KOBAYASHI Pharmaceutical Co., Ltd.

Annual Report 2016.12

Fiscal Period Ended December 31, 2016

あったらいいな®

をカタチにする

Creativity and Innovation

あったらいいな® 100th

"You Make a Wish and We Make it Happen"

Guided by the brand slogan, "You Make a Wish and We Make it Happen," the Kobayashi Pharmaceutical Group supplies pharmaceuticals, oral care products, nutritional supplements, deodorizing air fresheners, household products and a wide range of other items.

Kobayashi Pharmaceutical is marking its 100th anniversary in 2017. We would like to thank all our stakeholders for their support in reaching this major milestone.

Eyebon

Breath Care

Netsusama Sheet

Ekitai Bluelet Okudake

Oheya no Shoshugen

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Forward-looking Statements

Plans, strategies, beliefs and other statements concerning future business operations of the Kobayashi Pharmaceutical Group included in this annual report are forward-looking statements based not on historical facts but on management's assumptions and beliefs in light of information currently available.

These forward-looking statements include risks, known and unknown, and uncertainties. Actual management achievements and business results may therefore differ significantly from forecasts in this annual report.

Kobayashi Pharmaceutical in Numbers

Net sales
¥120.1 billion

Operating income
¥17.4 billion

Operating income to net sales ratio
14.5%

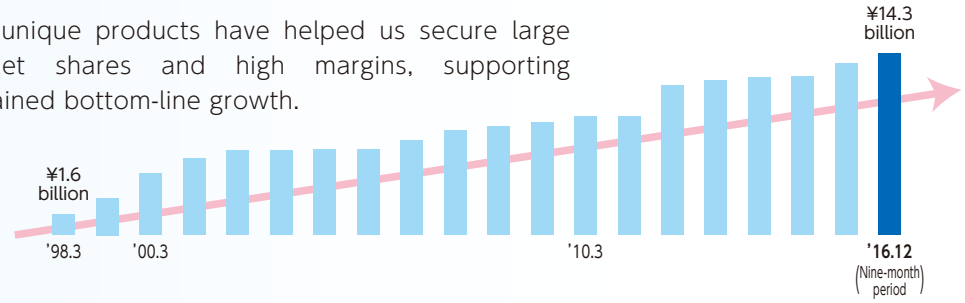
*Results for fiscal 2016.12 (Nine-month transitional fiscal period)

We have secured large market shares and achieved high margins by developing unique products and creating new markets, guided by our brand slogan, "You Make a Wish and We Make it Happen."

More details on pages **6, 11, 25**

19
straight years of profit growth

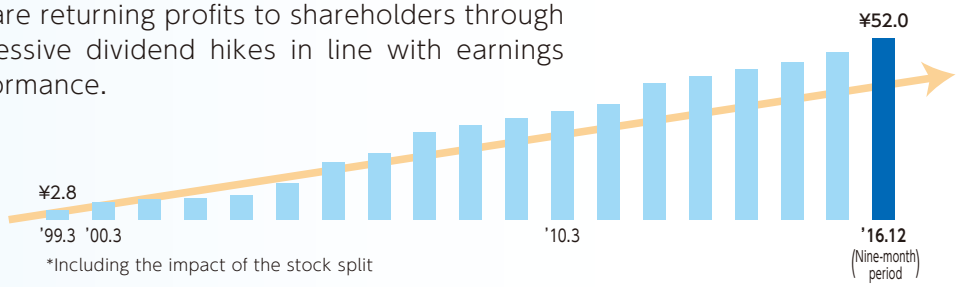
Our unique products have helped us secure large market shares and high margins, supporting sustained bottom-line growth.



More details on pages **5, 7**

18
successive years of dividend hikes

We are returning profits to shareholders through successive dividend hikes in line with earnings performance.



*Including the impact of the stock split

More details on pages **5, 7, 29**

100
years in business
あったらいいな! 100th

Kobayashi Pharmaceutical will celebrate its centenary in 2017. We have achieved sustained growth by adapting our business and management structure to the changing times.

Founder
Chubei Kobayashi

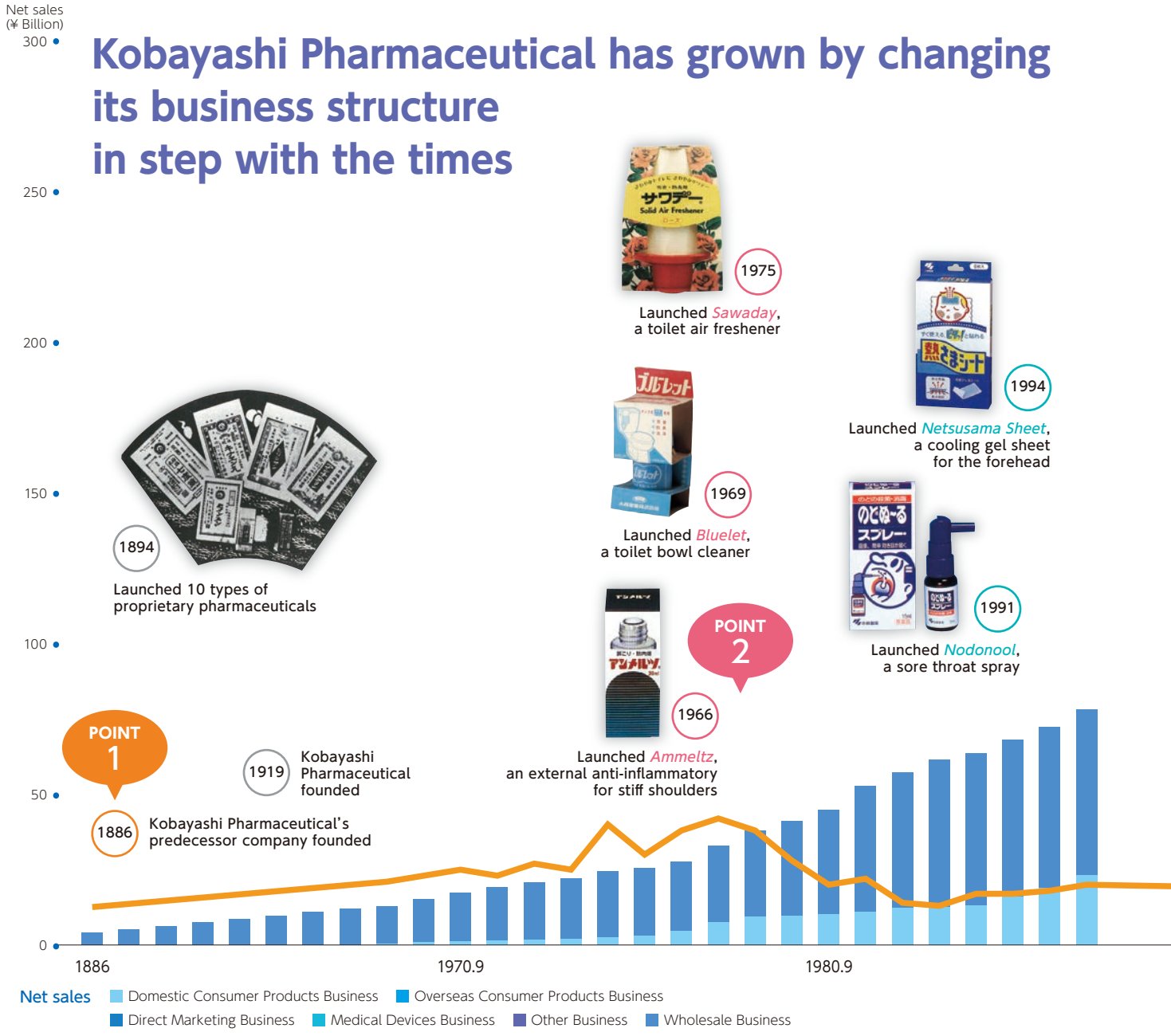
Products from our founding era

First business premises

More details on pages **3, 63**

Net sales / operating income to net sales ratio

Kobayashi Pharmaceutical has grown by changing its business structure in step with the times

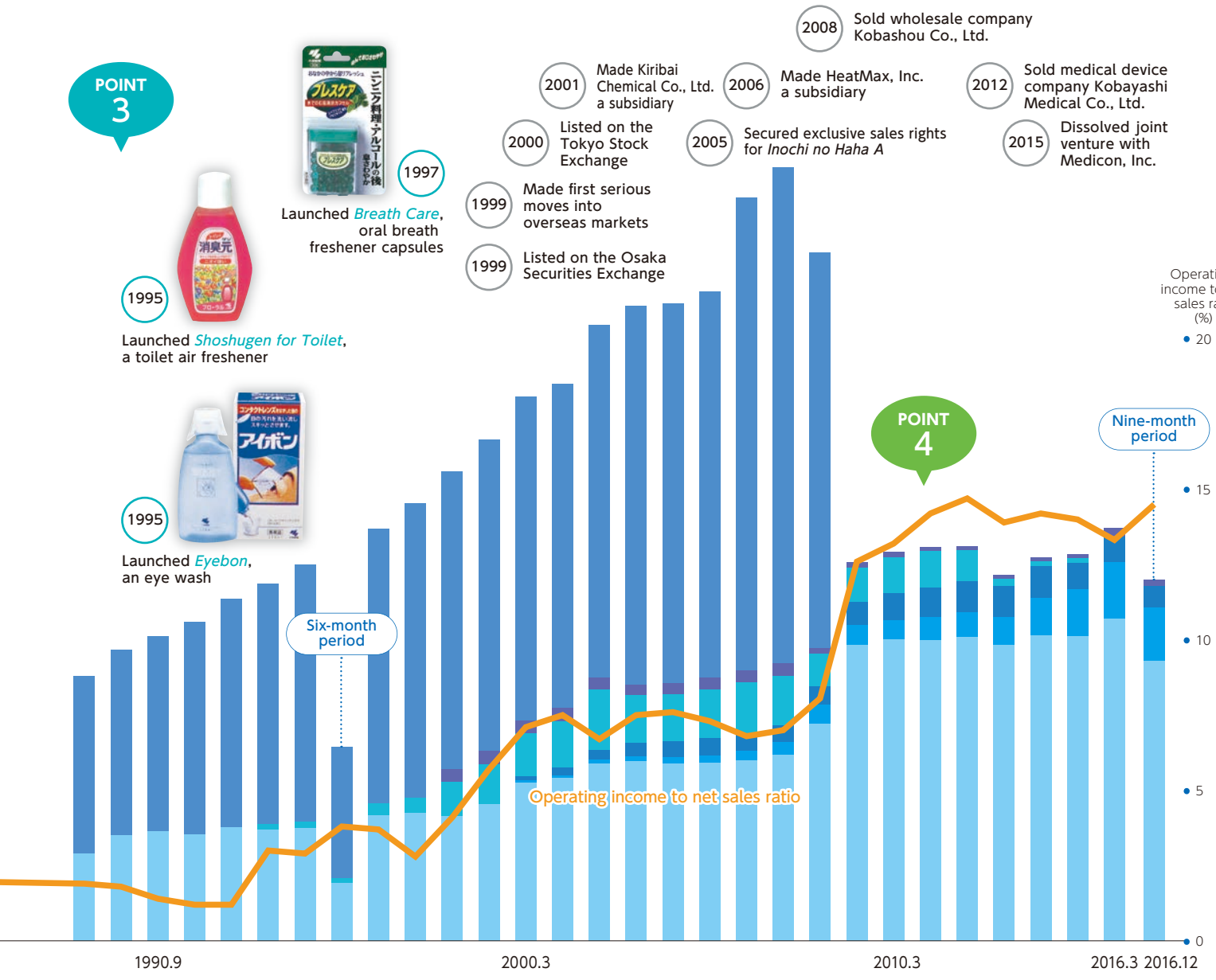


POINT 1 Started operations as a wholesaler

Kobayashi Pharmaceutical was founded to sell general merchandise and cosmetics. Seeing opportunities in the pharmaceutical sector, the Company reinforced its business by moving into drug wholesaling.

POINT 2 Transformation into a manufacturer

The Company's era as a manufacturer began with the launch of *Ammeltz*, *Bluelet* and *Sawaday*, which are still core brands today.



*Photos show product packaging at the time of launch.
*Fiscal 1995.3 was a six-month transitional period due to a change in fiscal year-end.
*Fiscal 2016.12 was a nine-month transitional period due to a change in fiscal year-end.

POINT 3 Sales growth as a manufacturer

The Company subsequently launched *Nodonool*, *Netsusama Sheet*, *Shoshugen*, *Eyebon* and *Breath Care*, brands that continue to support earnings to this day. At this point, sales growth is being driven by the manufacturing business. The first serious moves are made into overseas markets.

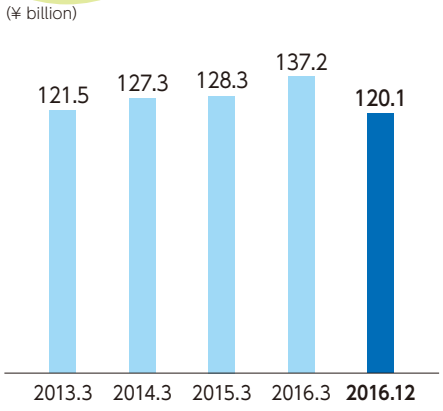
POINT 4 Targeted management resources on strategic business fields

The Company exits its original business of wholesaling to concentrate management resources on manufacturing operations, which offer greater growth potential. This strategic refocus leads to a large improvement in the operating income to net sales ratio. M&A strategy is also stepped up.

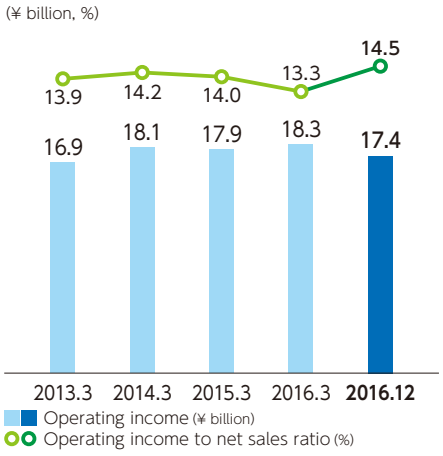
Financial Highlights

*Year-on-year changes have been omitted, as the fiscal period ended December 31, 2016 was a transitional period due to a change in fiscal year-end.

