits	**80**	80	**708**

Time deposits were pledged as collateral for the debt guarantees.

Security deposits were deposited in order to utilize an extension system for payment due dates of customs duties and consumption taxes.

16. Research and Development Costs

Research and development costs charged to income for the twelve months ended December 31, 2017 and nine months ended December 31, 2016 amounted to ¥7,240 million ($64,071) and ¥4,122 million, respectively.

17. Financial Instruments

(a) Overview

(1) Policy for financial instruments

The Group manages funds through highly liquid and safe financial assets. Furthermore, the Group principally utilizes its own funds for its funding needs.

(2) Types of financial instruments and related risk

Trade notes and accounts receivable, are exposed to credit risk in relation to customers. In addition, the Group is exposed to foreign currency exchange risk arising from trade receivables denominated in foreign currencies.

Securities and investments in securities are exposed to market risk. Those securities are mainly composed of national government guaranteed bonds, local government bonds, interest-bearing national government bonds and the shares of common stock of other companies with which the Group has business relationships.

Trade notes, accounts payable and electronically recorded obligations, have payment due dates within four months. Although the Group is exposed to foreign currency exchange risk arising from those payables denominated in foreign currencies, forward foreign currency exchange contracts and option contracts are arranged to hedge the risk.

Loans and lease obligations are raised principally for the purpose of making capital investments or working capital.

Regarding derivative transactions, the Group enters into forward foreign currency exchange contracts and option contracts to reduce the foreign currency exchange risk arising from the trade payables denominated in foreign currencies. Further information regarding the method of hedge accounting, hedging instruments and hedged items, hedging policy, and the assessment of the effectiveness of hedging activities can be found in Note 2 (r).

17. Financial Instruments (continued)

(a) Overview (continued)

(3) Risk management for financial instruments

(i) Monitoring of credit risk (the risk that customers or counterparties may default)

In accordance with the internal policies of the Group for managing credit risk arising from receivables, each related division monitors the credit worthiness of their main customers periodically, and monitors due dates and outstanding balances by customer. In addition, the Group makes efforts to identify and mitigate risks of bad debt from customers experiencing financial difficulties.

The Group also believes that the credit risk of derivatives is insignificant as the Group enters into derivative transactions only with financial institutions with high credit ratings.

(ii) Monitoring of market risks (the risks arising from fluctuations in foreign exchange rates, interest rates and others)

For trade payables denominated in foreign currencies, the Group identifies the foreign currency exchange risk by each currency on a monthly basis and enters into forward foreign exchange contracts and option contracts to hedge such risk.

For securities and investments in securities, the Group periodically reviews the fair values of such financial instruments and the financial position of the issuers. In addition, the Group continuously reviews market conditions and its business relationships with those companies to decide whether the shares should be retained or disposed of.

In conducting derivative transactions, the division in charge of each derivative transaction follows the internal policies, which set forth delegation of authority and maximum upper limit on positions, and obtains approval from the finance director.

(iii) Monitoring of liquidity risk (the risk that the Group may not be able to meet its obligations on the scheduled due dates)

Based on reports from each division, the Group prepares and updates its cash flow plans on a timely basis to manage liquidity risk.

17. Financial Instruments (continued)

(a) Overview (continued)

(4) Supplementary explanation of the estimated fair value of financial instruments

The fair value of financial instruments is based on their quoted market price, if available. When there is no quoted market price available, fair value is reasonably estimated. Since various assumptions and factors are reflected in estimating the fair value, different assumptions and factors could result in different fair value. In addition, the notional amounts of derivatives in Note 18. “Derivatives and Hedging Activities” are not necessarily indicative of the actual market risk involved in derivative transactions.

(b) Estimated Fair Value of Financial Instruments

The carrying value of financial instruments on the consolidated balance sheet as of December 31, 2017 and 2016, the estimated fair value and difference are shown in the following table. The following table does not include financial instruments for which it is extremely difficult to determine the fair value (Please refer to Note (2) below).

	Millions of yen					
	December 31, 2017			December 31, 2016		
	Carrying value	Estimated fair value	Difference	Carrying value	Estimated fair value	Difference
Assets						
(i) Cash and time deposits	**¥ 64,991**	**¥ 64,991**	**¥ –**	¥ 58,173	¥ 58,173	¥ –
(ii) Trade notes and accounts receivable	**50,032**	**50,032**	**–**	47,046	47,046	–
(iii) Securities and investments in securities	**54,640**	**54,640**	**–**	45,369	45,369	–
(iv) Long-term loans receivable included in other assets	**262**	**–**	**–**	172	–	–
Allowance for doubtful accounts (*1)	**(241)**	**–**	**–**	(121)	–	–
	21	**20**	**(1)**	51	48	(3)
Total assets	**¥ 169,684**	**¥ 169,683**	**¥ (1)**	¥ 150,639	¥ 150,636	¥ (3)
Liabilities						
(i) Trade notes and accounts payable	**¥ 8,279**	**¥ 8,279**	**¥ –**	¥ 8,169	¥ 8,169	¥ –
(ii) Electronically recorded obligations-operating	**9,222**	**9,222**	**–**	7,850	7,850	–
(iii) Short-term loans	**194**	**194**	**–**	192	192	–
(iv) Other accounts payable	**24,447**	**24,447**	**–**	20,192	20,192	–
(v) Current portion of lease obligations	**56**	**55**	**(1)**	57	57	0
(vi) Income taxes payable	**4,654**	**4,654**	**–**	3,357	3,357	–
(vii) Accrued consumption taxes, included in other current liabilities	**1,245**	**1,245**	**–**	1,090	1,090	–
(viii) Lease obligations	**528**	**527**	**(1)**	581	583	2
Total liabilities	**¥ 48,625**	**¥ 48,623**	**¥ (2)**	¥ 41,488	¥ 41,490	¥ 2
Derivative transactions (*2)	**¥ 13**	**¥ 13**	**¥ –**	¥ 58	¥ 58	¥ –