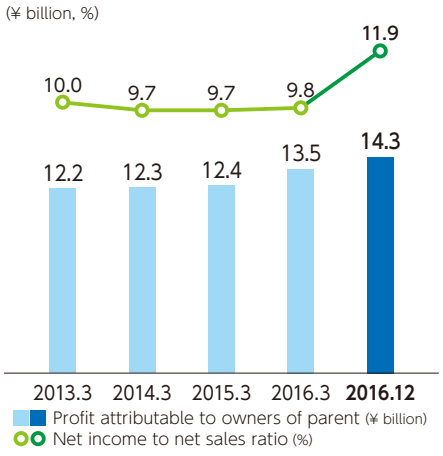
Net Sales



Operating Income Operating Income to Net Sales Ratio

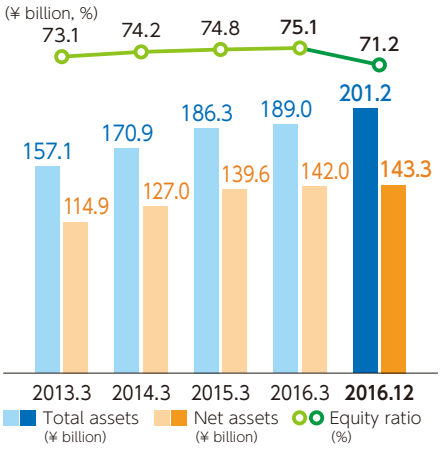


Profit Attributable to Owners of Parent Net Income to Net Sales Ratio

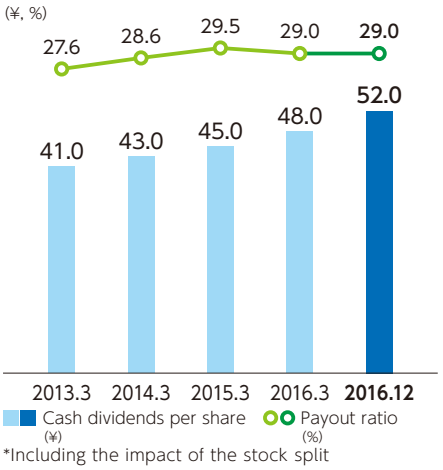


	2008.3	2009.3	2010.3	2011.3	2012.3
For the year			Millions of yen		
Net sales	228,826	125,693	129,184	130,824	131,167
Cost of sales	147,638	57,013	57,295	56,184	54,636
Gross profit	81,187	68,679	71,889	74,640	76,531
Selling, general and administrative expenses	62,611	52,861	54,848	56,019	57,233
Operating income	18,576	15,818	17,041	18,621	19,298
Profit before income taxes	15,800	16,270	14,553	13,178	19,822
Profit attributable to owners of parent	8,504	8,853	9,250	9,336	11,726
Cash flows from operating activities	12,192	12,849	15,319	13,168	17,250
Free cash flows*1	5,767	11,467	10,618	4,789	14,321
Depreciation and amortization	3,765	4,214	4,257	4,155	3,232
Capital expenditures*2	2,895	3,468	3,562	2,347	2,213
Research and development costs	2,813	3,361	3,962	4,069	4,386
At year-end			Millions of yen		
Current assets	66,069	73,172	85,209	88,837	102,538
Property, plant and equipment, net	15,236	17,618	14,779	14,156	13,628
Current liabilities	37,940	39,834	39,025	34,525	37,791
Long-term liabilities	7,286	9,011	8,344	8,488	8,221
Net assets	77,182	76,364	84,603	91,343	101,879
Total assets	122,409	125,210	131,972	134,356	147,890
Working capital*3	28,128	33,337	46,184	54,312	64,747
Interest-bearing debt	726	645	1,708	26	5
Per share data*4			Yen		
Net income	102.81	107.95	112.94	113.99	143.18
Cash dividends	27.00	29.00	31.00	33.00	39.00
Payout ratio (%)	26.3	26.9	27.4	28.9	27.2
Cash flows*5	143.4	151.1	180.2	154.9	202.9
Net assets	931.62	930.57	1,030.90	1,113.21	1,242.04
Financial ratios			%		
Gross profit to net sales ratio	35.5	54.6	55.6	57.1	58.3
Operating income to net sales ratio	8.1	12.6	13.2	14.2	14.7
Net income to net sales ratio	3.7	7.0	7.2	7.1	8.9
Current ratio	174.1	183.7	218.3	257.3	271.3
ROA	10.9	12.4	13.3	14.3	14.2
ROE	11.2	11.5	11.5	10.6	12.2
Equity ratio	63.0	60.9	64.0	67.9	68.8
Debt-equity ratio (times)*6	0.01	0.01	0.02	0.0003	0.00005
PER (times)*7	18.7	15.1	17.0	16.9	14.5

Total Assets / Net Assets / Equity Ratio

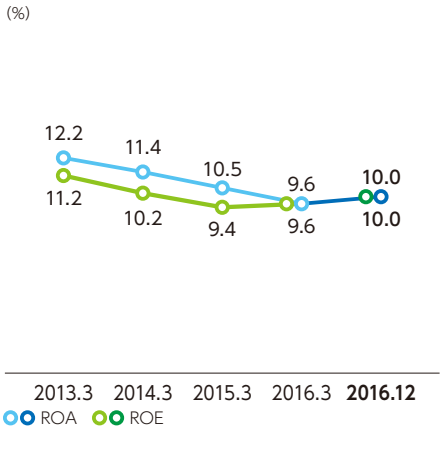


Cash Dividends per Share / Payout Ratio



*Including the impact of the stock split

ROA / ROE



2013.3	2014.3	2015.3	2016.3	2016.12	2016.12
		Millions of yen			Thousands of U.S. dollars*8
121,532	127,294	128,345	137,211	120,052	1,030,578
51,732	54,194	54,719	57,518	48,639	417,538
69,800	73,100	73,626	79,693	71,413	613,040
52,896	54,977	55,709	61,433	54,003	463,585
16,904	18,123	17,917	18,260	17,410	149,455
18,854	19,667	20,057	18,755	19,802	169,989
12,177	12,307	12,449	13,466	14,322	122,946
9,243	13,513	15,445	14,329	16,098	138,192
(17,363)	6,554	10,905	3,396	15,578	133,728
2,970	3,097	3,095	3,072	2,626	22,543
3,174	4,003	3,656	4,318	6,270	53,824
4,545	4,930	5,289	5,789	4,122	35,385
		Millions of yen			Thousands of U.S. dollars*8
94,354	105,615	115,991	120,347	128,647	1,104,361
13,730	14,945	16,023	17,187	17,834	153,095
34,477	34,217	35,891	36,482	46,976	403,262
7,757	9,749	10,829	10,493	10,938	93,897
114,873	126,953	139,611	142,023	143,320	1,230,320
157,107	170,919	186,331	188,998	201,234	1,727,479
59,876	71,398	80,100	83,865	81,671	701,099
4	6	41	181	192	1,648
		Yen			U.S. dollars*8
148.69	150.28	152.73	165.56	179.12	1.54
41.00	43.00	45.00	48.00	52.00	0.45
27.6	28.6	29.5	29.0	29.0	
108.7	158.9	181.6	168.5	189.3	1.63
1,402.64	1,549.16	1,711.77	1,766.06	1,818.10	15.61
		%			
57.4	57.4	57.4	58.1	59.5	
13.9	14.2	14.0	13.3	14.5	
10.0	9.7	9.7	9.8	11.9	
273.7	308.7	323.2	329.9	273.9	
12.2	11.4	10.5	9.6	10.0	
11.2	10.2	9.4	9.6	10.0	
73.1	74.2	74.8	75.1	71.2	
0.00004	0.00005	0.00029	0.00127	0.00134	
15.3	19.8	28.2	29.8	27.9	

*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 the impact of the 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
*8 Japanese yen amounts have been converted into US dollars, for convenience only, at the rate of ¥116.49 / US$1.00 on December 31, 2016.

Targeting "growth with real strength" by improving our ability to develop and cultivate new products

Representative Director,
President and Chief Operating Officer
Akihiro Kobayashi

Results for the Fiscal 2016.12

Record profits and the 19th straight year of bottom-line growth

In the fiscal period ended December 31, 2016, net sales rose a strong 6.8% year on year*1, supported by solid sales of new products, firm sales of existing products on the back of heavy investment in advertising, and strong inbound demand from overseas visitors to Japan.

Although the fiscal period under review was a nine-month transitional period due to a change in fiscal year-end, profit attributable to owners of parent exceeded the level in the previous 12-month period, resulting in record profits and the 19th consecutive period of bottom-line growth.

In line with our commitment to increasing shareholder returns, we raised the dividend per share to ¥52.00, up ¥4.00 year on year, marking the 18th consecutive period of dividend hikes*2.

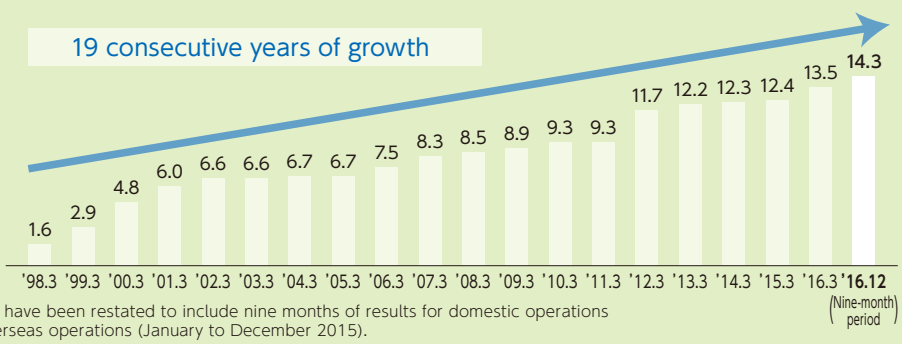
*1: Due to a change in fiscal year-end, the fiscal period ended December 31, 2016 is a transitional period comprising nine months of results for domestic operations (April to December 2016) and 12 months of results for overseas operations (January to December 2016). To facilitate year-on-year comparison, results for the previous fiscal year, ended March 31, 2016, have been restated to include nine months of results for domestic operations (April to December 2015) and 12 months of results for overseas operations (January to December 2015).

*2: Including the impact of the stock split in the period under review.

■ **Fiscal 2016.12 Results** (Billions of yen)

	Fiscal 2016.12	YoY change*
Net Sales	¥120.1	+6.8%
Operating Income	17.4	+1.1%
Profit attributable to owners of parent	14.3	+12.2%

■ **Profit Attributable to Owners of Parent** (Billions of yen)



* Results for the previous fiscal year, ended March 31, 2016, have been restated to include nine months of results for domestic operations (April to December 2015) and 12 months of results for overseas operations (January to December 2015).

Medium-term Management Plan (2017-2019)
(Announced November 1, 2016)

Theme:

"Growth with real strength"

Future goals:

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

Targets (Billions of yen)

	Fiscal 2019 targets	Vs 2016*
Net Sales	¥165	+14%
Operating Income	23	+25%
Profit attributable to owners of parent	17	+13%
ROE	More than 10%	—

*Based on results for Jan-Dec 2016

Sales have grown strongly in the last two years, underpinned by firm sales of new products. However, sales have also been supported by inbound demand. The real test for us now is whether we can maintain our recent growth, even if inbound demand slows. Under our current medium-term management plan, which is based on the theme "growth with real strength," we are targeting a high rate of growth by improving our ability to develop and cultivate new products.

Outline of strategies

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**

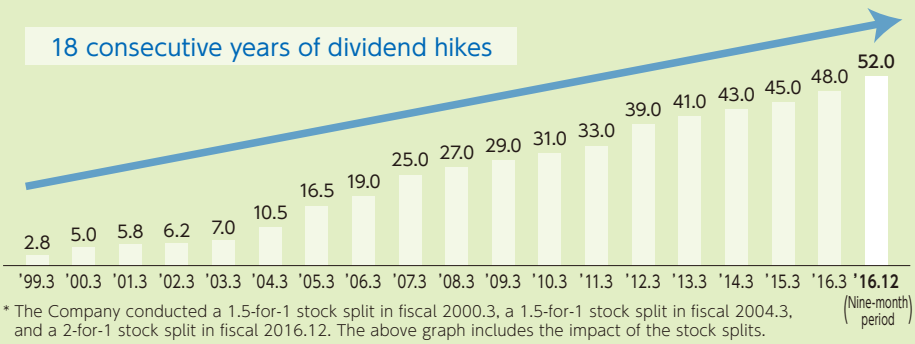
We aim to significantly grow sales by investing heavily in four growth businesses – overseas, direct marketing, skincare and Kampo. We will also work to deliver robust growth in domestic operations by reinforcing our ability to develop and cultivate products that create new markets.

Also, we intend to accelerate growth, supported by investment in the Group's future in areas such as M&A and research and development. The whole Group will work towards the goals in the current medium-term management plan, aiming to achieve "growth with real strength."

Fiscal 2017, the Company's 100th fiscal year, is the first year of the medium-term management plan. We will work towards our targets in the plan's first year, aiming for sales and profit growth and the 20th consecutive period of bottom-line growth.

I would like to take this opportunity to thank all our shareholders for their support and understanding. I hope we can continue to count on your support in the years ahead.

Dividends (Yen)



* The Company conducted a 1.5-for-1 stock split in fiscal 2000.3, a 1.5-for-1 stock split in fiscal 2004.3, and a 2-for-1 stock split in fiscal 2016.12. The above graph includes the impact of the stock splits.

Fiscal 2017 Targets (Billions of yen)

	Fiscal 2017	YoY change*
Net Sales	¥150.0	+3.6%
Operating Income	20.0	+8.4%
Profit attributable to owners of parent	15.1	+0.5%

* Results for the fiscal period under review, ended December 31, 2016, have been restated to 12 months of results for both domestic and overseas operations (January to December 2016).

Theme

Growth with real strength

Under the plan, we aim to 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.

Numerical Targets

	Fiscal 2019 targets	Versus 2016*
Net sales	¥165 billion	+14%
Operating income	¥23 billion	+25%
Profit attributable to owners of parent	¥17 billion	+13%
ROE	More than 10%	—

*Based on results for Jan-Dec 2016

Key Strategies

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**

Develop and cultivate products that create new markets

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.” In recent years, we have been focusing on cultivating new products after development is completed. By enhancing our ability to develop and cultivate new products, we aim to create new markets that are capable of supporting sales and profits five to ten years from launch.

Strategic launch products (Promising new products)

Strategic launch products

Use the resources of the whole Group to cultivate strategic launch products

- Developing in-store sales areas
- Rolling out sales campaigns
- Advertising heavily on TV
- Improving products and reducing costs

etc.

Create new markets

Products that have created new markets

Promote four growth businesses

Overseas business

Fiscal 2019 target	¥27 billion
Versus 2016*	+50%

Reinforce OTC pharmaceuticals

Establish a business base to sell OTC pharmaceuticals in North America, China and other parts of Asia

September 2016

Acquired Perfecta Products, Inc., a U.S. company involved in the planning and sale of OTC pharmaceuticals and cosmetics

Eyebon eyewash is selling well in South Korea

Direct marketing business

Fiscal 2019 target	¥12 billion
Versus 2016*	+26%

Develop brands

Develop brands using a mix of direct marketing and in-store sales channels

Sarashia

Use scientific and PR approaches to build trust in brands

Implement sales campaigns that combine TV, in-store and online advertising

Develop major new products

Attract new customers

Skincare business

Fiscal 2019 target	¥9 billion
Versus 2016*	+67%

Develop a third major brand

Develop another brand in the skincare business to complement the existing *Keshimin* and *Eaude Muge* brands

Keshimin skincare series to prevent skin blemishes

Eaude Muge medicated lotion to prevent skin disorders and spots

Kampo business

Fiscal 2019 target	¥12.5 billion
Versus 2016*	+13%

Make products easier to understand

Develop Kampo (Chinese herbal medicine) products that are easier to understand to help customers choose the best products for their condition and symptoms

Efficacy of medicine is unclear to consumers

Kampo name ***Seihaito***

Easy-to-understand packaging and product names

*Based on results for Jan-Dec 2016

Invest in growth for the future

	Target areas	Investment budget
M&As	**Overseas**: Establish a business base to sell OTC pharmaceuticals in China and other parts of Asia **Japan**: Invest in pharmaceuticals, skincare products, health food products and household products	¥30 billion
R&D New businesses	Focus on key themes of immunity ingredients, fermentation technology, natural product science, new OTC pharmaceuticals Develop new highly functional healthcare products and new products based on innovative technologies	¥3 billion

A Big Fish in a Small Pond

We identify hidden ponds (markets) and then grow them so they are big enough for large fish (sales). This allows us to secure high market shares and high profit margins.

New product concepts

Competition is severe in ponds where everyone comes to fish

We identify undiscovered ponds (markets)

Speed

We beat other competitors to the market

Small ponds are good when nobody else is fishing

Easy to understand

We grow the ponds so they are big enough for large fish (sales)

Idea Meetings

A venue for product development teams to present and thoroughly discuss new product ideas with the President

every month

Rapid commercialization through parallel product development, research and production preparation

Average time for product development:

13 months
(excluding OTC pharmaceuticals)

Product name and packaging designs help consumers know straight away what the product does

Clearly communicate product concept in 15-second TV commercials

The Big Fish in Small Pond strategy helps us secure large market shares

Eye wash

Women's health medicine

Deodorizing air freshener

Toilet bowl cleaner

Cooling gel sheet for the forehead

*Domestic market share (Kobayashi Pharmaceutical data)
*Fiscal 2016.12

Domestic Consumer Products Business

A portfolio of around 130 brands in 4 categories: healthcare products, household products, skincare products and body warmers.

Fiscal 2016.12 Results

Net Sales

¥93.0 billion

+9.6% (YoY change*)

Operating Income

¥16.5 billion

+5.7% (YoY change*)

Sales by Category and Reasons for Change in Sales

	Fiscal 2016.12 net sales	Key factors
Healthcare products	¥42.2 billion (+12.9% YoY*)	Strong demand for new products, OTC pharmaceuticals (including Kampo and herbal medicines) and nutritional supplements and rising inbound demand
Household products	¥41.0 billion (+4.3% YoY*)	Firm sales of new products and deodorizers and support from inbound demand
Skincare products	¥4.2 billion (+21.9% YoY*)	Robust demand for mainstay brands *Keshimin* and *Eaude Muge*
Body warmers	¥5.5 billion (+18.1% YoY*)	Sales recovered due to a decline in product returns and other factors

* Due to a change in fiscal year-end, the fiscal period ended December 31, 2016 is a transitional period comprising nine months of results for domestic operations (April to December 2016) and 12 months of results for overseas operations (January to December 2016). To facilitate year-on-year comparison, results for the previous fiscal year, ended March 31, 2016, have been restated to include nine months of results for domestic operations (April to December 2015) and 12 months of results for overseas operations (January to December 2015).

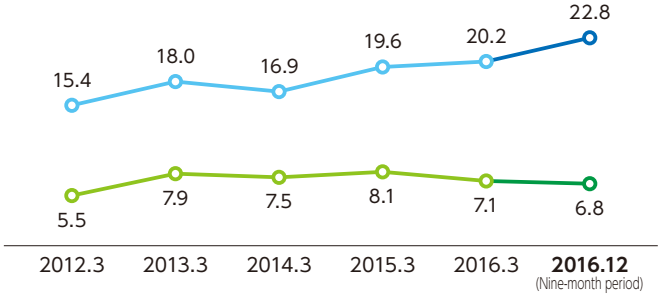
Domestic Business Strategy

Developing and cultivating new products

The Kobayashi Pharmaceutical Group has achieved sustained growth by developing unique products and creating new markets to secure large market shares and high margins, guided by its brand slogan "You Make a Wish and We Make it Happen."

In recent years, we have been focusing on cultivating products after they have been launched, in addition to developing new products. From our portfolio of new products, we select "strategic launch products" that receive Groupwide support in the form of in-store sales area development, sales promotion campaigns, intensive TV advertising, product improvements and cost reduction. By rigorously following this approach, we have increased the new product contribution rate to 22.8%, based on sales from products launched in the last four years. Going forward, we will reinforce our ability to develop and cultivate new products, aiming to ensure that at least two to four of the new products we launch each spring and autumn are firmly established in the market, so that they contribute to sales and profits five or ten years down the track.

New Product Contribution Rate (%)



Four-year contribution rate: Percentage of net sales generated by products launched in the last four years.

First-year contribution rate: Percentage of net sales generated by products launched in the most recent year.

Eyebon
An eye wash solution that flushes out protein buildup, dust and other fine particles.

Breath Care
Oral breath freshener capsules that refresh bad breath originating from the stomach.

Netsusama Sheet
Cooling gel sheet for the forehead containing cooling beads.

Ekitai Bluelet Okudake
A toilet deodorizer and freshener placed in toilet tank sinks.

Oheya no Shoshugen
A powerful air freshener that eliminates annoying indoor odors.

Results Highlights

New Products

Sales contributions from 31 new products

Ammeltz NEO

Senacure

Curerare

Oheya no Shoshugen Parfum

Bluelet Stampy Extra Strength Sterilization

Existing Products

Sales growth on the back of efforts to cultivate existing products

Dusmock

Saiki

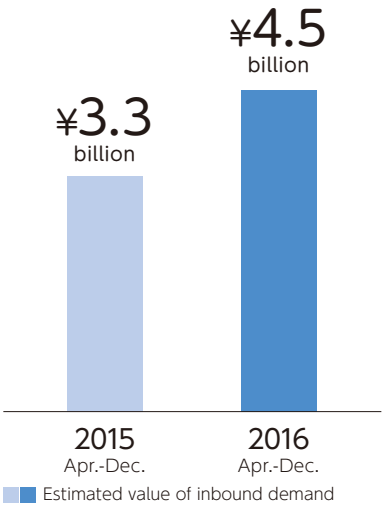
Attonon

Keshimin

Eaude Muge

Inbound demand from overseas visitors to Japan

Contribution to sales of ¥4.5 billion



Creating markets for medicated skincare products

OTC pharmaceuticals and skincare products are two distinct markets. OTC products are used to treat pain, itchiness and other similar conditions, while skincare products help to keep skin healthy and beautiful. Medicated skincare products sit between those two markets and are mainly used to treat mild skin conditions such as small scars and rashes, rather than pain and itchiness. Targeting this area as a new category, we are working to create new markets by rolling out medicated skincare products such as *Attonon*, a cream that helps improve scars, *Ninocure*, a treatment for skin rashes on upper arms, and *Saiki*, a lotion for dry skin. We will continue to expand our lineup of products in this category to create and grow new markets.

■ Medicated skincare products

Overseas Consumer Products Business

Focused on the sale of body warmers, cooling gel sheets and other products in three main markets: the United States, China and Southeast Asia.

Fiscal 2016.12 Results

Net Sales

¥18.0 billion

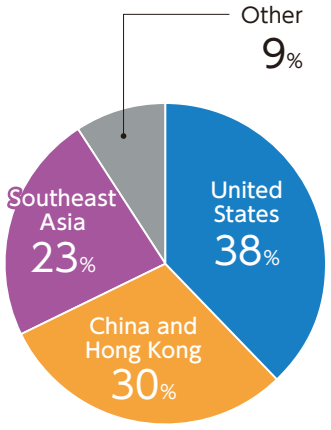
−6.6% (YoY change*)

Operating Income

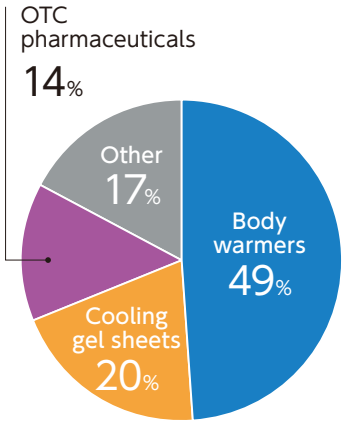
¥7.1 billion

−38.8% (YoY change*)

Sales Breakdown by Region



Sales Breakdown by Product



* Due to a change in fiscal year-end, the fiscal period ended December 31, 2016 is a transitional period comprising nine months of results for domestic operations (April to December 2016) and 12 months of results for overseas operations (January to December 2016). To facilitate year-on-year comparison, results for the previous fiscal year, ended March 31, 2016, have been restated to include nine months of results for domestic operations (April to December 2015) and 12 months of results for overseas operations (January to December 2015).

Overseas Business Strategy

Creating global brands

In fiscal 2016, ended December 31, 2016, sales declined in the overseas business, partly due to the impact of foreign exchange rates. However, on a local currency basis, sales rose 6% year on year, supported by steady growth in sales of body warmers in China and sales of *Netsusama Sheet*, a cooling gel sheet for the forehead, and *Ammeltz*, an external anti-inflammatory for stiff shoulders, in Southeast Asia.

We are targeting further business growth by creating new lifestyle choices tailored to each country and region using six global brands – body warmers, *Netsusama Sheet*, *Ammeltz*, oral care, skincare and household products.

Hothands
A body warmer product sold in the United States.

Be KOOOL
A cooling gel sheet sold in the United States.

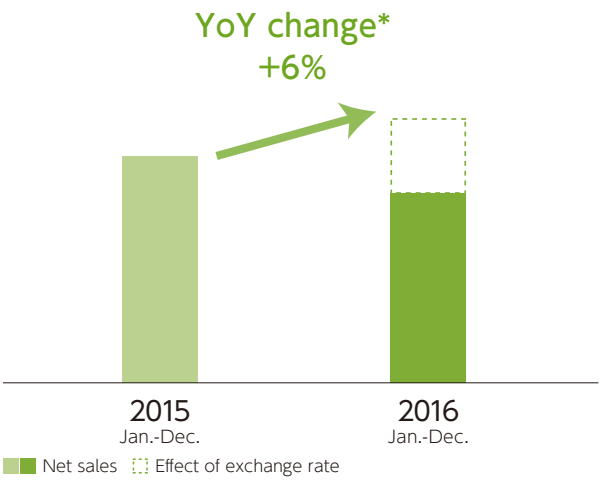
Nuan Bao Bao
A body warmer product sold in China.

New Anmeiru
An anti-inflammatory product sold in Hong Kong

KOOL FEVER
A cooling gel sheet sold in Singapore.

Results Highlights

Sales rose 6% year on year on a local currency basis, excluding forex factors



Perfecta acquisition
Establishing a business base in North America to launch OTC pharmaceuticals

ZIM'S MAX FREEZE
A range of external anti-inflammatory products

* To facilitate year-on-year comparison, results for the previous fiscal year, ended March 31, 2016, have been restated to include nine months of results for domestic operations (April to December 2015) and 12 months of results for overseas operations (January to December 2015).

Rapidly launching OTC pharmaceuticals

To accelerate growth in our overseas business, we need to launch and expand sales of new OTC pharmaceutical products. Starting in March 2016, we launched medicated eye wash *Eyebon* in South Korea and *Ninocure*, a cream for arm rashes, in Hong Kong. We are now working to increase sales of those products.

In September 2016, we acquired Perfecta Products, Inc., owner of the *ZIM'S MAX FREEZE* brand of external anti-inflammatory products, which have a highly visible market presence in North America. The acquisition will be used as a base to roll out OTC pharmaceutical products in North America. We plan to step up expansion in the OTC pharmaceuticals category in the region by combining our marketing capabilities with Perfecta strength's in sales. Going forward, we intend to explore various approaches, including potential M&A deals, and leverage the strengths of the whole Group to rapidly launch OTC pharmaceuticals in other countries.

March 2016
Eyebon launched in South Korea

April 2016
Ninocure launched in Hong Kong

Direct Marketing Business

Involved in the sale of nutritional supplements, skincare products and other items over the phone and online.

Fiscal 2016.12 Results

Net Sales

¥7.2 billion

+15.9% ↗

(YoY change*)

Operating Income

¥(0.29) billion

−¥0.32 billion ↘

(YoY change*)

Main Products

Nokogiriyashi EX

Nattokinase & DHA & EPA

Shiitagen – α

Hifmid

Aloe Ikumo Eki

* Due to a change in fiscal year-end, the fiscal period ended December 31, 2016 is a transitional period comprising nine months of results for domestic operations (April to December 2016) and 12 months of results for overseas operations (January to December 2016). To facilitate year-on-year comparison, results for the previous fiscal year, ended March 31, 2016, have been restated to include nine months of results for domestic operations (April to December 2015) and 12 months of results for overseas operations (January to December 2015).

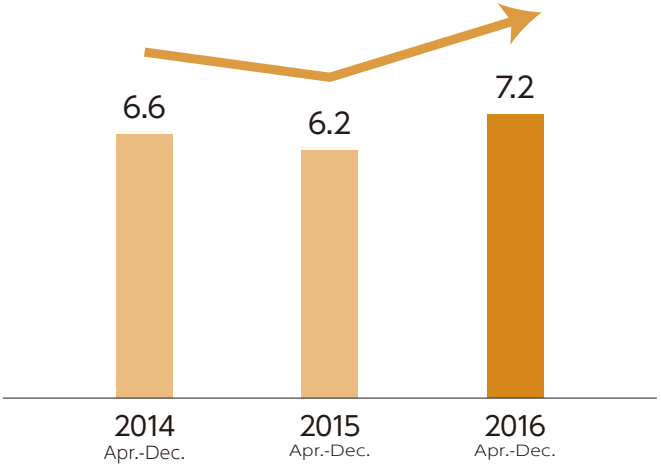
Direct Marketing Business Strategy

Actively investing in advertising to grow sales

Sales in this business returned to growth, supported by active investment in advertising and the full introduction of a new system that enables consumers to receive regular deliveries of any product in our direct marketing range. We will continue to invest actively in advertising in order to attract new customers. We will also use our regular delivery service to make sure we retain those customers. We believe this will translate into a positive cycle of rising sales, supporting a more stable growth trend.

Looking further ahead, we aim to generate growth by investing heavily in basic material research and by reinforcing development to help us create more distinctive products.

Direct Marketing Business Sales (¥ billion)



Building Stakeholder Confidence Aimed at Maximizing Corporate Value

Corporate Governance Framework

The Kobayashi Pharmaceutical Group constantly strives to maximize corporate value. In this pursuit, it is of major importance to earn the trust of our stakeholders, including shareholders and investors. Therefore, we are committed to enhancing our corporate governance through developing a system that ensures transparent management practices and undertaking timely and appropriate information disclosure.

Enhancing Management Transparency

Monitoring Management from Multiple Viewpoints

The Kobayashi Pharmaceutical Group has adopted an executive officer system to separate management from business operations, and implements a wide range of measures in order to ensure transparency in management.

Board of Directors

We have selected outside directors since 2008 with the purpose of strengthening the board of directors' supervisory function. The board of directors consists of nine directors, including three outside directors, and constantly monitors the status of business operations by meeting monthly or when necessary to determine important matters concerning the management of the company and to check deliberations made at the Group Officers Meeting (GOM / SSK). Board of directors meetings are also attended by all four audit and supervisory board members, including the two outside members. The Company's outside directors and outside audit and supervisory board members actively participate in discussions and fulfill their oversight role from an independent perspective.

Principal Activities of Outside Directors and Outside Audit and Supervisory Board Members in Fiscal 2016.12

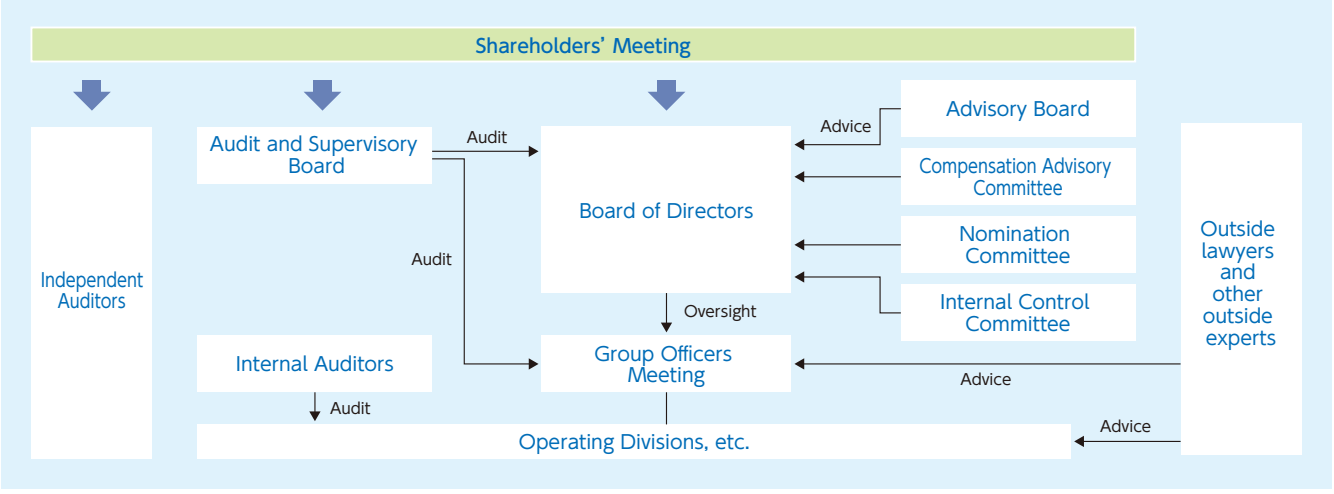
Title	Name	Principal Activities
Outside Directors	Haruo Tsuji	Attended 11 of 11 board of directors meetings
	Kunio Ito	Attended 11 of 11 board of directors meetings
	Kaori Sasaki	Attended 7 of 7 board of directors meetings
Outside Audit and Supervisory Board Members	Ryuji Sakai	Attended 11 of 11 board of directors meetings Attended 11 of 11 audit and supervisory board meetings
	Yoko Hatta	Attended 10 of 11 board of directors meetings Attended 11 of 11 audit and supervisory board meetings

Note: For Kaori Sasaki, the table shows the number of meetings attended since her appointment as outside director on June 29, 2016.

Group Officers Meeting (GOM / SSK)

The GOM / SSK consists of executive officers and other personnel who meet four times each month to review significant matters relating to business operations.

Corporate Governance Organization



Advisory Board

As a supporting arm to the board of directors and GOM / SSK, the Advisory Board, consisting of outside directors, the Chairman, the Vice Chairman, the President and relevant directors, meets half-yearly. The Advisory Board provides guidance on significant business issues and management policy, which is in turn reflected in the daily management of the Group.

Compensation Advisory Committee

The Compensation Advisory Committee ensures transparency and impartiality in the determination process for director compensation and consists of outside experts, outside directors, the Vice Chairman and relevant directors.

Nomination Committee

The Nomination Committee ensures transparency and impartiality in the selection process of directors and executive officers, and consists of outside experts, outside directors, the President and relevant directors.

Internal Control Committee

The Internal Control Committee consists of principal directors, who deliberate primarily on basic issues relating to compliance and the development of internal control systems. The committee also formulates the basic plan for internal control and oversees the internal control management framework.

Audit and Supervisory Board

Kobayashi Pharmaceutical has an audit and supervisory board with four members. To ensure management transparency, the Company has appointed two outside members to the board who do not maintain a capital or business relationship with the Group. Statutory members of the audit and supervisory board attend principal meetings, have access to required records, and conduct interviews of operating divisions in order to monitor management to identify business risk as early as possible.