17. Financial Instruments (continued)

(b) Estimated Fair Value of Financial Instruments (continued)

	Thousands of U.S. dollars		
	December 31, 2017		
	Carrying value	Estimated fair value	Difference
Assets			
(i) Cash and time deposits	**$ 575,142**	**$ 575,142**	**$ –**
(ii) Trade notes and accounts receivable	**442,761**	**442,761**	**–**
(iii) Securities and investments in securities	**483,540**	**483,540**	**–**
(iv) Long-term loans receivable included in other assets	**2,319**	**–**	**–**
Allowance for doubtful accounts (*1)	**(2,134)**	**–**	**–**
	185	**176**	**(9)**
Total assets	**$ 1,501,628**	**$ 1,501,619**	**$ (9)**
Liabilities			
(i) Trade notes and accounts payable	**$ 73,265**	**$ 73,265**	**$ –**
(ii) Electronically recorded obligations-operating	**81,611**	**81,611**	**–**
(iii) Short-term loans	**1,717**	**1,717**	**–**
(iv) Other accounts payable	**216,345**	**216,345**	**–**
(v) Current portion of lease obligations	**496**	**486**	**(10)**
(vi) Income taxes payable	**41,186**	**41,186**	**–**
(vii) Accrued consumption taxes, included in other current liabilities	**11,018**	**11,018**	**–**
(viii) Lease obligations	**4,673**	**4,663**	**(10)**
Total liabilities	**$ 430,311**	**$ 430,291**	**$ (20)**
Derivative transactions (*2)	**$ 115**	**$ 115**	**$ –**

(*1) Excluding allowances for doubtful accounts recorded individually for long-term loans receivable.

(*2) Assets and liabilities arising from derivatives were shown at net value, and an amount in parentheses represented net liability position.

17. Financial Instruments (continued)

(b) Estimated Fair Value of Financial Instruments (continued)

(1) Method to determine the estimated fair value of financial instruments and other matters related to derivative transactions.

Assets

(i) Cash and time deposits and (ii) trade notes and accounts receivable

Since these items are settled in a short period of time, their carrying values approximate the fair value.

(iii) Securities and investments in securities

The fair values of equity securities are based on quoted market prices. The fair value of debt securities is based on either quoted market price or the price provided by the financial institutions making markets in these securities. For information on securities classified by holding purpose, please refer to Note 6.

(iv) Long-term loans receivable

The fair value of long-term loans receivable is based on the present value of the future cash flows discounted by the interest rate which is determined using an appropriate index including interest rates of government bonds plus a credit spread premium, classifying long-term loans receivable by credit risk status based on credit risk management and a certain remaining period. The fair value of probable specific bad debt is based on the present value of the estimated cash flows discounted by an interest rate described above or the estimated amounts collectable by the collaterals and guarantees.

Liabilities

(i) Trade notes and accounts payable, (ii) electronically recorded obligations-operating (iv) other accounts payable, (vi) income taxes payable and (vii) accrued consumption taxes

Since these items are settled in a short period of time, their carrying values approximate the fair value.

(iii) Short-term loans, (v) current portion of lease obligations and (viii) lease obligations

The fair value is based on the present value of the total of principal and interest discounted by the interest rate to be applied if similar new borrowings or lease agreements were entered into.

Derivatives

Refer to Note 18. “Derivatives and Hedging Activities.”

17. Financial Instruments (continued)

(b) Estimated Fair Value of Financial Instruments (continued)

(2) Financial instruments for which it was extremely difficult to determine the fair value

Type	*Millions of yen* **December 31, 2017**	*Millions of yen* December 31, 2016	*Thousands of U.S. dollars* **December 31, 2017**
Unlisted equity securities	**¥ 457**	¥ 412	**$ 4,044**

Because no quoted market price is available and it is extremely difficult to determine the fair value, the above financial instruments are not included in the preceding table on estimated fair value.

(3) The redemption schedules for monetary assets and debt securities with maturity dates as of December 31, 2017 and 2016 were summarized as follows:

	Millions of yen **December 31, 2017**				*Millions of yen* December 31, 2016			
	Due in 1 year or less	**Due after 1 year through 5 years**	**Due after 5 years through 10 years**	**Due after 10 years**	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years through 10 years	Due after 10 years
(i) Time deposits	**¥ 64,986**	**¥ –**	**¥ –**	**¥ –**	¥ 58,169	¥ –	¥ –	¥ –
(ii) Trade notes and accounts receivable	**50,032**	**–**	**–**	**–**	47,046	–	–	–
(iii) Securities and investments in securities:								
Government bonds (national and local)	**–**	**20,064**	**–**	**–**	–	14,351	4,713	–
Trust beneficiary right	**8,300**	**–**	**–**	**–**	5,500	–	–	–
(iv) Long-term loans receivable included in other assets	**1**	**1**	**–**	**20**	1	2	–	48
Total assets	**¥123,319**	**¥20,065**	**¥ –**	**¥20**	¥110,716	¥14,353	¥ 4,713	¥48

17. Financial Instruments (continued)

(b) Estimated Fair Value of Financial Instruments (continued)