"LA & LA"— Utilizing Employee Feedback

We actively provide opportunities referred to internally as "LA & LA" (Looking Around & Listening Around) for employees to convey their views and opinions directly to management to fulfill our commitment to developing an organizational climate in which all employees can openly share their opinion. Kobayashi Pharmaceutical believes this culture is a significant part of corporate governance.

Information Disclosure

Pursuing Timely and Easy-to-Understand Disclosure

Kobayashi Pharmaceutical strives to provide timely disclosure of corporate data and information in order for shareholders and investors to form an accurate assessment of the Company. Our corporate website is also extensively used to disseminate the latest information, provide commentary on business strategy and product lineups, and the timely disclosure of important information related to financial filings.

Internal Control Systems and Compliance

The Kobayashi Pharmaceutical Group is actively building internal frameworks to adhere to relevant laws and regulations, such as ensuring that appropriate financial statements are prepared and that operations comply with stipulations of the Companies Act and Financial Instrument and Exchange Act of Japan. In addition, we conduct a variety of educational 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.

Internal Control System

Strengthening Internal Control for Expansion of Overseas Business

The Internal Control Committee has met three times each year since it was established in May 2007. Chaired by the President, this committee oversees the Kobayashi Pharmaceutical Group's internal control system and compliance framework, while also seeking the advice of outside attorney advisors. Based on its work, the committee issues recommendations and advice on measures concerning internal controls.

In fiscal 2016.12, the committee continued efforts from the previous fiscal year to enhance the Group's internal control structure by covering seven domestic consolidated subsidiaries, including Kobayashi Pharmaceutical Co., Ltd., and four overseas consolidated subsidiaries within the scope of Groupwide internal control audits.

* Basic Policy on Internal Control Systems
http://www.kobayashi.co.jp/corporate/governance/policy/index.html

Compliance

Compliance training that focuses on continuity

We provide educational training on compliance issues to board members, executive officers and employees, with a focus on continuity in learning, in order to enhance compliance awareness and understanding among our people.

Educational training through the In-house Newsletter and intranet

Since September 2006, we have used the Kobayashi Pharmaceutical In-house Newsletter to highlight compliance issues that employees need to be aware of in their business activities and to share information about general compliance trends in the industry. Since July 2011, we have been providing monthly Compliance e-Learning Sessions over our intranet for all eligible employees, board members and executive officers.

Fiscal 2016.12 e-Learning Sessions

Month Held	Theme
April 2016	Compliance and employee counseling office
May 2016	Handling personal information
June 2016	Crisis management information
July 2016	Workplace mental health and stress checks
August 2016	Ransomware awareness
September 2016	Tainted pharmaceutical products
October 2016	Controlling the use of unauthorized IT devices
November 2016	Act against Unjustifiable Premiums and Misleading Representations
December 2016	Awareness check testing

Compliance Survey and Group Training Sessions

In fiscal 2016.12, we again surveyed all employees in Japan about compliance. Based on the results of the survey, we conducted a total of 25 compliance training sessions for management-level employees at all business sites in Japan. A total of 231 managers participated in the training, helping to raise their awareness and knowledge about preventing misconduct in the workplace.

Whistleblower System

The Kobayashi Pharmaceutical Group established the Employee Consulting Center in January 2003 both internally and externally in a law office as a special hotline for employees to anonymously report compliance violations or ask general questions on compliance issues. In May 2013, the Group also established an external hotline for overseas employees at a law office. To ensure these whistleblower systems work effectively, we regularly conduct employee training and use In-house newsletters to increase awareness about the Employee Consulting Center, which has led to an increase in the number of employees seeking advice.

Risk Management Framework

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

Management of Business Risks

Reducing Business Risks Based on Three Themes

In fiscal 2016.12, we focused on mitigating management risk based on three main themes: global corporate governance, adjusting working hours and protecting classified information. To ensure the solid execution of risk management, our progress on the action plan was reported to the Internal Control Committee to receive feedback. As a result, measures such as adding checks to daily business activities and implementing training were taken.

Business Continuity Plan

Bolstering Our Ability to Respond to Emergencies

In 2008, we began bolstering our measures to deal with disasters, accidents and pandemics to better manage risks to our businesses. This culminated in spring 2010 with the creation of a business continuity plan addressing aggressive influenza strains. In 2011, we drew up a business continuity plan on disasters, given our experiences from the Great East Japan Earthquake. In this regard, we are carefully preparing ourselves for emergencies by constantly revising our business continuity plan every year.

Directors, Audit and Supervisory Board Members and Executive Officers (As of March 31, 2017)

Directors

Kazumasa Kobayashi
Chairman of the Board and
Chief Executive Officer

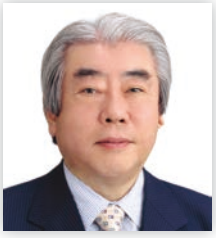
Yutaka Kobayashi
Vice Chairman of the Board

Akihiro Kobayashi
Representative Director,
President and
Chief Operating Officer

Takashi Tsujino
Senior Managing Director and
Executive Vice President
Senior General Manager
Product Development
and Marketing Headquarters

Satoshi Yamane
Senior Executive Director
Senior General Manager
Corporate Administration
Headquarters

Susumu Horiuchi
Executive Director
Senior General Manager
Sales Division



Haruo Tsuji
Outside Director

Kunio Ito
Outside Director

Kaori Sasaki
Outside Director

Audit and Supervisory Board Members

Hiroshi Goto
Audit and Supervisory
Board Member

Kazuhiro Shiratsuchi
Audit and Supervisory
Board Member

Ryuji Sakai
Outside Audit and
Supervisory Board Member

Yoko Hatta
Outside Audit and
Supervisory Board Member

Executive Officers

Toshio Namba
Executive Officer
Senior General Manager
QA, RA, Pharmacovigilance and
Consumer Relations Division

Tetsuji Nishioka
Executive Officer
Senior General Manager
Manufacturing Division

Kenichiro Tanaka
Executive Officer
Deputy Senior General Manager
Sales Division
General Manager
of the Regional Area
Sales Division

Kazuhito Miyanishi
Executive Officer
Senior General Manager
International Business Division

Naoki Ayabe
Executive Officer
General Manager
of the Metropolitan Area
Sales Division

Fujito Owaki
Executive Officer
Senior General Manager
Healthcare Division
Product Development
and Marketing Headquarters

Nobuya Matsuoka
Executive Officer
Senior General Manager
Central Research Institute
Product Development
and Marketing Headquarters

Note: The Company uses the executive officer system. Four directors–Akihiro Kobayashi, Takashi Tsujino, Satoshi Yamane, and Susumu Horiuchi–each concurrently serve as executive officers.

Creating a Stable Working Environment for all Employees

Secure Long-term Job Opportunities

In 2015, the Group converted around 80 temporary employees with fixed-term contract periods into permanent employees at an affiliate responsible for in-store sales promotions and other activities. Following that move, on April 1, 2017, we converted around 250 temporary employees who met certain criteria into permanent employees at a manufacturing affiliate.

Guided by the brand slogan, "You Make a Wish and We Make it Happen," the Kobayashi Pharmaceutical Group develops, manufactures and sells unique products. The part of our business that "Makes it Happen," in other words our manufacturing division, plays a vital role in the Group. The division's key mission is to remain focused on quality so that the Group retains the trust of society and, more specifically, its customers. Given that role, we believe that the personnel who work at our manufacturing affiliates – which sit at the heart of our manufacturing division – need to have a secure, long-term working environment. That thinking prompted us to introduce new conditions and systems that enable part-time staff to become full-time employees. The new approach will also help to reinforce our manufacturing framework by giving all our employees the opportunity to acquire advanced manufacturing skills and expertise from a long-term perspective.

We have introduced a similar system at Kobayashi Pharmaceutical Co., Ltd., with any temporary employee eligible to receive indefinite-term employee contracts up to the statutory retirement age of 60 (same as permanent employees), provided they meet certain criteria. In January 2017, around 100 people moved over to the new contracts. In addition to indefinite terms, employees under these contracts are also entitled to receive a higher level of health and welfare support, based on the assumption that their time with the Company will be longer.

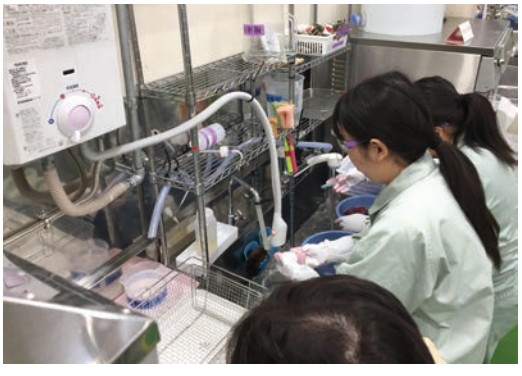
Going forward, we will continue to create a more secure, long-term working environment for our personnel, while also attracting high-quality people and actively training existing personnel to support the continued growth and development of our employees and the Group.

Providing Job Opportunities for People with Disabilities

We established Kobayashi Pharmaceutical Challenged Co., Ltd. (Toyama City, Toyama Prefecture) in November 2011 to promote job opportunities for disabled people and provide them with a safe working environment.

The company initially employed two people with disabilities, mainly to provide on-site cleaning services for Toyama Kobayashi Pharmaceutical Co., Ltd. However, as employment systems have become more established within the Group, we are increasing the number of people we employ, adding more work sites and expanding the type of work they carry out. Currently, we employ 15 people with disabilities at the Toyama business site, 10 at our Sendai site (part of Sendai Kobayashi Pharmaceutical Co., Ltd.), and six at our Sanda site (part of Kiribai Kobayashi Pharmaceutical Co., Ltd.) for a total of 31 people. Employees are mainly tasked with on-site cleaning services, preparing raw materials for production, cleaning equipment, supporting production activities and supervising work uniforms.

By working closely with each business site, we aim to add new tasks and increase the number of people with disabilities employed by the Group.



Kobayashi Pharmaceutical Challenged employees at work

Working to gain the trust of all stakeholders by contributing to society through our business activities

Contributing to Society

The Kobayashi Pharmaceutical Group is actively contributing to society through its business activities, in line with its brand slogan "You Make a Wish and We Make it Happen." Aiming to be a company trusted by all stakeholders, we are implementing CSR activities in areas such as health, education, communities and the environment from the Group's unique perspective, as part of our broader efforts to make life more comfortable and help build a better society.

Providing Support for Single Mother Families

Tackling Child Poverty

Japan is regarded as a well-fed country, but the national child poverty rate is 16.3%*, meaning one in six children in Japan are struggling with the hidden issue of poverty. Many children in Japan still do not receive enough food to meet the basic requirements for healthy lives. This poverty can carry on into adulthood, leading to a cycle of poverty. This is one of the major challenges facing society today.

* National Livelihood Survey, Ministry of Health, Labour and Welfare

A food package distributed to families in need

Aoitori Child Support Project Launched

In January 2016, we teamed up with an NPO called FoodBank YAMANASI to launch the Aoitori Child Support Project for single mother families. Our goal is to alleviate concerns children may have in their daily lives, give them hope for a brighter future and help them lead healthier lifestyles.

Once every two weeks, Kobayashi Pharmaceutical and the NPO deliver food items such as rice, canned food, curry, snacks and cup noodles to a total of 400 single mother households with more than 1,000 children. The food is delivered once a week during long school holidays when children do not receive school meals.

Kobayashi Pharmaceutical employees filling packages

NPO FoodBank YAMANASI

FoodBank YAMANASI distributes food and other items donated by companies and the public free of charge to families in need. The NPO also emphasizes the importance of communication. Handwritten letters to the families are included in each delivery, and the families receive blank postcards to reply to the letters, giving them a chance to describe their everyday lives and their hopes and wishes.

Providing Support for Guide Dog Training

A recipient of one of the guide dogs trained by Eye Mate

Each year since 2010, Kobayashi Pharmaceutical has donated funds to The Eye Mate Inc., a public foundation that provides guide dog training. Our donations subsidize the cost of training programs for guide dogs, which help to improve the lives of people with visual impairments. Also, in 2011, we added donations to Eye Mate to our menu of shareholder benefits. Using this option, shareholders can donate funds to pay for the cost of training guide dogs.

We plan to continue these donation programs to ensure as many visually impaired people as possible have access to guide dogs.

Improving Toilet Facilities at Elementary Schools

In Japan, toilet facilities in the home and commercial facilities have improved over the years, but many elementary schools still have toilets that are several decades old. Many are dirty, smelly and dark, but these problems cannot be rectified by cleaning alone. We surveyed elementary students about toilets in 2016 and found that half of all children do not use school toilets for bowel movements because old Japanese-style toilets are difficult to use or the toilets are dirty and smelly.

In order to help resolve these issues, we have been working since 2010 to improve the conditions of school toilet facilities by making them more comfortable and easier to use for children.

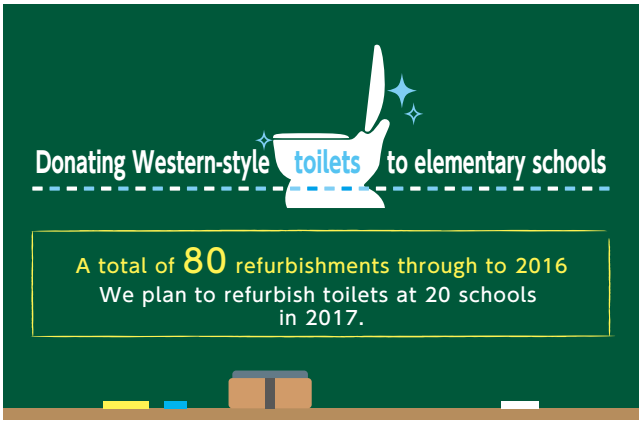
In 2016, we implemented our sixth toilet renovation program, which covered 20 elementary schools. The work included replacing Japanese-style toilets with Western ones and installing protective sheets around toilets to help reduce odors. Also, with many children shy about doing their bowel movements at school, we sent employees to each school after the refurbishments to run workshops that teach children about the importance of going to the toilet.

In 2017, when we mark the Company's centenary, we plan to refurbish 20 more school toilet facilities across Japan, putting us on track to achieve our target for a total of 100 school toilets by the Company's 100th fiscal year.

Replacing Japanese-style toilets with Western ones

Sheets installed around toilets to help reduce odors

Refurbished toilet handover ceremony (Shinpukuji Elementary School, Kawasaki City, Kanagawa, 2016)



Workshop (Hachiman-minami Elementary School, Tokushima City, Tokushima, 2016)

Analysis of Financial Results

Effective from fiscal 2016.12, ended December 31, 2016, the Company has changed its fiscal year-end from March 31 to December 31. Consequently, the fiscal period ended December 31, 2016 is a nine-month transitional period (April 1, 2016 to December 31, 2016) for the Company and consolidated subsidiaries with March fiscal year-ends, and a 12-month period (January 1, 2016 to December 31, 2016) for consolidated subsidiaries with December fiscal year-ends.

Consolidated Business Results

Net Sales

The Domestic Consumer Products Business (Domestic Business) launched 31 new products in the fiscal period under review. Sales were supported by those new products, strong demand for existing products and firm inbound demand from overseas visitors to Japan. Growth in the Direct Marketing Business also reported solid net sales.

As a result, the Company reported consolidated net sales of ¥120,052 million, an increase of 6.8% year on year*.

Gross Profit

In the Domestic Business, OTC pharmaceuticals, food products and other items that generate high gross profits accounted for a higher ratio of sales in the fiscal year under review.

As a result, gross profit increased 9.2% year on year to ¥71,413 million and the gross profit to net sales ratio improved 1.3 percentage points year on year to 59.5%.

Operating Income

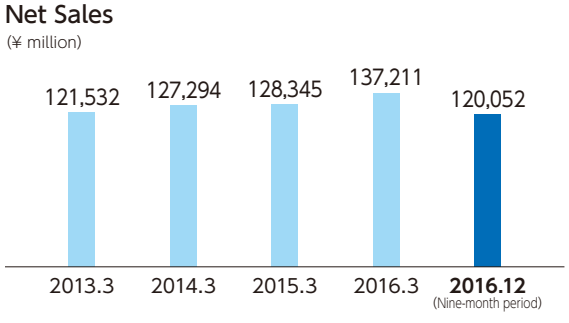
The Group invested aggressively in advertising in the Domestic Business, the Overseas Consumer Products Business (Overseas Business) and the Direct Marketing Business. As a result, advertising expenses increased 32.3% year on year to ¥17,049 million and the ratio of advertising expenses to net sales ratio rose 2.7 percentage points to 14.2%. Also, R&D costs increased 1.4% year on year to ¥4,122 million and the R&D costs to net sales ratio declined 0.2 of a percentage point to 3.4%. Due to the above factors, selling, general and administrative expenses increased 12.0% year on year to ¥54,003 million.

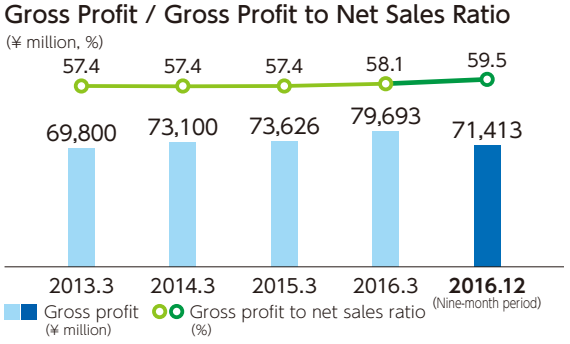
As a result, operating income increased 1.1% year on year to ¥17,410 million and the operating income to net sales ratio declined 0.8 of a percentage point to 14.5%.

Profit Attributable to Owners of Parent

Profit before income taxes increased 9.6% year on year to ¥19,802 million, mainly reflecting the booking of impairment loss, outweighed by gain on sales of investment securities.

As a result, profit attributable to owners of parent increased 12.2% year on year to ¥14,322 million, a record high for the Kobayashi Pharmaceutical Group. The fiscal period ended December 31, 2016 also marked the 19th consecutive fiscal year of bottom-line growth. Net income per share rose ¥13.56 year on year to ¥179.12.

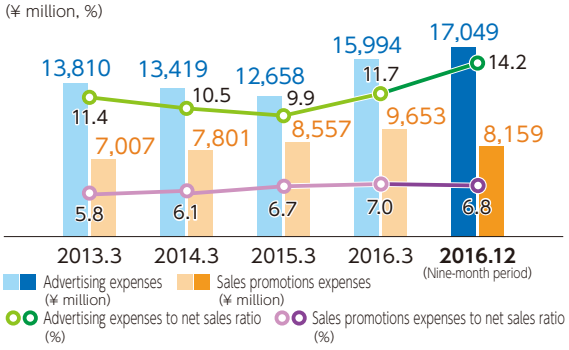




* Due to a change in fiscal year-end, the fiscal period ended December 31, 2016 is a nine-month transitional period (April 1, 2016 to December 31, 2016) for the Company and consolidated subsidiaries with March fiscal year-ends, and a 12-month period (January 1, 2016 to December 31, 2016) for consolidated subsidiaries with December fiscal year-ends. Consequently, results for the fiscal year ended March 31, 2016 have been restated to facilitate year-on-year comparison with results for the fiscal period ended December 31, 2016.

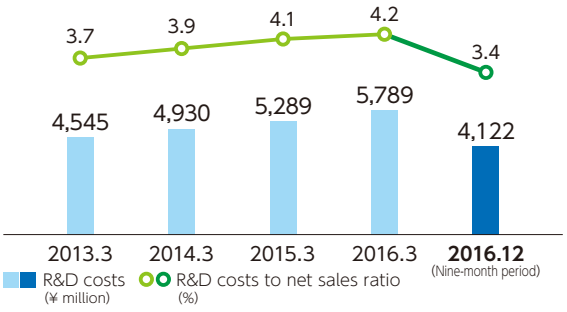
Advertising Expenses / Advertising Expenses to Net Sales Ratio
Sales Promotions Expenses / Sales Promotions Expenses to Net Sales Ratio

(¥ million, %)



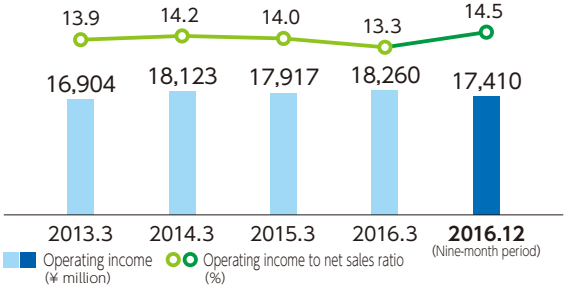
R&D Costs / R&D Costs to Net Sales Ratio

(¥ million, %)



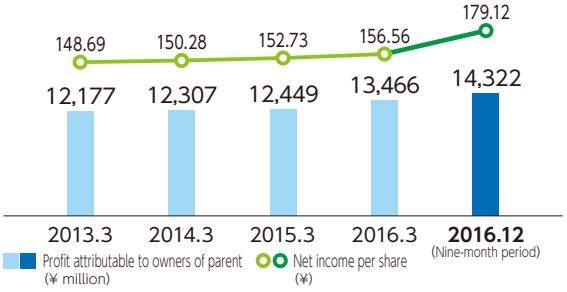
Operating Income / Operating Income to Net Sales Ratio

(¥ million, %)



Profit Attributable to Owners of Parent / Net Income per Share

(¥ million, ¥)



Reportable Segment Business Results

The Kobayashi Pharmaceutical Group classifies its business activities into four segments: Domestic Consumer Products Business, Overseas Consumer Products Business, Direct Marketing Business, and Other. Net sales by segment also include inter-segment sales and transfers, which amounted to ¥9,110 million in the fiscal period ended December 31, 2016.

(Millions of yen)

Net Sales by Segment

	2016.3	YoY change*	2016.12 (Nine-month period)
1. Domestic Consumer Products Business			
Sales to third parties	¥ 106,963	¥ 84,827	¥ 92,955
Inter-segment sales and transfers	5,069	4,035	4,547
Total	112,032	88,863	97,502
2. Overseas Consumer Products Business			
Sales to third parties	18,998	19,303	18,027
Inter-segment sales and transfers	1,875	1,483	948
Total	20,873	20,786	18,975
3. Direct Marketing Business			
Sales to third parties	8,539	6,177	7,160
4. Other			
Sales to third parties	2,711	2,147	1,910
Inter-segment sales and transfers	4,625	3,490	3,615
Total	¥ 7,336	¥ 5,638	¥ 5,525

(Millions of yen)

Operating Income by Segment

	2016.3	YoY change*	2016.12 (Nine-month period)
1. Domestic Consumer Products Business	¥ 17,019	¥ 15,565	¥ 16,456
2. Overseas Consumer Products Business	756	1,152	706
3. Direct Marketing Business	35	34	(287)
4. Other	497	461	305

1. Domestic Consumer Products Business

In the fiscal period under review, we launched a total of 31 new products in this business segment in order to create new markets and expand existing markets. Among those products, there were particularly strong contributions to sales from *Ammeltz NEO*, an external anti-inflammatory, *Bisrat Gold EX*, an obesity therapeutic drug, *Senacure*, a therapeutic drug for blotches on the back or décolleté, *Oheya No Shoshugen Parfum*, a stylish deodorizer and freshener with a refined fragrance, and *Inochi No Haha Skin Care*, a skincare product for skin during menopause.

There were also strong contributions to sales from a number of existing healthcare products, including *Attonon*, a scar concealer, and *Saiki*, a dry skin curative drug, in the medicated skincare products category; *Inochi No Haha A*, a women's health medicine, *Naicitol*, an obesity remedy, and *Dusmock*, a kampo medicine that ameliorates persistent coughing and bronchitis, in the kampo and herbal medicines product category; *Sarasaty*, a sheet for absorbing vaginal discharge, and *Bluelet*, a toilet deodorizer and bowl bleach tablet, in the household products category; and *Keshimin*, a skincare product for spots, and *Eaude Muge*, a medicated lotion, in the skincare products category.

As a result, net sales in the Domestic Consumer Products Business rose 9.7% year on year to ¥97,502 million and net sales to third parties increased 9.6% year on year to ¥92,955 million.

Net Sales to Third Parties (by Category)

	2016.3		2016.12 (Nine-month period)		Changes*1	
	Sales (Millions of yen)	% of Total Sales	Sales (Millions of yen)	% of Total Sales	Sales (Millions of yen)	Changes (%)
Healthcare products	¥ 48,632	45.5	¥ 42,237	45.4	—	—
Household products	48,034	44.9	41,045	44.2	—	—
Skincare	4,673	4.4	4,181	4.5	—	—
Body warmers	5,623	5.2	5,490	5.9	—	—
Total	¥ 106,963	100.0	¥ 92,955	100.0	—	—

*1 Year-on-year changes have been omitted, as the fiscal period ended December 31, 2016 was a transitional period due to a change in fiscal year-end.

Number of Profitable and Unprofitable Brands

We rigorously followed our own strict market launch standards for new products, taking steps such as conducting test marketing to assess the marketability of products. In addition, we tightened profitability control for existing brands and withdrew unprofitable brands from the market.

Trends in Number of Profitable and Unprofitable Brands

	2013.3	2014.3	2015.3	2016.3	2016.12 (Nine-month period)
Profitable brands	101	104	93	101	92
Unprofitable brands	49	30	30	30	41

New Product Contribution Rate

We refer to the percentage of net sales generated by new products as the new product contribution rate. We calculate two rates, one based on sales in the first fiscal year on the market and the other based on sales for the most recent four years on the market. In the fiscal period ended December 31, 2016, we launched 31 new products. However, the combined new product contribution rate for the first fiscal year on the market declined 0.3 of a percentage point year on year to 6.8%, partly reflecting sales growth for existing products and rising inbound demand for existing products from overseas visitors to Japan. However, the new product contribution rate for the most recent four years on the market rose 2.6 percentage points to 22.8%, reflecting efforts to cultivate new products.

New Product Contribution Rate

(%)

	2013.3	2014.3	2015.3	2016.3	2016.12 (Nine-month period)
First-year	7.9	7.5	8.1	7.1	6.8
Four-year	18.0	16.9	19.6	20.2	22.8

Note: First-year contribution rate: Percentage of net sales generated by products launched in the most recent year.
Four-year contribution rate: Percentage of net sales generated by products launched in the last four years.

2. 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*, an external anti-inflammatory, mainly in the United States, China and Southeast Asia. During the fiscal period under review, we worked to grow sales by actively investing in advertising and sales promotion. However, sales of body warmers were sluggish due to the impact of foreign exchange rates and a warm winter in the United States.

As a result, net sales in the Overseas Consumer Products Business contracted 8.7% year on year to ¥18,975 million and net sales to third parties declined 6.6% year on year to ¥18,027 million.

* Due to a change in fiscal year-end, the fiscal period ended December 31, 2016 is a nine-month transitional period (April 1, 2016 to December 31, 2016) for the Company and consolidated subsidiaries with March fiscal year-ends, and a 12-month period (January 1, 2016 to December 31, 2016) for consolidated subsidiaries with December fiscal year-ends. Consequently, results for the fiscal year ended March 31, 2016 have been restated to facilitate year-on-year comparison with results for the fiscal period ended December 31, 2016.

Net Sales to Third Parties (by Area)

	2016.3		2016.12 (Nine-month period)		Changes*1	
	Sales (Millions of yen)	% of Total Sales	Sales (Millions of yen)	% of Total Sales	Sales (Millions of yen)	Changes (%)
United States	¥ 8,574	45.1	¥ 6,783	37.6	—	—
China	5,072	26.7	5,378	29.9	—	—
Southeast Asia	3,513	18.5	4,218	23.4	—	—
Other	1,837	9.7	1,646	9.1	—	—
Total	¥ 18,998	100.0	¥ 18,027	100.0	—	—

*1 Year-on-year changes have been omitted, as the fiscal period ended December 31, 2016 was a transitional period due to a change in fiscal year-end.

3. Direct Marketing Business

This segment engages in mail order sales of nutritional supplements, skincare products and other items. In the fiscal period under review, 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, net sales in the Direct Marketing Business increased 15.9% year on year to ¥7,160 million.

4. Other Business

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

As a result, net sales in the Other Business declined 2.0% year on year to ¥5,525 million.

Financial Position

Assets

Total assets as of the end of the fiscal period were ¥201,234 million, an increase of 6.5% compared with the end of the previous fiscal year.

Current assets rose 6.9% year on year to ¥128,647 million, mainly reflecting an increase in trade notes and accounts receivable of ¥10,957 million due to growth in sales, and an increase in securities of ¥1,000 million.

Investments and other assets rose 6.4% to ¥54,753 million, mainly due to an increase in goodwill of ¥1,188 million.

Liabilities

Total liabilities as of the end of the fiscal period were ¥57,914 million, up 23.3% compared with the end of the previous fiscal year.

Current liabilities rose 28.8% year on year to ¥46,976 million, mainly due to an increase in other accounts payable of ¥5,774 million.

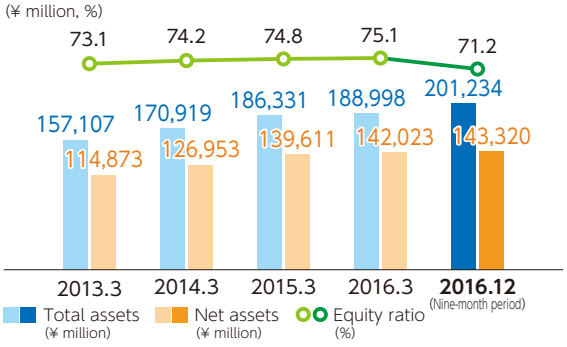
Long-term liabilities were rising 4.2% to ¥10,938 million.

Net Assets

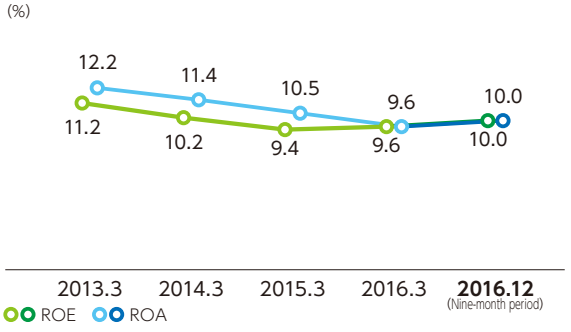
Net assets as of the end of the fiscal period totaled ¥143,320 million, an increase of 0.9% compared with the end of the previous fiscal year. This mainly reflected growth in retained earnings of ¥10,415 million due to an increase in profit attributable to owners of parent.

As a result, the equity ratio declined 3.9 percentage points to 71.2%. ROE increased 0.4 of a percentage point year on year to 10.0%, and ROA rose 0.4 of a percentage point to 10.0%.

Total Assets / Net Assets / Equity Ratio



ROE / ROA



Cash Flows

Cash Flows from Operating Activities

Net cash provided by operating activities was ¥16,098 million. The main factors were profit before income taxes of ¥19,802 million and depreciation and amortization of ¥2,626 million.

Cash Flows from Investing Activities

Net cash used in investing activities was ¥520 million. The main uses of cash were purchase of shares of subsidiaries resulting in change in scope of consolidation of ¥2,470 million and purchase of property, plant and equipment of ¥2,851 million, versus cash provided of ¥5,151 million in net proceeds from withdrawal of time deposits.

Cash Flows from Financing Activities

Net cash used in financing activities was ¥11,923 million. The main uses of cash were increase in treasury stock of ¥8,054 million and dividends paid of ¥3,920 million.

As a result, cash and cash equivalents as of December 31, 2016 totaled ¥28,323 million.

Cash Flows

	2016.3	2016.12 (Nine-month period)	Changes*1	
	Amount (Millions of yen)	Amount (Millions of yen)	Amount (Millions of yen)	Changes (%)
Cash flows from operating activities	¥ 14,329	¥ 16,098	—	—
Cash flows from investing activities	(10,933)	(520)	—	—
Free cash flows*2	3,396	15,578	—	—
Cash flows from financing activities	(10,200)	(11,923)	—	—
Cash and cash equivalents at the end of the year	25,428	28,323	—	—

*1 Year-on-year changes have been omitted, as the fiscal period ended December 31, 2016 was a transitional period due to a change in fiscal year-end.
*2 Free cash flows: Cash flows from operating activities + Cash flows from investing activities

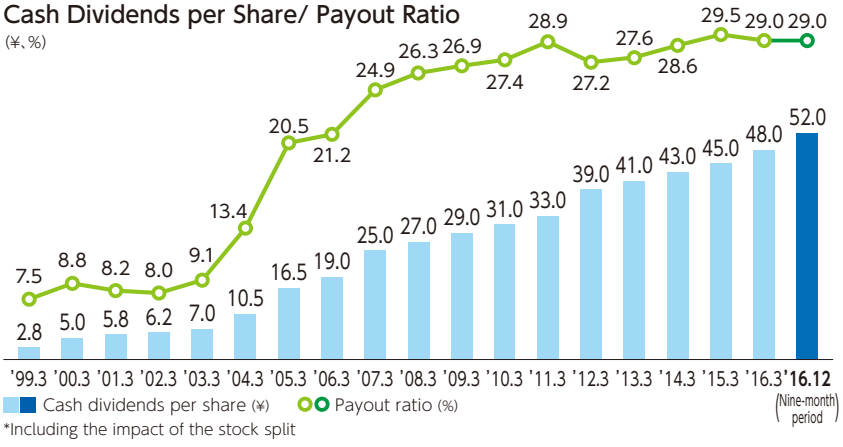
Shareholder Returns

Dividends

The Kobayashi Pharmaceutical Group's basic policy is to consistently pay stable dividends to shareholders while maintaining a sound business structure and actively investing in businesses with growth potential. The Group aims to increase shareholder returns by paying dividends that reflect consolidated results.