(3) The redemption schedules for monetary assets and debt securities with maturity dates as of December 31, 2017 and 2016 were summarized as follows: (continued)

	Thousands of U.S. dollars			
	December 31, 2017			
	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years through 10 years	Due after 10 years
(i) Time deposits	**$ 575,097**	**$ –**	**$ –**	**$ –**
(ii) Trade notes and accounts receivable	**442,761**	**–**	**–**	**–**
(iii) Securities and investments in securities:				
Government bonds (national and local)	**–**	**177,558**	**–**	**–**
Trust beneficiary right	**73,451**	**–**	**–**	**–**
(iv) Long-term loans receivable included in other assets	**10**	**10**	**–**	**177**
Total assets	**$1,091,319**	**$177,568**	**$ –**	**$ 177**

(4) The redemption schedule for lease obligations as of December 31, 2017 is disclosed in Note 10.

18. Derivatives and Hedging Activities

The notional amounts and the estimated fair value of the derivative instruments outstanding as of December 31, 2017 and 2016 were as follows:

(a) Derivatives for which hedge accounting is not applied

There were no derivative transactions which did not qualify for deferral hedge accounting as of December 31, 2017 and 2016.

(b) Derivatives for which hedge accounting is applied

Currency-related transactions

			Millions of yen					
			December 31, 2017			December 31, 2016		
Method of hedge accounting	Description of transaction	Hedged items	Notional amount	Notional amount (over 1 year)	Estimated fair value	Notional amount	Notional amount (over 1 year)	Estimated fair value
Allocation method for forward foreign exchange contracts	Forward foreign exchange contracts Purchase:							
	U.S. dollars	Trade accounts payable	**¥ 387**	**¥ 78**	**¥ 13**	¥ 1,060	¥ 370	¥ 56
	Thai baht	Trade accounts payable	**–**	**–**	**–**	370	–	2
	Total		**¥ 387**	**¥ 78**	**¥ 13**	¥ 1,430	¥ 370	¥ 58

			Thousands of U.S. dollars		
			December 31, 2017		
Method of hedge accounting	Description of transaction	Hedged items	Notional amount	Notional amount (over 1 year)	Estimated fair value
Allocation method for forward foreign exchange contracts	Forward foreign exchange contracts Purchase:				
	U.S. dollars	Trade accounts payable	**$ 3,425**	**$ 690**	**$ 115**
	Thai baht	Trade accounts payable	**–**	**–**	**–**
	Total		**$ 3,425**	**$ 690**	**$ 115**

The fair value of derivatives is based on the prices provided by financial institutions.

19. Amounts per Share

	Yen		U.S. dollars
	December 31, 2017	December 31, 2016	**December 31, 2017**
Profit attributable to owners of parent:			
Basic	**¥ 201.31**	¥ 179.12	**$ 1.78**
Diluted	**201.03**	178.86	**1.78**
Net assets	**1,947.82**	1,818.10	**17.24**
Cash dividends	**58.00**	52.00	**0.51**

The Company implemented a two-for-one common stock split, effective July 1, 2016. Profit attributable to owners of parent per share, diluted profit attributable to owners of parent per share, net assets per share, and cash dividends per share were calculated on the assumption that the relevant stock split had been implemented the beginning of the nine-month period ended December 31, 2016.

Profit attributable to owners of parent per share has been computed based on the profit attributable to owners of parent available for distribution to shareholders of common stock and the weighted-average number of shares of common stock outstanding during the period, and diluted profit attributable to owners of parent has been computed based on profit attributable to owners of parent available for distribution to the shareholders and the weighted average number of shares of common stock outstanding during each of the twelve months ended December 31, 2017 and the nine months ended December 31,2016 after giving effect to the dilutive potential of shares of common stock to be issued upon the exercise of stock acquisition rights.

The amounts per share of net assets have been computed based on the net assets available for distribution to the shareholders of common stock and the number of shares of common stock outstanding at the period end.

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

20. Other Comprehensive Income

Reclassification adjustments and tax effects allocated to each component of other comprehensive income (loss) for the twelve months ended December 31, 2017 and nine months ended December 31, 2016 were as follows:

	(Millions of yen)		*(Thousands of U.S. dollars)*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Unrealized holding gain on securities:			
Amount arising during the period	**¥ 5,460**	¥ 851	**$ 48,319**
Reclassification adjustments for gain included in profit	**(3)**	(8)	**(26)**
Amount before tax effect	**5,457**	843	**48,293**
Tax effect	**(1,671)**	(224)	**(14,789)**
Unrealized holding gain on securities	**3,786**	619	**33,504**
Deferred (loss) gain on hedges:			
Amount arising during the period	**(45)**	114	**(398)**
Amount before tax effect	**(45)**	114	**(398)**
Tax effect	**14**	(35)	**124**
Deferred (loss) gain on hedges	**(31)**	79	**(274)**
Translation adjustments:			
Amount arising during the period	**(277)**	(998)	**(2,451)**
Translation adjustments	**(277)**	(998)	**(2,451)**
Retirement benefit liability adjustments:			
Amount arising during the period	**(211)**	(1,423)	**(1,867)**
Reclassification adjustments for loss included in profit	**403**	208	**3,567**
Amount before tax effect	**192**	(1,215)	**1,700**
Tax effect	**(59)**	372	**(523)**
Retirement benefit liability adjustments	**133**	(843)	**1,177**
Total other comprehensive income (loss)	**¥ 3,611**	¥(1,143)	**$ 31,956**

21. Segment Information

(a) Business Segment Information

(1) Outline of reportable segments

The Company's reportable segments are its structural units, for which separate financial information is available. These segments are subject to periodic review by the Board of Directors in order to assist decision making on the allocation business resources and assessment of business performance.