In line with that policy, for the fiscal period ended December 31, 2016, the Company paid a dividend of ¥52.00 per share, an increase of ¥4.00 year on year, comprising an interim dividend of ¥25.00 and a year-end dividend of ¥27.00. The Company has now raised the dividend for 18 consecutive fiscal periods. The payout ratio was 29.0%.

Cash Dividends per Share/ Payout Ratio



*Including the impact of the stock split

Scope of Consolidation

In the fiscal period ended December 31, 2016, the Kobayashi Pharmaceutical Group had 36 consolidated subsidiaries (16 in Japan and 20 overseas).

By reportable segment, the Group has eight companies in the Domestic Consumer Products Business, 21 companies in the Overseas Consumer Products Business and seven companies in the Other Business.

* Due to a change in fiscal year-end, the fiscal period ended December 31, 2016 is a nine-month transitional period (April 1, 2016 to December 31, 2016) for the Company and consolidated subsidiaries with March fiscal year-ends, and a 12-month period (January 1, 2016 to December 31, 2016) for consolidated subsidiaries with December fiscal year-ends. Consequently, results for the fiscal year ended March 31, 2016 have been restated to facilitate year-on-year comparison with results for the fiscal period ended December 31, 2016.

Risk Factors

1. Highly Competitive Business Environment

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

2. Highly Susceptible to Sales of New Products

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

3. Risk Concerning Inability to Reap Anticipated Benefits of Mergers and Alliances

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

4. Legal Constraints

The Group's products include OTC pharmaceuticals, quasi-pharmaceuticals, cosmetics, medical devices, and more. The Group's operating results and financial position could be affected if the development or launch of products is subject to sanctions or other measures under Japan's Pharmaceutical and Medical Device Act or other relevant laws and regulations.

5. Product Liability Risk

The Group's products include OTC pharmaceuticals, quasi-pharmaceuticals, cosmetics, medical devices, foods, and more. Any health problems caused to consumers as a result of quality defects in these products may result in significant damage to the Group, which could affect the Group's operating results and financial position.

6. Changes in Raw Material Prices

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

7. Impact of Inclement Weather

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

8. Impact from Natural Disasters

The Group's manufacturing bases are located throughout Japan. As such, if a natural disaster such as an earthquake or a large typhoon should strike an area or areas in which these bases are located, the Group's management and financial performance could be affected.

9. Overseas Business Risk

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

10. Information Management and System Risk

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

11. Intellectual Property Risk

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

12. Share Price Fluctuation

Most of the investment securities owned by the Kobayashi Pharmaceutical Group are listed, and therefore have a risk of share price fluctuation. Any losses or declines in valuation gains for securities, based on the market prices of the fiscal year-ends, may impact the business results and financial status of the Kobayashi Pharmaceutical Group.

Consolidated Financial Statements

Consolidated Balance Sheet

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
December 31, 2016

	Millions of yen		Thousands of U.S. dollars (Note 1)
	December 31, 2016	March 31, 2016	**December 31, 2016**
Assets			
Current assets:			
Cash and time deposits *(Notes 3, 14 and 15)*	**¥ 58,173**	¥ 61,428	**$ 499,382**
Trade notes and accounts receivable *(Notes 4 and 15)*	**47,046**	36,089	**403,863**
Securities *(Notes 3, 5 and 15)*	**5,500**	4,500	**47,214**
Inventories:			
Commodities and finished goods	**9,222**	10,379	**79,166**
Work in process	**752**	778	**6,455**
Raw materials and supplies	**2,833**	2,796	**24,320**
Total inventories	**12,807**	13,953	**109,941**
Deferred income taxes *(Note 12)*	**2,899**	2,772	**24,886**
Other current assets	**2,267**	1,681	**19,461**
Allowance for doubtful accounts	**(45)**	(76)	**(386)**
Total current assets	**128,647**	120,347	**1,104,361**
Property, plant and equipment:			
Buildings and structures *(Note 6)*	**20,536**	18,724	**176,290**
Machinery, equipment and vehicles *(Note 6)*	**10,684**	9,769	**91,716**
Tools, furniture and fixtures *(Note 6)*	**6,257**	6,157	**53,713**
Land	**3,553**	3,381	**30,501**
Construction in progress	**389**	1,564	**3,339**
Leased assets *(Note 9)*	**815**	988	**6,996**
Total property, plant and equipment	**42,234**	40,583	**362,555**
Accumulated depreciation	**(24,400)**	(23,396)	**(209,460)**
Property, plant and equipment, net *(Note 9)*	**17,834**	17,187	**153,095**
Investments and other assets:			
Investments in securities *(Notes 5 and 15)*:			
Unconsolidated subsidiaries and affiliate	**375**	387	**3,219**
Other	**39,906**	39,269	**342,570**
Total investments in securities	**40,281**	39,656	**345,789**
Deferred income taxes *(Note 12)*	**383**	322	**3,288**
Goodwill *(Notes 3, 6 and 19)*	**4,730**	3,542	**40,604**
Software	**963**	1,078	**8,267**
Other intangible assets *(Notes 6 and 19)*	**1,531**	715	**13,143**
Investment properties, net *(Note 7)*	**2,968**	2,992	**25,479**
Other assets *(Notes 14 and 15)*	**4,162**	3,298	**35,728**
Allowance for doubtful accounts	**(265)**	(139)	**(2,275)**
Total investments and other assets	**54,753**	51,464	**470,023**
Total assets *(Note 19)*	**¥201,234**	¥188,998	**$1,727,479**

See accompanying notes to consolidated financial statements

	Millions of yen		Thousands of U.S. dollars (Note 1)
	December 31, 2016	March 31, 2016	**December 31, 2016**
Liabilities and Net Assets			
Current liabilities:			
Short-term loans *(Notes 8 and 15)*	**¥ 192**	¥ 181	**$ 1,648**
Trade notes and accounts payable *(Notes 4 and 15)*	**8,169**	7,142	**70,126**
Electronically recorded obligations-operating *(Note 15)*	**7,850**	6,519	**67,388**
Current portion of lease obligations *(Notes 9 and 15)*	**57**	67	**489**
Income taxes payable *(Notes 12 and 15)*	**3,357**	1,789	**28,818**
Other accounts payable *(Note 15)*	**20,192**	14,418	**173,337**
Provision for sales returns	**1,410**	1,478	**12,104**
Accrued bonuses	**1,147**	1,997	**9,846**
Asset retirement obligations *(Note 11)*	**38**	24	**326**
Other current liabilities *(Notes 12 and 15)*	**4,564**	2,867	**39,180**
Total current liabilities	**46,976**	36,482	**403,262**
Long-term liabilities:			
Lease obligations *(Notes 9 and 15)*	**581**	619	**4,988**
Deferred income taxes *(Note 12)*	**3,842**	3,184	**32,981**
Liability for retirement benefits *(Note 10)*	**4,337**	4,478	**37,231**
Provision for retirement benefits for directors and audit & supervisory board members	**34**	32	**292**
Asset retirement obligations *(Note 11)*	**80**	87	**687**
Other long-term liabilities	**2,064**	2,093	**17,718**
Total long-term liabilities	**10,938**	10,493	**93,897**
Total liabilities	**57,914**	46,975	**497,159**
Contingent liabilities *(Note 14)*			
Net Assets			
Shareholders' equity *(Note 13)*:			
Common stock:			
Authorized — 340,200,000 at December 31, 2016 and 170,100,000 shares at March 31, 2016 Issued — 85,050,000 shares at December 31, 2016 and 42,525,000 shares at March 31, 2016	**3,450**	3,450	**29,616**
Capital surplus	**4,959**	4,954	**42,570**
Retained earnings	**147,901**	137,486	**1,269,645**
Treasury stock, at cost	**(21,088)**	(13,180)	**(181,028)**
Total shareholders' equity	**135,222**	132,710	**1,160,803**
Accumulated other comprehensive income:			
Unrealized holding gain on securities *(Note 5)*	**9,481**	8,862	**81,390**
Unrealized gain (loss) on deferred hedges *(Note 16)*	**40**	(39)	**343**
Translation adjustments	**681**	1,668	**5,846**
Retirement benefit liability adjustments *(Note 10)*	**(2,171)**	(1,328)	**(18,637)**
Total accumulated other comprehensive income	**8,031**	9,163	**68,942**
Stock acquisition rights	**67**	75	**575**
Non-controlling interests	—	75	—
Total net assets	**143,320**	142,023	**1,230,320**
Total liabilities and net assets	**¥201,234**	¥188,998	**$1,727,479**

Consolidated Statement of Income

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Nine months ended December 31, 2016

	Millions of yen		*Thousands of U.S. dollars (Note 1)*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Net sales *(Note 19)*	**¥120,052**	¥137,211	**$1,030,578**
Cost of sales *(Note 10)*	**48,639**	57,518	**417,538**
Gross profit	**71,413**	79,693	**613,040**
Selling, general and administrative expenses:			
Sales promotions	**8,159**	9,653	**70,040**
Freight and storage	**4,521**	5,629	**38,810**
Advertising	**17,049**	15,994	**146,356**
Provision for allowance for doubtful accounts	**32**	18	**275**
Salaries and bonuses	**8,019**	9,778	**68,839**
Net pension cost *(Note 10)*	**545**	621	**4,679**
Provision for retirement benefits for directors and audit & supervisory board members	**2**	4	**17**
Taxes and dues other than income taxes	**454**	404	**3,897**
Depreciation and amortization *(Note 19)*	**526**	635	**4,515**
Amortization of goodwill *(Note 19)*	**513**	485	**4,404**
Office rent and other rental charges	**1,130**	1,455	**9,700**
External service fees	**4,069**	4,800	**34,930**
Research and development costs	**4,122**	5,789	**35,385**
Other	**4,862**	6,168	**41,738**
Total selling, general and administrative expenses	**54,003**	61,433	**463,585**
Operating income	**17,410**	18,260	**149,455**
Other income (expenses):			
Interest and dividend income *(Note 19)*	**540**	638	**4,636**
Equity in loss of an affiliate *(Note 19)*	**—**	(607)	**—**
Interest expense *(Note 19)*	**(22)**	(34)	**(189)**
Sales discounts	**(583)**	(688)	**(5,005)**
Foreign currency exchange gain (loss), net	**50**	(222)	**429**
Loss on disposal or sales of property, plant and equipment, net	**(114)**	(77)	**(979)**
Loss on impairment of fixed assets *(Notes 6 and 19)*	**(1,342)**	(127)	**(11,520)**
Gain on sales of investment in an affiliate	**8**	1,379	**69**
Gain on sales of investments in securities *(Note 5)*	**1,796**	8	**15,418**
Loss on defective inventories	**—**	(195)	**—**
Loss on business transfer	**(10)**	(110)	**(86)**
Compensation income	**1,900**	—	**16,310**
Loss on impairment of investment in a subsidiary	**—**	(50)	**—**
Other, net	**169**	580	**1,451**
Profit before income taxes	**19,802**	18,755	**169,989**
Income taxes *(Note 12)*:			
Current	**5,223**	4,916	**44,836**
Deferred	**322**	384	**2,765**
	5,545	5,300	**47,601**
Profit	**14,257**	13,455	**122,388**
Profit (loss) attributable to:			
Non-controlling interests	**(65)**	(11)	**(558)**
Owners of parent *(Note 17)*	**¥ 14,322**	¥ 13,466	**$122,946**

See accompanying notes to consolidated financial statements

Consolidated Statement of Comprehensive Income

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Nine months ended December 31, 2016

	Millions of yen		*Thousands of U.S. dollars (Note 1)*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Profit	**¥14,257**	¥13,455	**$122,388**
Other comprehensive loss *(Note 18)*:			
Unrealized holding gain on securities	**619**	1,310	**5,315**
Unrealized gain (loss) on deferred hedges	**79**	(188)	**678**
Translation adjustments	**(998)**	(210)	**(8,567)**
Retirement benefit liability adjustments	**(843)**	(474)	**(7,237)**
Share of other comprehensive loss of an affiliate accounted for by the equity method	—	(1,355)	—
Total other comprehensive loss	**(1,143)**	(917)	**(9,811)**
Comprehensive income	**¥13,114**	¥12,538	**$112,577**
Comprehensive income (loss) attributable to:			
Owners of parent	**¥13,189**	¥12,553	**$113,221**
Non-controlling interests	**(75)**	(15)	**(644)**

See accompanying notes to consolidated financial statements

Consolidated Statement of Changes in Net Assets

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Nine months ended December 31, 2016

Millions of yen

	Numbers of shares issued (Thousands)	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized holding gain on securities	Unrealized gain (loss) on deferred hedges	Translation adjustments	Retirement benefit liability adjustments	Stock acquisition rights	Non-controlling interests	Total net assets
Balance at April 1, 2015	42,525	¥3,450	¥4,219	¥127,858	¥ (6,208)	¥7,554	¥ 1,361	¥1,874	¥ (711)	¥ 191	¥ 23	¥139,611
Profit attributable to owners of parent for the year		—	—	13,466	—	—	—	—	—	—	—	13,466
Cash dividends		—	—	(3,838)	—	—	—	—	—	—	—	(3,838)
Change in scope of consolidation		—	—	—	—	—	—	—	—	—	—	—
Purchase of treasury stock		—	—	—	(8,002)	—	—	—	—	—	—	(8,002)
Disposal of treasury stock		—	735	—	1,030	—	—	—	—	—	—	1,765
Other changes		—	—	—	—	1,308	(1,400)	(206)	(617)	(116)	52	(979)
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 December 31, 2016	**85,050***	**¥3,450**	**¥4,959**	**¥147,901**	**¥(21,088)**	**¥9,481**	**¥ 40**	**¥ 681**	**¥(2,171)**	**¥ 67**	**¥ —**	**¥143,320**

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

Thousands of U.S. dollars (Note 1)

	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized holding gain on securities	Unrealized gain (loss) on deferred hedges	Translation adjustments	Retirement benefit liability adjustments	Stock acquisition rights	Non-controlling interests	Total net assets
Balance at April 1, 2016	$29,616	$42,527	$1,180,239	$(113,143)	$76,075	$(335)	$14,319	$(11,400)	$644	$ 644	$1,219,186
Profit attributable to owners of parent for the period	—	—	**122,946**	—	—	—	—	—	—	—	**122,946**
Cash dividends	—	—	**(33,694)**	—	—	—	—	—	—	—	**(33,694)**
Change in scope of consolidation	—	—	**154**	—	—	—	—	—	—	—	**154**
Purchase of treasury stock	—	—	—	**(68,701)**	—	—	—	—	—	—	**(68,701)**
Disposal of treasury stock	—	**43**	—	**816**	—	—	—	—	—	—	**859**
Other changes	—	—	—	—	**5,315**	**678**	**(8,473)**	**(7,237)**	**(69)**	**(644)**	**(10,430)**
Balance at December 31, 2016	**$29,616**	**$42,570**	**$1,269,645**	**$(181,028)**	**$81,390**	**$ 343**	**$ 5,846**	**$(18,637)**	**$575**	**$ —**	**$1,230,320**

See accompanying notes to consolidated financial statements

Consolidated Statement of Cash Flows

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
Nine months ended December 31, 2016

	Millions of yen		*Thousands of U.S. dollars (Note 1)*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Cash flows from operating activities:			
Profit before income taxes	**¥ 19,802**	¥ 18,755	**$ 169,989**
Adjustments for:			
Depreciation and amortization	**2,626**	3,072	**22,543**
Loss on impairment of investment in a subsidiary	**—**	50	**—**
Loss on impairment of fixed assets	**1,342**	127	**11,520**
Increase in allowance for doubtful accounts	**102**	38	**876**
Decrease in liability for retirement benefits	**(1,583)**	(1,809)	**(13,589)**
Decrease in asset for retirement benefits	**—**	287	**—**
Interest and dividend income	**(540)**	(638)	**(4,636)**
Interest expense	**22**	34	**189**
Equity in loss of an affiliate	**—**	607	**—**
Gain on sales of investment in an affiliate	**(8)**	(1,379)	**(69)**
Gain on sales of investments in securities	**(1,796)**	(8)	**(15,418)**
Loss on disposal or sales of property, plant and equipment	**114**	81	**979**
Changes in operating assets and liabilities:			
Increase in trade notes and accounts receivable	**(11,045)**	(282)	**(94,815)**
Decrease (increase) in inventories	**1,148**	(1,535)	**9,855**
Increase in trade notes and accounts payable	**2,328**	164	**19,985**
Increase in other accounts payable	**5,955**	1,883	**51,120**
Increase (decrease) in consumption taxes payable	**347**	(706)	**2,979**
Other, net	**481**	1,319	**4,128**
Subtotal	**19,295**	20,060	**165,636**
Interest and dividends received	**528**	705	**4,533**
Interest paid	**(22)**	(19)	**(189)**
Income taxes paid	**(3,703)**	(6,417)	**(31,788)**
Net cash provided by operating activities	**16,098**	14,329	**138,192**
Cash flows from investing activities:			
Payments for time deposits	**(63,870)**	(83,000)	**(548,287)**
Proceeds from time deposits	**69,021**	73,000	**592,506**
Payments for purchases of property, plant and equipment	**(2,851)**	(3,382)	**(24,474)**
Proceeds from sales of property, plant and equipment	**6**	20	**52**
Payments for purchases of intangible assets	**(636)**	(666)	**(5,460)**
Payments for purchases of investments in securities	**(19)**	(23)	**(163)**
Proceeds from sales of investments in securities	**316**	339	**2,713**
Decrease (increase) in other assets, net	**33**	(64)	**283**
Proceeds from sales of investment in an affiliate	**19**	2,962	**163**
Payments for purchase of shares of subsidiaries resulting in change in scope of consolidation	**(2,470)**	—	**(21,204)**
Other, net	**(69)**	(119)	**(593)**
Net cash used in investing activities	**(520)**	(10,933)	**(4,464)**
Cash flows from financing activities:			
Increase in short-term loans, net	**11**	140	**94**
Dividends paid	**(3,920)**	(3,837)	**(33,651)**
Purchase of treasury stock	**(8,054)**	(8,110)	**(69,139)**
Proceeds from disposal of treasury stock	**92**	1,625	**790**
Decrease in lease obligations	**(52)**	(94)	**(446)**
Proceeds from non-controlling interests	**—**	76	**—**
Net cash used in financing activities	**(11,923)**	(10,200)	**(102,352)**
Effect of exchange rate changes on cash and cash equivalents	**(760)**	(167)	**(6,524)**
Net increase (decrease) in cash and cash equivalents	**2,895**	(6,971)	**24,852**
Cash and cash equivalents at the beginning of the period	**25,428**	32,399	**218,285**
Increase in cash and cash equivalents from newly consolidated subsidiary	**0**	—	**0**
Cash and cash equivalents at the end of the period *(Note 3)*	**¥ 28,323**	¥ 25,428	**$ 243,137**

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

Kobayashi Pharmaceutical Co., Ltd. and Consolidated Subsidiaries
December 31, 2016

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.

Certain reclassifications of previously reported amounts have been made to conform the consolidated financial statements for the year ended March 31, 2016 to the presentation used for the nine months ended December 31, 2016. Such reclassifications had had no effect on consolidated profit, net assets or cash flows.

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 ¥116.49 = U.S.$1.00, the approximate exchange rate in effect on December 31, 2016. 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.

(b) Change in fiscal year

The Company and certain consolidated subsidiaries whose fiscal year end was on March 31 changed their fiscal year end from March 31 to December 31. The change is to align the closing date of the Company and certain consolidated subsidiaries in order to expand the globalization of business operations and correspondingly improve the efficiency of Group management. Accordingly, the fiscal year ended December 31, 2016 is an irregular settlement period whereby the period of consolidation is nine months (from April 1, 2016 to December 31, 2016) for the Company and such certain consolidated subsidiaries whose fiscal year end was preciously on March 31 while the settlement period is twelve months (January 1, 2016 to December 31, 2016) for the remaining consolidated subsidiaries whose fiscal year end was already on December 31.

The operating results from January 1, 2016 to March 31, 2016 for the consolidated subsidiaries, whose fiscal year end was already on December 31, were adjusted on the consolidated statement of income for the nine months ended December 31, 2016. Net sales, operating income and profit before income taxes for these consolidated subsidiaries for the period from January 1, 2016 to March 31, 2016 amounted to ¥3,662 million ($31,436 thousand), ¥449 million ($3,854 thousand) and ¥375 million ($3,219 thousand), respectively.

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.

(c) 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.

(d) 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.

(e) 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.

(f) 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.

(g) 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.

(h) 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.

(i) 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.

(j) 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.

(k) 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.

(l) 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.

(m) 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.

(n) Liability for retirement benefits

The liability for retirement benefits for employees of the Company and certain 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.

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

Directors and audit & 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.

(p) 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.

(q) Research and development costs
Research and development costs are charged to income when incurred.

(r) 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 22 (a)).

(s) 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.

(Additional Information)
Application of Implementation Guidance on Recoverability of Deferred Tax Assets
Effective from the period ended December 31, 2016, the Company and its domestic subsidiaries adopted "Implementation Guidance on Recoverability of Deferred Tax Assets" (Accounting Standards Board of Japan ("ASBJ")) Guidance No.26, issued on March 28, 2016.

3. Cash and Cash Equivalents

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

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Cash and time deposits	**¥ 58,173**	¥ 61,428	**$ 499,382**
Time deposits over three months	**(35,350)**	(40,500)	**(303,459)**
Securities maturing within three months	**5,500**	4,500	**47,214**
Cash and cash equivalents	**¥ 28,323**	¥ 25,428	**$ 243,137**

Berlin Industries, Inc. and its 100% subsidiary Perfecta Products, Inc. became consolidated subsidiaries of the Company in the fiscal period ended December 31, 2016. Assets and liabilities of these companies as of the date of consolidation, acquisition cost and payments for purchase, net of these newly consolidated subsidiaries were as follows:

	Millions of yen	*Thousands of U.S. dollars*
	December 31, 2016	**December 31, 2016**
Current assets	**¥ 368**	**$ 3,159**
Non-current assets	**1,080**	**9,271**
Goodwill	**1,544**	**13,254**
Current liabilities	**(107)**	**(919)**
Long-term liabilities	**(387)**	**(3,321)**
Acquisition cost	**2,498**	**21,444**
Cash and cash equivalents	**(28)**	**(240)**
Payments for purchase, net	**¥2,470**	**$21,204**

4. Trade Notes Receivable and Trade Notes Payable

Although the balance sheet date for the nine months ended December 31, 2016 fell on a bank holiday, trade notes receivable of ¥5 million ($43 thousand) and trade notes payable of ¥544 million ($4,670 thousand) were accounted for as settled on that date and were excluded from the respective balances in the consolidated balance sheet at December 31, 2016.

5. Securities and Investments in Securities

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

(1) Securities whose carrying value exceeds their acquisition cost

	Millions of yen					
	December 31, 2016			March 31, 2016		
	Acquisition cost	Carrying value	Unrealized gain	Acquisition cost	Carrying value	Unrealized gain
Equity securities	**¥ 7,160**	**¥19,901**	**¥12,741**	¥ 7,116	¥18,899	¥11,783
Debt securities	**19,266**	**19,960**	**694**	19,299	20,109	810
	¥26,426	**¥39,861**	**¥13,435**	¥26,415	¥39,008	¥12,593

	Thousands of U.S. dollars		
	December 31, 2016		
	Acquisition cost	Carrying value	Unrealized gain
Equity securities	**$ 61,465**	**$170,839**	**$109,374**
Debt securities	**165,388**	**171,345**	**5,957**
	$226,853	**$342,184**	**$115,331**

(2) Securities whose acquisition cost exceeds their carrying value

	Millions of yen					
	December 31, 2016			March 31, 2016		
	Acquisition cost	Carrying value	Unrealized loss	Acquisition cost	Carrying value	Unrealized loss
Equity securities	**¥ 9**	**¥ 8**	**¥(1)**	¥ 40	¥ 37	¥(3)
Other	**5,500**	**5,500**	—	4,500	4,500	—
	¥5,509	**¥5,508**	**¥(1)**	¥4,540	¥4,537	¥(3)

	Thousands of U.S. dollars		
	December 31, 2016		
	Acquisition cost	Carrying value	Unrealized loss
Equity securities	**$ 78**	**$ 69**	**$(9)**
Other	**47,214**	**47,214**	—
	$47,292	**$47,283**	**$(9)**

(3) Securities whose market value is not determinable

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Unlisted equity securities	**¥37**	¥223	**$317**

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

	Millions of yen			
	Nine months ended December 31, 2016		Twelve months ended March 31, 2016	
	Proceeds from sales	Gross realized gain	Proceeds from sales	Gross realized gain
Equity securities	**¥1,960**	**¥1,796**	¥15	¥8
	¥1,960	**¥1,796**	¥15	¥8

	Thousands of U.S. dollars	
	Nine months ended December 31, 2016	
	Proceeds from sales	Gross realized gain
Equity securities	**$16,825**	**$15,418**
	$16,825	**$15,418**

6. 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 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%.

For the year ended March 31, 2016, the carrying values of production facilities such as machinery, equipment and other, which are not anticipated to be utilized in the future, and trademark rights and other intangible assets, which future cash flow is not expected, 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 production facilities, trademark rights and other intangible assets are based on the higher amount of net selling value or value in use. For the year ended March 31, 2016, the carrying values of the production facilities, trademark rights and other intangible assets were reduced to zero because future cash flow was not expected.

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

Nine months ended December 31, 2016

Location	Description	Classification	*Millions of yen*	*Thousands of U.S. dollars*
Osaka and other	Production facilities	Machinery, equipment and other	**¥ 59**	**$ 506**
Osaka	Other	Other intangible assets	**275**	**2,361**
China	Production facilities	Machinery, equipment and other	**842**	**7,228**
U.S.A.	Other	Goodwill	**166**	**1,425**
			¥1,342	**$11,520**

Twelve months ended March 31, 2016

Location	Description	Classification	*Millions of yen*
Osaka and other	Production facilities	Machinery, equipment and other	¥ 30
Osaka	Other	Trademark rights	39
Osaka	Other	Other intangible assets	58
			¥127

7. 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 ¥222 million ($1,906 thousand) and ¥290 million, and rental cost amounted to ¥59 million ($506 thousand) and ¥70 million for the nine months ended December 31, 2016 and the twelve months ended March 31, 2016, respectively.

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

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**

Millions of yen

Carrying value			Fair value
April 1, 2015	Net change	March 31, 2016	March 31, 2016
¥3,917	¥(34)	¥3,883	¥4,847

Thousands of U.S. dollars

Carrying value			Fair value
April 1, 2016	Net change	December 31, 2016	December 31, 2016
$33,333	**$(206)**	**$33,127**	**$41,841**

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 nine months ended December 31, 2016 were due to the net effect of decreases related to sales of buildings in the amount of ¥0 million ($0 thousand), and depreciation in the amount of ¥24 million ($206 thousand), and for the changes for the twelve months ended March 31, 2016 were due to the net effect of the decrease related to depreciation in the amount of ¥34 million, and the increase related to repair work on 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.

8. Short-Term Loans

The average interest rate on short-term bank loans as of December 31, 2016 and March 31, 2016 was 0.10%.

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, 2016 and March 31, 2016 were summarized as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Lines-of-credit	**¥16,659**	¥16,786	**$143,008**
Credit used	**(4)**	(4)	**(34)**
Available credit	**¥16,655**	¥16,782	**$142,974**

9. 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, 2016 and March 31, 2016 were summarized as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Finance lease obligations due in installments from 2017 through 2030	**¥638**	¥686	**$5,477**
Less current portion	**(57)**	(67)	**(489)**
	¥581	¥619	**$4,988**

The aggregate annual maturities of finance lease obligations subsequent to December 31, 2016 were summarized as follows:

Year ending December 31,	*Millions of yen*	*Thousands of U.S. dollars*
2017	**¥ 57**	**$ 489**
2018	**54**	**464**
2019	**53**	**455**
2020	**52**	**446**
2021	**51**	**438**
2022 and thereafter	**371**	**3,185**
Total	**¥638**	**$5,477**

(b) Operating lease transactions

Future minimum lease payments (including the interest portion thereon) subsequent to December 31, 2016 for non-cancelable operating leases were summarized as follows:

Year ending December 31,	*Millions of yen*	*Thousands of U.S. dollars*
2017	**¥ 211**	**$ 1,811**
2018 and thereafter	**1,017**	**8,730**
Total	**¥1,228**	**$10,541**

10. 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.

(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*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Retirement benefit obligation at beginning of period	**¥10,410**	¥ 9,486	**$ 89,364**
Service cost	**413**	473	**3,545**
Interest cost	**25**	127	**215**
Actuarial differences	**1,369**	1,241	**11,752**
Prior service cost	—	(400)	—
Benefits paid	**(518)**	(519)	**(4,447)**
Other	—	2	—
Retirement benefit obligation at end of period	**¥11,699**	¥10,410	**$100,429**

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

	Millions of yen		*Thousands of U.S. dollars*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Plan assets at fair value at beginning of period	**¥6,644**	¥5,180	**$57,035**
Expected return on plan assets	**100**	104	**858**
Actuarial differences	**(50)**	56	**(429)**
Contributions paid by the employer	**1,886**	1,516	**16,190**
Benefits paid	**(459)**	(207)	**(3,940)**
Other	**(4)**	(5)	**(34)**
Plan assets at fair value at end of period	**¥8,117**	¥6,644	**$69,680**

(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*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Liability for retirement benefits at beginning of period	**¥712**	¥903	**$6,112**
Retirement benefit expenses	**126**	152	**1,082**
Benefits paid	**(83)**	(343)	**(712)**
Liability for retirement benefits at end of period	**¥755**	¥712	**$6,482**

(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, 2016	March 31, 2016	**December 31, 2016**
Funded retirement benefit obligation	**¥11,604**	¥10,267	**$ 99,614**
Plan assets at fair value	**(8,117)**	(6,644)	**(69,680)**
	3,487	3,623	**29,934**
Unfunded retirement benefit obligation	**850**	855	**7,297**
Net amount of liabilities recognized in the consolidated balance sheet	**4,337**	4,478	**37,231**
Liability for retirement benefits	**4,337**	4,478	**37,231**
Net amount of liabilities recognized in the consolidated balance sheet	**¥ 4,337**	¥ 4,478	**$ 37,231**

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

	Millions of yen		*Thousands of U.S. dollars*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Service cost	**¥ 413**	¥ 473	**$ 3,545**
Interest cost	**25**	127	**215**
Expected return on plan assets	**(100)**	(104)	**(858)**
Amortization of actuarial differences	**237**	169	**2,035**
Amortization of prior service cost	**(29)**	(30)	**(249)**
Retirement benefit expenses calculated by the simplified method	**126**	152	**1,082**
Retirement benefit expenses	**¥ 672**	¥ 787	**$ 5,770**

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

	Millions of yen		*Thousands of U.S. dollars*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Actuarial differences	**¥(1,186)**	¥(1,021)	**$(10,181)**
Prior service cost	**(29)**	368	**(249)**
Total	**¥(1,215)**	¥ (653)	**$(10,430)**

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

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Unrecognized actuarial differences	**¥3,469**	¥2,283	**$29,779**
Unrecognized prior service cost	**(339)**	(368)	**(2,910)**
Total	**¥3,130**	¥1,915	**$26,869**

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

	December 31, 2016	March 31, 2016
Bonds	**22%**	21%
General accounts	**78**	77
Other	**0**	2
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:

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

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

	Millions of yen		*Thousands of U.S. dollars*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Contributions to defined contribution pension plans	**¥130**	¥166	**$1,116**

11. 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 nine months ended December 31, 2016 and the twelve months ended March 31, 2016 were as follows:

	Millions of yen		*Thousands of U.S. dollars*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Asset retirement obligations at beginning of period	**¥111**	¥109	**$ 953**
Liabilities incurred for leased buildings	**6**	10	**51**
Decrease due to settlement of asset retirement liabilities	**—**	(9)	**—**
Accretion expense	**1**	1	**9**
Asset retirement obligations at end of period	**¥118**	¥111	**$1,013**

12. Income Taxes

The Company and its domestic subsidiaries are subject to several taxes based on income which, in the aggregate, resulted in statutory tax rates of approximately 30.81% and 33.06% for the nine months ended December 31, 2016 and the twelve months ended March 31, 2016, respectively. The overseas subsidiaries are subject to the income taxes of their respective countries of domicile.