The Company sets up divisions by product and service under an operational headquarters. Each division formulates comprehensive domestic and overseas strategies for its products and services and conducts business activities according to these strategies.

The Company's segments are classified by product and service on the basis of its operational headquarters. There are three reportable segments, which are the Domestic Consumer Products Business, Overseas Consumer Products Business, and Direct Marketing Business.

The Domestic Consumer Products Business and Overseas Consumer Products Business manufacture and sell healthcare products, household products, skincare products and body warmers. The Direct Marketing Business sells nutritional supplement products and skin care products and similar items.

(2) Calculation methods used for sales, income or loss, assets, and other items on each reportable segment.

The accounting policies of the segments are substantially the same as those described in the significant accounting policies in Note 2. Reportable segment income represents ordinary income, which consists of operating income and nonoperating income/expenses. Inter-segment sales and transfers are recorded at the same prices used in transactions with third parties.

21. Segment Information (continued)

(a) Business Segment Information (continued)

(3) Information as to sales, income or loss, assets, and other items for each reportable segment for the twelve months ended December 31, 2017 and nine months ended December 31, 2016 were as follows:

Millions of yen

	Twelve months ended December 31, 2017							
	Reportable segments							
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Total	Other	Total	Adjustments and eliminations	Consolidated
Net sales								
Sales to third parties	**¥ 123,494**	**¥ 21,768**	**¥10,180**	**¥ 155,442**	**¥ 1,319**	**¥ 156,761**	**¥ –**	**¥ 156,761**
Inter-segment sales and transfers	**6,342**	**1,044**	**–**	**7,386**	**5,243**	**12,629**	**(12,629)**	**–**
Total	**¥ 129,836**	**¥ 22,812**	**¥10,180**	**¥ 162,828**	**¥ 6,562**	**¥ 169,390**	**¥(12,629)**	**¥ 156,761**
Segment income (loss)	**¥ 20,831**	**¥ 829**	**¥ (72)**	**¥ 21,588**	**¥ 3,028**	**¥ 24,616**	**¥ (424)**	**¥ 24,192**
Segment assets	**¥ 79,552**	**¥ 24,435**	**¥ 1,726**	**¥ 105,713**	**¥11,004**	**¥ 116,717**	**¥102,114**	**¥ 218,831**
Other items								
Depreciation and amortization	**¥ 1,914**	**¥ 413**	**¥ 34**	**¥ 2,361**	**¥ 188**	**¥ 2,549**	**¥ 378**	**¥ 2,927**
Amortization of goodwill	**13**	**580**	**–**	**593**	**–**	**593**	**–**	**593**
Interest income	**23**	**41**	**0**	**64**	**299**	**363**	**(90)**	**273**
Interest expense	**42**	**84**	**–**	**126**	**3**	**129**	**(90)**	**39**
Increase in property, plant, and equipment and intangible assets	**2,252**	**574**	**47**	**2,873**	**172**	**3,045**	**316**	**3,361**

Notes:

1. "Other" consisted of business segments that were not included in reportable segments, such as medical devices, transportation, plastic container manufacture and sale, insurance agency, real estate management, and advertisement planning and creation.
2. Details of adjustments and eliminations were as follows:
   (i) Segment loss of ¥ 424 million ($3,753 thousand), posted in adjustment reflects the eliminations of transactions between segments and income and expenses which are not allocable to the reportable segments.
   (ii) Corporate assets included in the adjustments and eliminations of segment assets of ¥ 102,114 million ($903,664 thousand) mainly consisted of extra funds for investment by the parent company (cash and securities), funds for long-term investment (investments in securities), and assets related to administrative departments.
   (iii) Adjustments and eliminations of depreciation and amortization of ¥378 million ($3,345 thousand) were the depreciation and amortization of the corporate assets.

21. Segment Information (continued)

(a) Business Segment Information (continued)

(3) Information as to sales, income or loss, assets, and other items for each reportable segment for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 were as follows: (continued)

(iv) Interest income of ¥90 million ($796 thousand) and interest expense of ¥90 million ($797 thousand) posted as adjustments reflect the elimination of transactions between segments.

(v) Adjustments and eliminations of increase in property, plant, and equipment and intangible assets of ¥316 million ($2,796 thousand) were the increase of the corporate assets.

3. Segment income was adjusted for the ordinary income in the consolidated financial statements.
4. Increase in depreciation, property, plant and equipment and intangible assets included an increase in long-term prepaid expenses and amortization of long-term prepaid expenses.

Millions of yen

	Nine months ended December 31, 2016							
	Reportable segments							
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Total	Other	Total	Adjustments and eliminations	Consolidated
Net sales								
Sales to third parties	¥ 92,955	¥ 18,027	¥ 7,160	¥ 118,142	¥ 1,910	¥ 120,052	¥ –	¥ 120,052
Inter-segment sales and transfers	4,547	948	–	5,495	3,615	9,110	(9,110)	–
Total	¥ 97,502	¥ 18,975	¥ 7,160	¥ 123,637	¥ 5,525	¥ 129,162	¥ (9,110)	¥ 120,052
Segment income	¥ 16,326	¥ 638	¥ (284)	¥ 16,680	¥ 2,810	¥ 19,490	¥ 10	¥ 19,500
Segment assets	¥ 74,096	¥ 24,415	¥ 1,561	¥ 100,072	¥11,559	¥ 111,631	¥ 89,603	¥ 201,234
Other items								
Depreciation and amortization	¥ 1,384	¥ 285	¥ 26	¥ 1,695	¥ 135	¥ 1,830	¥ 283	¥ 2,113
Amortization of goodwill	15	498	–	513	–	513	–	513
Interest income	17	32	–	49	186	235	(50)	185
Interest expense	6	42	0	48	25	73	(51)	22
Equity in loss of an affiliate								
Increase in property, plant, and equipment and intangible assets	2,832	3,119	31	5,982	156	6,138	132	6,270

21. Segment Information (continued)

(a) Business Segment Information (continued)

(3) Information as to sales, income or loss, assets, and other items for each reportable segment for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 were as follows: (continued)

Notes:

1. "Other" consisted of business segments that were not included in reportable segments, such as medical devices, transportation, plastic container manufacture and sale, insurance agency, real estate management, and advertisement planning and creation.
2. Details of adjustments and eliminations were as follows:
   (i) Segment income of ¥10 million, posted in adjustment reflects the eliminations of transactions between segments and income and expenses which are not allocable to the reportable segments.
   (ii) Corporate assets included in the adjustments and eliminations of segment assets of ¥97,972 million mainly consisted of extra funds for investment by the parent company (cash and securities), funds for long-term investment (investments in securities), and assets related to administrative departments.
   (iii) Adjustments and eliminations of depreciation and amortization of ¥283 million were the depreciation and amortization of the corporate assets.

   (iv) Interest income of ¥50 million and interest expense of ¥51 million posted as adjustments reflect the elimination of transactions between segments.
   (v) Adjustments and eliminations of increase in property, plant, and equipment and intangible assets of ¥132 million were the increase of the corporate assets.
3. Segment income was adjusted for the ordinary income in the consolidated financial statements.
4. Increase in depreciation, property, plant and equipment and intangible assets included an increase in long-term prepaid expenses and amortization of long-term prepaid expenses.

21. Segment Information (continued)

(a) Business Segment Information (continued)

(3) Information as to sales, income or loss, assets, and other items for each reportable segment for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 were as follows: (continued)

	Thousands of U.S. dollars							
	Twelve months ended December 31, 2017							
	Reportable segments							
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Total	Other	Total	Adjustments and eliminations	Consolidated
Net sales								
Sales to third parties	**$1,092,867**	**$ 192,637**	**$ 90,088**	**$ 1,375,592**	**$ 11,673**	**$ 1,387,265**	**$ –**	**$ 1,387,265**
Inter-segment sales and transfers	**56,125**	**9,239**	**–**	**65,364**	**46,398**	**111,762**	**(111,762)**	**–**
Total	**$1,148,992**	**$ 201,876**	**$ 90,088**	**$ 1,440,956**	**$ 58,071**	**$ 1,499,027**	**$ (111,762)**	**$ 1,387,265**
Segment income (loss)	**$ 184,345**	**$ 7,336**	**$ (637)**	**$ 191,044**	**$ 26,797**	**$ 217,841**	**$ (3,753)**	**$ 214,088**
Segment assets	**$ 704,000**	**$ 216,239**	**$ 15,274**	**$ 935,513**	**$ 97,381**	**$ 1,032,894**	**$ 903,664**	**$ 1,936,558**
Other items								
Depreciation and amortization	**$ 16,938**	**$ 3,655**	**$ 301**	**$ 20,894**	**$ 1,664**	**$ 22,558**	**$ 3,344**	**$ 25,902**
Amortization of goodwill	**115**	**5,133**	**–**	**5,248**	**–**	**5,248**	**–**	**5,248**
Interest income	**204**	**362**	**0**	**566**	**2,646**	**3,212**	**(796)**	**2,416**
Interest expense	**372**	**743**	**–**	**1,115**	**27**	**1,142**	**(797)**	**345**
Increase in property, plant, and equipment and intangible assets	**19,929**	**5,080**	**416**	**25,425**	**1,522**	**26,947**	**2,796**	**29,743**

21. Segment Information (continued)

(b) Related information

(1) Geographical information

(i) Net sales

	Millions of yen		*Thousands of U.S. dollars*
	Twelve months ended December 31, 2017	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Domestic	**¥ 134,994**	¥ 101,139	**$ 1,194,637**
Overseas	**21,767**	18,913	**192,628**
Total	**¥ 156,761**	¥ 120,052	**$ 1,387,265**

Net sales were categorized by the geographical area of the customers.

(ii) Property, plant and equipment

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2017	December 31, 2016	**December 31, 2017**
Domestic	**¥ 15,131**	¥ 15,069	**$ 133,903**
Overseas	**3,116**	2,765	**27,575**
Total	**¥ 18,247**	¥ 17,834	**$ 161,478**

(2) Information by major customers

	Millions of yen	
	Twelve months ended December 31, 2017	
	Sales	Related segment
PALTAC CORPORATION	**¥ 70,410**	Domestic Consumer Products Business
ARATA CORPORATION	**¥ 17,209**	Domestic Consumer Products Business

	Millions of yen	
	Nine months ended December 31, 2016	
	Sales	Related segment
PALTAC CORPORATION	¥ 52,442	Domestic Consumer Products Business
ARATA CORPORATION	¥ 13,073	Domestic Consumer Products Business

21. Segment Information (continued)

(b) Related information (continued)

(2) Information by major customers (continued)

	Thousands of U.S. dollars	
	Twelve months ended December 31, 2017	
	Sales	Related segment
PALTAC CORPORATION	**$ 623,097**	Domestic Consumer Products Business
ARATA CORPORATION	**$ 152,292**	Domestic Consumer Products Business

(c) Loss on impairment of fixed assets by reportable segment

Information on loss on impairment of fixed assets by reportable segment for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 was as follows:

	Millions of yen					
	Twelve months ended December 31, 2017					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Loss on impairment of fixed assets	**¥ 338**	**¥ 1,206**	**¥ –**	**¥ –**	**¥ –**	**¥ 1,544**

	Millions of yen					
	Nine months ended December 31, 2016					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Loss on impairment of fixed assets	¥ 1,176	¥ 166	¥ –	¥ –	¥ –	¥ 1,342

	Thousands of U.S. dollars					
	Twelve months ended December 31, 2017					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Loss on impairment of fixed assets	**$ 2,991**	**$ 10,673**	**$ –**	**$ –**	**$ –**	**$ 13,664**

21. Segment Information (continued)

(d) Amortization of goodwill and remaining balance of goodwill by reportable segment

Information on amortization of goodwill and the remaining balance of goodwill by reportable segment as of and for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 were as follows:

	Millions of yen					
	Twelve months ended December 31, 2017					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Amortization for the period	**¥13**	**¥ 580**	**¥ –**	**¥ –**	**¥ –**	**¥ 593**
Balance at the end of the period	**–**	**2,626**	**–**	**–**	**–**	**2,626**

	Millions of yen					
	Nine months ended December 31, 2016					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Amortization for the year	¥15	¥ 498	¥ –	¥ –	¥ –	¥ 513
Balance at the end of the year	240	4,490	–	–	–	4,730

	Thousands of U.S. dollars					
	Twelve months ended December 31, 2017					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Amortization for the period	**$115**	**$ 5,133**	**$ –**	**$ –**	**$ –**	**$ 5,248**
Balance at the end of the period	**–**	**23,239**	**–**	**–**	**–**	**23,239**

22. Related Party Transactions

There was no information on related party transactions between Company and related companies to be disclosed for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016, respectively.

Information on related party transactions between the Company and executive directors for the twelve months ended December 31, 2017 and the nine months ended December 31, 2016 was as follows:

		Millions of yen		*Thousands of U.S. dollars*
Name	Details of transaction	**Twelve months ended December 31, 2017**	Nine months ended December 31, 2016	**Twelve months ended December 31, 2017**
Kazumasa Kobayashi	Exercise of stock acquisition rights	**¥ 12**	¥ 12	**$ 106**
Yutaka Kobayashi	Exercise of stock acquisition rights	**12**	–	**106**
Akihiro Kobayashi	Exercise of stock acquisition rights	**67**	–	**593**
Takashi Tsujino	Exercise of stock acquisition rights	**12**	–	**106**

Kazumasa Kobayashi directly owned 0.26%, Yutaka Kobayashi directly owned 0.21%, Akihiro Kobayashi directly owned 11.73%, and Takashi Tsujino directly owned 0.03% of shares of the Company, respectively, as of December 31, 2017.

23. Business Combination

Business combination through acquisition

Finalization of provisional accounting treatment

The Company provisionally accounted for the business combination through acquisition of Berlin Industries, Inc. and Perfecta Products during the nine months ended December 31, 2016. Purchase price allocation has been completed during the twelve months ended December 31, 2017, and there was no adjustment to the amount of goodwill.

Notes to Consolidated Financial Statements (continued)

24. Subsequent Events

Appropriation of retained earnings

The following appropriation of retained earnings of the Company, which has not been reflected in the consolidated financial statements for the twelve months ended December 31, 2017, was approved at the Board of Directors' meeting held on February 22, 2018:

	Millions of yen	*Thousands of U.S. dollars*
Cash dividends (¥30.00 = $0.27 per share)	**¥ 2,368**	**$ 20,956**

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Independent Auditor's Report

The Board of Directors
KOBAYASHI PHARMACEUTICAL CO., LTD.

We have audited the accompanying consolidated financial statements of KOBAYASHI PHARMACEUTICAL CO., LTD. and its consolidated subsidiaries, which comprise the consolidated balance sheet as at December 31, 2017, and the consolidated statements of income, comprehensive income, changes in net assets, and cash flows for the twelve months then ended and a summary of significant accounting policies and other explanatory information, all expressed in Japanese yen.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Japan, and for designing and operating such internal control as management determines is necessary to enable the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. The purpose of an audit of the consolidated financial statements is not to express an opinion on the effectiveness of the entity's internal control, but in making these risk assessments the auditor considers internal controls relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of KOBAYASHI PHARMACEUTICAL CO., LTD. and its consolidated subsidiaries as at December 31, 2017, and their consolidated financial performance and cash flows for the twelve months then ended in conformity with accounting principles generally accepted in Japan.

Convenience Translation

We have reviewed the translation of these consolidated financial statements into U.S. dollars, presented for the convenience of readers, and, in our opinion, the accompanying consolidated financial statements have been properly translated on the basis described in Note 1.

Ernst & Young ShinNihon LLC

March 29, 2018
Osaka, Japan

Our History

1886	Founder Chubei Kobayashi established Kobayashi Seidaido, an unlimited partnership company, in Monzen-cho, Naka-ku, Nagoya The Company sold general merchandise and cosmetics
1894	Launched 10 types of proprietary pharmaceuticals including *Daikomaru, Ichinichimaru* and *Tamushichinki*
1912	Established Kobayashi Daiyakubou, a limited partnership company, in Hiranomachi, Higashi-ku, Osaka
1919	Incorporated as Kobayashi Daiyakubou, Co., Ltd. in Kyomachibori, Nishi-ku, Osaka through a merger involving unlimited partnership company Kobayashi Seidaido and limited partnership company Kobayashi Daiyakubou Kichitaro Kobayashi is appointed as the first president
1939	Launched *Hakkiri*, a headache medicine
1940	Spun off the manufacturing division of Kobayashi Daiyakubou, to establish Kobayashi Pharmaceutical Co., Ltd. Juso Plant began operations in Higashi-yodogawa-ku, Osaka (currently Yodogawa-ku)
1948	Saburo Kobayashi is appointed as the second president
1956	Kobayashi Daiyakubou Co., Ltd. and Kobayashi Pharmaceutical Co., Ltd. were merged and renamed Kobayashi Pharmaceutical Co., Ltd. Relocated the Head Office to Dosho-machi, Higashi-ku, Osaka (currently Dosho-machi, Chuo-ku)
1958	Teruko Kobayashi is appointed as the third president
1966	Launched *Ammeltz*, a topical anti-inflammatory
1969	Launched *Bluelet*, a toilet bowl cleaner and freshener, and entered household products market
1972	Formed partnership with C.R. Bard, Inc. of the U.S. to establish medical devices importer Japan Medico, Inc. and enter the medical devices market
1975	Launched *Sawaday*, a toilet air freshener, and entered the deodorizing air fresheners market
1976	Kazumasa Kobayashi is appointed as the fourth president Japan Medico, Inc. became Medicon, Inc., a joint venture company with C.R. Bard, Inc.
1983	Established Toyama Kobayashi Pharmaceutical Co., Ltd. (Toyama City, Toyama Prefecture)
1988	Angel Ltd. was made a consolidated subsidiary of Kobayashi Pharmaceutical Co., Ltd. to acquire a manufacturing site (Niihama City, Ehime Prefecture)
1992	Established Kobayashi Medical as part of the Medical Devices Business
1993	Established Sendai Kobayashi Pharmaceutical Co., Ltd. (Kurokawa-gun, Miyagi Prefecture)
1996	Launched *Toughdent*, a denture cleanser
1998	Established Shanghai Kobayashi Friendship Daily Chemicals Co., Ltd., a joint venture company in China Established Kobayashi Healthcare, Inc. in the U.S.
1999	Listed on the Second Section of the Osaka Securities Exchange Launched mail order sales of nutritional supplements, marking the start of the Direct Marketing Business
2000	Listed on the First Section of the Tokyo Stock Exchange and Osaka Securities Exchange Established the Central R&D Laboratory in Ibaraki City, Osaka Prefecture Spun off the trade division to form Kobashou Co., Ltd.
2001	Made Kiribai Chemical Co., Ltd., a body warmer manufacturer, a subsidiary (Yodogawa-ku, Osaka) Established Kobayashi Healthcare Europe, Ltd. in the U.K.
2002	Established Kobayashi Pharmaceutical (Hong Kong) Co., Ltd. in Hong Kong Made Shanghai Kobayashi Friendship Daily Chemicals Co., Ltd. a wholly owned subsidiary and changed its name to Shanghai Kobayashi Daily Chemicals Co., Ltd. Took over the health food business, mainly for *Tochucha* (eucommia leaf tea), from Hitachi Zosen Corporation
2003	Angel Ltd. renamed Ehime Kobayashi Pharmaceutical Co., Ltd.
2004	Yutaka Kobayashi is appointed as the fifth president
2005	Obtained exclusive sales rights for women's health medicine *Inochi no Haha A* from Sasaokayakuhin Corporation
2006	Made eVent Medical Ltd., a medical device manufacturer in Ireland, a subsidiary Made HeatMax, Inc., a body warmer manufacturer in the U.S., a subsidiary
2008	Kobashou Co., Ltd. and Mediceo Paltac Holdings Co., Ltd. conducted share exchange Spun off the manufacturing division of Kiribai Chemical Co., Ltd. to establish Kiribai Kobayashi Pharmaceutical Co., Ltd. Obtained trademark rights for *Bisrat Gold* from Ishihara Chemical Co., Ltd.
2009	Established Kobayashi Pharmaceutical (Singapore) Pte. Ltd. in Singapore
2010	Spun off the medical device division into Kobayashi Medical Co., Ltd.
2011	Transferred all eVent Medical Ltd. shares in a management buy-out Established Kobayashi Healthcare (Malaysia) Sdn. Bhd. in Malaysia Established Kobayashi Pharmaceutical (Taiwan) Co., Ltd. in Taiwan
2012	Made Grabber, Inc., a body warmer manufacturer in the U.S., a subsidiary Established PT. Kobayashi Pharmaceutical Indonesia in Indonesia Established Hefei Kobayashi Daily Products Co., Ltd. in China Sold 80 percent of Kobayashi Medical Co., Ltd. (currently Japan Medicalnext Co., Ltd.) shares to Mitsubishi Corporation
2013	Made Rokuyo Pharmaceutical Co., Ltd., a manufacturer of pharmaceutical products, quasi-pharmaceutical products and cosmetics, a subsidiary Established Kobayashi Healthcare Australia Pty., Ltd. in Australia Transferred all Japan Medicalnext Co., Ltd. shares to Mitsubishi Corporation Established Hefei Kobayashi Pharmaceutical Co., Ltd. in China Akihiro Kobayashi is appointed as the sixth president Established Kobayashi Healthcare (Thailand) Co., Ltd. in Thailand Made Juju Cosmetics Co., Ltd., a cosmetics manufacturer, into a subsidiary
2015	Acquired *Ganyaku Hitifuku* brand from Hitifuku Inc. Dissolved the joint venture with U.S. company Bard International Inc. and sold all its shares to Medicon, Inc.
2016	Acquired monascus purpureus business from Gunze Limited Made Perfecta Products, Inc., a company engaged in the planning and sale of OTC pharmaceuticals and cosmetics in the U.S., a subsidiary
2017	Acquired exclusive marketing rights in Japan for *Bioil* from Union-Swiss (Pty) Ltd. (headquartered in South Africa)

Corporate Data / Investor Information (As of December 31, 2017)

Corporate Data

Corporate Name	KOBAYASHI PHARMACEUTICAL CO., LTD.
Incorporated	August 22, 1919
Head Office	KDX Kobayashi Doshomachi Bldg., 4-4-10 Doshomachi, Chuo-ku, Osaka 541-0045, Japan
Representative Director	Akihiro Kobayashi, President and Chief Operating Officer
Employees	3,033 (consolidated) 1,267 (non-consolidated)
Consolidated Subsidiaries	38 (18 domestic, 20 overseas)

Investor Information

Common Stock	¥3,450 million
Shares Authorized	340,200,000
Shares Issued	82,050,000
Shareholders	15,863
Stock Exchange Listing	Tokyo Stock Exchange First Section
Transfer Agent / Account Management Institution for Special Accounts	Mitsubishi UFJ Trust and Banking Corporation

Group Companies

● Domestic Consumer Products Business ● Overseas Consumer Products Business ● Other Business

Consolidated Subsidiaries (Domestic)

- Toyama Kobayashi Pharmaceutical Co., Ltd.
- Sendai Kobayashi Pharmaceutical Co., Ltd.
- Ehime Kobayashi Pharmaceutical Co., Ltd.
- Kiribai Chemical Co., Ltd.
- Kiribai Kobayashi Pharmaceutical Co., Ltd.
- Juju Cosmetics Co., Ltd.
- Aloe Pharmaceutical Co., Ltd.
- Kobayashi Pharmaceutical Plax Co., Ltd.
- SP-Planning, Inc.
- Archer Corporation
- Suehiro Sangyo Co., Ltd.
- Kobayashi Pharmaceutical Life Service Co., Ltd.
- Kobayashi Pharmaceutical Distribution Co., Ltd.
- Kobayashi Pharmaceutical Value Support Co., Ltd.
- Kobayashi Pharmaceutical Global E-commerce Co., Ltd.
- Kobayashi Pharmaceuticals of America, Inc.
- Kobayashi Pharmaceutical Sales Promotion Co., Ltd.
- Kobayashi Pharmaceutical Challenged Co., Ltd.

Consolidated Subsidiaries (Overseas)

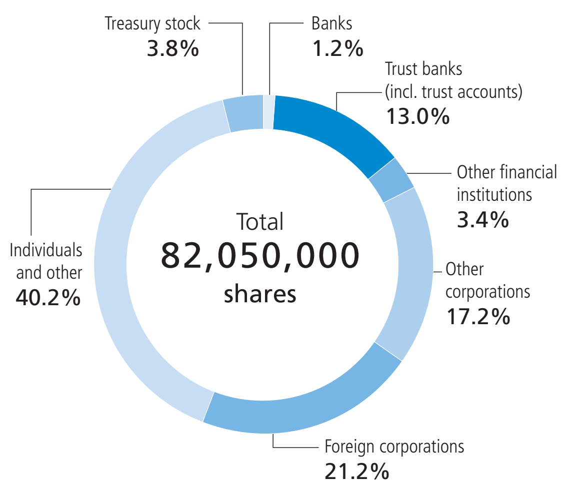
- Kobayashi Healthcare, LLC
- Kobayashi Healthcare Europe, Ltd.
- Shanghai Kobayashi Daily Chemicals Co., Ltd.
- Hefei Kobayashi Daily Products Co., Ltd.
- Hefei Kobayashi Pharmaceutical Co., Ltd.
- Shanghai Kobayashi Pharmaceutical Business Co., Ltd.
- Kobayashi Pharmaceutical (Hong Kong) Co., Ltd.
- Kobayashi Pharmaceutical (Singapore) Pte. Ltd.
- Kobayashi Pharmaceutical (Taiwan) Co., Ltd.
- Kobayashi Healthcare (Malaysia) Sdn. Bhd.
- PT. Kobayashi Pharmaceutical Indonesia
- Kobayashi Healthcare Australia Pty., Ltd.
- Kobayashi Healthcare (Thailand) Co., Ltd.
- Kobayashi Healthcare International Inc.
- Kobayashi Consumer Products LLC
- Kobayashi America Manufacturing LLC
- Grabber, Inc.
- Mediheat, Inc.
- Berlin Industries, Inc.
- Perfecta Products, Inc.

Major Shareholders

Name	Percentage of Total Shares Held (%)
Akihiro Kobayashi	11.3
Kobayashi International Scholarship Foundation	7.3
Yukako Iue	6.3
State Street Bank and Trust Company 505223	6.1
Ikuko Watanabe	3.0
Japan Trustee Services Bank, Ltd. (trust account)	2.9
The Master Trust Bank of Japan, Ltd. (trust account)	2.7
Ohtori Co., Ltd.	2.7
Forum Co., Ltd.	2.5
Teruhisa Miyata	2.5

Note: The Company holds treasury stock, but is excluded from the above list of major shareholders.

Shareholder Composition



KOBAYASHI Pharm. Co., Ltd.

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