Reconciliations of the differences between the statutory tax rates and the effective tax rates in the accompanying consolidated statement of income for the nine months ended December 31, 2016 and the twelve months ended March 31, 2016 were as follows:

	Nine months ended December 31, 2016	Twelve months ended March 31, 2016
Statutory tax rates	**30.81%**	33.06%
Tax loss carryforwards of consolidated subsidiaries	**0.56**	0.21
Valuation allowances	**1.22**	(0.17)
Utilization of tax loss carryforwards	**(0.62)**	(0.36)
Consolidated adjustment for gain on sales of investment in an affiliate	**—**	2.75
Tax credits on research and development costs and other	**(2.79)**	(5.03)
Expenses not deductible for tax purposes	**0.45**	0.51
Equity in loss of an affiliate	**—**	1.07
Nontaxable dividend income	**(0.11)**	(5.34)
Change in statutory tax rates	**—**	0.59
Other	**(1.52)**	0.97
Effective tax rates	**28.00%**	28.26%

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, 2016 and March 31, 2016 were as follows:

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Deferred tax assets:			
Liability for retirement benefits	**¥ 1,342**	¥ 1,391	**$ 11,520**
Tax loss carryforwards	**736**	714	**6,318**
Accrued bonuses	**332**	602	**2,850**
Provision for retirement benefits for directors and audit & supervisory board members	**10**	9	**86**
Accrued expenses	**1,777**	1,343	**15,255**
Accrued enterprise taxes	**147**	185	**1,262**
Unrealized intercompany profits	**207**	213	**1,777**
Loss on impairment of fixed assets	**891**	578	**7,649**
Loss on disposal or write-offs of inventories	**355**	153	**3,047**
Allowance for doubtful accounts	**149**	112	**1,279**
Other	**1,098**	1,142	**9,426**
Gross deferred tax assets	**7,044**	6,442	**60,469**
Valuation allowance	**(2,377)**	(2,096)	**(20,405)**
Total deferred tax assets	**4,667**	4,346	**40,064**
Deferred tax liabilities:			
Unrealized holding gain on securities	**(3,953)**	(3,729)	**(33,934)**
Forward foreign currency exchange contracts	**(18)**	—	**(155)**
Gain on sales of investment securities	**(944)**	—	**(8,104)**
Other	**(556)**	(791)	**(4,773)**
Total deferred tax liabilities	**(5,471)**	(4,520)	**(46,966)**
Net deferred tax liabilities	**¥ (804)**	¥ (174)	**$ (6,902)**

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

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Current assets — deferred income taxes	**¥ 2,899**	¥ 2,772	**$ 24,886**
Investments and other assets — deferred income taxes	**383**	322	**3,288**
Current liabilities — deferred income taxes	**(244)**	(84)	**(2,095)**
Long-term liabilities — deferred income taxes	**(3,842)**	(3,184)	**(32,981)**
	¥ (804)	¥ (174)	**$ (6,902)**

13. 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 ($2,919 thousand) as of December 31, 2016 and March 31, 2016.

Stock-based compensation plan

As of December 31, 2016, 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 ($24.69) per share as of December 31, 2016. 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 nine months ended December 31, 2016, although stock option expense included in cost of sales for the twelve months ended March 31, 2016 amounted to ¥1 million, and stock option expense included in selling, general and administrative expenses for the twelve months ended March 31, 2016 amounted to ¥22 million. Gain on reversal of stock acquisition rights recorded for the nine months ended December 31, 2016 and the twelve months ended March 31, 2016 amounted to ¥0 million ($0 thousand) and ¥0 million, respectively.

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 March 31, 2016	—
Granted	—
Forfeited	—
Vested	—
Outstanding as of December 31, 2016	—
Number of stock options (Vested):	
Outstanding as of March 31, 2016	307,800
Vested	—
Exercised	32,000
Forfeited	3,200
Outstanding as of December 31, 2016	272,600

	Yen	*U.S. dollars*
Exercise price	**¥2,876**	**$24.69**
Average price at exercise	**¥4,792**	**$41.14**
Fair value of options as of the grant date	**¥ 247**	**$ 2.12**

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.

Common stock and treasury stock

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

	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 in treasury stock was due to the two-for-one common stock split, effective July 1, 2016 of 2,354,713 shares, and purchases of treasury stock approved by the Board of Directors of 1,572,100 shares 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.

	Number of shares			
	Twelve months ended March 31, 2016			
	April 1, 2015	Increase	Decrease	March 31, 2016
Common stock	42,525,000	—	—	42,525,000
Treasury stock	1,807,775	833,038	282,500	2,358,313

Notes:

1. The increase in treasury stock was due to purchases of treasury stock approved by the Board of Directors of 832,800 shares and purchases of less than one voting unit of 238 shares for the twelve months ended March 31, 2016.
2. The decrease in treasury stock was due to the exercise of 282,500 shares under the 2013 stock option plan.

14. Contingent Liabilities, Guarantees and Pledged Assets

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

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Bank loans of small and medium-sized enterprises in areas affected by the Great East Japan Earthquake	**¥33**	¥36	**$283**

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

	Millions of yen		*Thousands of U.S. dollars*
	December 31, 2016	March 31, 2016	**December 31, 2016**
Time deposits	**¥50**	¥50	**$429**
Security deposits	**80**	80	**687**

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.

15. 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 (s).

(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.

(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 16. "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, 2016 and March 31, 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, 2016			March 31, 2016		
	Carrying value	Estimated fair value	Difference	Carrying value	Estimated fair value	Difference
Assets						
(i) Cash and time deposits	**¥ 58,173**	**¥ 58,173**	**¥ —**	¥ 61,428	¥ 61,428	¥ —
(ii) Trade notes and accounts receivable	**47,046**	**47,046**	**—**	36,089	36,089	—
(iii) Securities and investments in securities	**45,369**	**45,369**	**—**	43,546	43,546	—
(iv) Long-term loans receivable included in other assets	**172**	**—**	**—**	643	—	—
Allowance for doubtful accounts (*1)	**(121)**	**—**	**—**	(1)	—	—
	51	**48**	**(3)**	642	631	(11)
Total assets	**¥150,639**	**¥150,636**	**¥ (3)**	¥141,705	¥141,694	¥(11)
Liabilities						
(i) Trade notes and accounts payable	**¥ 8,169**	**¥ 8,169**	**¥ —**	¥ 7,142	¥ 7,142	¥ —
(ii) Electronically recorded obligations-operating	**7,850**	**7,850**	**—**	6,519	6,519	—
(iii) Short-term loans	**192**	**192**	**—**	181	181	—
(iv) Other accounts payable	**20,192**	**20,192**	**—**	14,418	14,418	—
(v) Current portion of lease obligations	**57**	**57**	**0**	67	67	0
(vi) Income taxes payable	**3,357**	**3,357**	**—**	1,789	1,789	—
(vii) Accrued consumption taxes, included in other current liabilities	**1,090**	**1,090**	**—**	751	751	—
(viii) Lease obligations	**581**	**583**	**2**	619	620	1
Total liabilities	**¥41,488**	**¥41,490**	**¥ 2**	¥31,486	¥31,487	¥ 1
Derivative transactions (*2)	**¥ 58**	**¥ 58**	**¥ —**	¥ (56)	¥ (56)	¥ —

Thousands of U.S. dollars

	December 31, 2016		
	Carrying value	Estimated fair value	Difference
Assets			
(i) Cash and time deposits	**$ 499,382**	**$ 499,382**	**$ —**
(ii) Trade notes and accounts receivable	**403,863**	**403,863**	**—**
(iii) Securities and investments in securities	**389,467**	**389,467**	**—**
(iv) Long-term loans receivable included in other assets	**1,477**	**—**	**—**
Allowance for doubtful accounts (*1)	**(1,039)**	**—**	**—**
	438	**412**	**(26)**
Total assets	**$1,293,150**	**$1,293,124**	**$(26)**
Liabilities			
(i) Trade notes and accounts payable	**$ 70,126**	**$ 70,126**	**$ —**
(ii) Electronically recorded obligations-operating	**67,388**	**67,388**	**—**
(iii) Short-term loans	**1,648**	**1,648**	**—**
(iv) Other accounts payable	**173,337**	**173,337**	**—**
(v) Current portion of lease obligations	**489**	**489**	**0**
(vi) Income taxes payable	**28,818**	**28,818**	**—**
(vii) Accrued consumption taxes, included in other current liabilities	**9,357**	**9,357**	**—**
(viii) Lease obligations	**4,988**	**5,005**	**17**
Total liabilities	**$356,151**	**$356,168**	**$ 17**
Derivative transactions (*2)	**$ 498**	**$ 498**	**$ —**

(*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.

(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 5.

(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 16. "Derivatives and Hedging Activities."

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

	Millions of yen		*Thousands of U.S. dollars*
Type	**December 31, 2016**	March 31, 2016	**December 31, 2016**
Unlisted equity securities	**¥412**	¥610	**$3,536**

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, 2016 and March 31, 2016 were summarized as follows:

	Millions of yen							
	December 31, 2016				March 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	**¥ 58,169**	**¥ —**	**¥ —**	**¥ —**	¥61,424	¥ —	¥ —	¥ —
(ii) Trade notes and accounts receivable	**47,046**	**—**	**—**	**—**	36,089	—	—	—
(iii) Securities and investments in securities:								
Government bonds (national and local)	**—**	**14,351**	**4,713**	**—**	—	7,123	11,941	—
Trust beneficiary right	**5,500**	**—**	**—**	**—**	4,500	—	—	—
(iv) Long-term loans receivable included in other assets	**1**	**2**	**—**	**48**	2	641	—	—
Total assets	**¥110,716**	**¥14,353**	**¥4,713**	**¥ 48**	¥102,015	¥7,764	¥11,941	¥ —

	Thousands of U.S. dollars			
	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
(i) Time deposits	**$499,348**	**$ —**	**$ —**	**$ —**
(ii) Trade notes and accounts receivable	**403,863**	**—**	**—**	**—**
(iii) Securities and investments in securities:				
Government bonds (national and local)	**—**	**123,195**	**40,458**	**—**
Trust beneficiary right	**47,214**	**—**	**—**	**—**
(iv) Long-term loans receivable included in other assets	**9**	**17**	**—**	**412**
Total assets	**$950,434**	**$123,212**	**$40,458**	**$412**

(4) The redemption schedule for lease obligations as of December 31, 2016 is disclosed in Note 9.

16. Derivatives and Hedging Activities

The notional amounts and the estimated fair value of the derivative instruments outstanding as of December 31, 2016 and March 31, 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, 2016 and March 31, 2016.

(b) Derivatives for which hedge accounting is applied
Currency-related transactions

			Millions of yen					
			December 31, 2016			March 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	**¥1,060**	**¥370**	**¥56**	¥1,404	¥487	¥ (5)
	Thai baht	Trade accounts payable	**370**	**—**	**2**	772	—	(51)
	Total		**¥1,430**	**¥370**	**¥58**	¥2,176	¥487	¥(56)

			Thousands of U.S. dollars		
			December 31, 2016		
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	**$ 9,099**	**$3,176**	**$481**
	Thai baht	Trade accounts payable	**3,176**	**—**	**17**
	Total		**$12,275**	**$3,176**	**$498**

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

17. Amounts per Share

	Yen		U.S. dollars
	December 31, 2016	March 31, 2016	**December 31, 2016**
Profit attributable to owners of parent:			
Basic	**¥ 179.12**	¥ 165.56	**$ 1.54**
Diluted	**178.86**	165.30	**1.54**
Net assets	**1,818.10**	1,766.06	**15.61**
Cash dividends	**52.00**	48.00	**0.45**

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 fiscal year ended March 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 the nine months ended December 31, 2016 and the twelve months ended March 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.

18. Other Comprehensive Loss

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

	Millions of yen		Thousands of U.S. dollars
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Unrealized holding gain on securities:			
Amount arising during the period	**¥851**	¥1,656	**$7,305**
Reclassification adjustments for gain included in profit	**(8)**	(8)	**(67)**
Amount before tax effect	**843**	1,648	**7,238**
Tax effect	**(224)**	(338)	**(1,923)**
Unrealized holding gain on securities	**619**	1,310	**5,315**
Unrealized gain (loss) on deferred hedges:			
Amount arising during the period	**114**	(278)	**979**
Amount before tax effect	**114**	(278)	**979**
Tax effect	**(35)**	90	**(301)**
Unrealized gain (loss) on deferred hedges	**79**	(188)	**678**
Translation adjustments:			
Amount arising during the period	**(998)**	(210)	**(8,567)**
Translation adjustments	**(998)**	(210)	**(8,567)**
Retirement benefit liability adjustments:			
Amount arising during the period	**(1,423)**	(791)	**(12,216)**
Reclassification adjustments for loss included in profit	**208**	138	**1,786**
Amount before tax effect	**(1,215)**	(653)	**(10,430)**
Tax effect	**372**	179	**3,193**
Retirement benefit liability adjustments	**(843)**	(474)	**(7,237)**
Share of other comprehensive loss of an affiliate accounted for by the equity method:			
Amount arising during the period	—	(691)	—
Reclassification adjustments for loss included in profit	—	(664)	—
Share of other comprehensive loss of an affiliate accounted for by the equity method	—	(1,355)	—
Total other comprehensive loss	**¥(1,143)**	¥(917)	**$(9,811)**

19. 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.

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

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 (loss)	¥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
Increase in property, plant, and equipment and intangible assets	2,832	3,119	31	5,982	156	6,138	132	6,270

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 ($86 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 ¥97,972 million ($841,034 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 ¥283 million ($2,429 thousand) were the depreciation and amortization of the corporate assets.
   (iv) Interest income of ¥50 million ($430 thousand) and interest expense of ¥51 million ($438 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 ¥132 million ($1,133 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							
	Twelve months ended March 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	¥106,963	¥18,998	¥8,539	¥134,500	¥2,711	¥137,211	¥ —	¥137,211
Inter-segment sales and transfers	5,069	1,875	—	6,944	4,625	11,569	(11,569)	—
Total	¥112,032	¥20,873	¥8,539	¥141,444	¥7,336	¥148,780	¥(11,569)	¥137,211
Segment income	¥ 16,600	¥ 675	¥ 40	¥ 17,315	¥ 909	¥ 18,224	¥ (274)	¥ 17,950
Segment assets	¥ 64,713	¥21,362	¥1,407	¥ 87,482	¥9,671	¥ 97,153	¥ 91,845	¥188,998
Other items								
Depreciation and amortization	¥ 1,740	¥251	¥ 45	¥ 2,036	¥ 152	¥ 2,188	¥ 399	¥ 2,587
Amortization of goodwill	4	481	—	485	—	485	—	485
Interest income	35	16	1	52	251	303	(36)	267
Interest expense	—	36	—	36	33	69	(35)	34
Equity in loss of an affiliate	—	—	—	—	(607)	(607)	0	(607)
Increase in property, plant, and equipment and intangible assets	3,191	334	46	3,571	318	3,889	429	4,318

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 ¥274 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 ¥97,314 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 ¥399 million were the depreciation and amortization of the corporate assets.
   (iv) Interest income of ¥36 million and interest expense of ¥35 million posted as adjustments reflect the elimination of transactions between segments.
   (v) Adjustments and eliminations of equity in loss of an affiliate of ¥0 million corresponded to adjustment of inventories.
   (vi) Adjustments and eliminations of increase in property, plant, and equipment and intangible assets of ¥429 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.

	Thousands of U.S. dollars							
	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	**$797,965**	**$154,751**	**$61,465**	**$1,014,181**	**$16,397**	**$1,030,578**	**$ —**	**$1,030,578**
Inter-segment sales and transfers	**39,033**	**8,138**	**—**	**47,171**	**31,033**	**78,204**	**(78,204)**	**—**
Total	**$836,998**	**$162,889**	**$61,465**	**$1,061,352**	**$47,430**	**$1,108,782**	**$ (78,204)**	**$1,030,578**
Segment income (loss)	**$140,149**	**$ 5,477**	**$ (2,438)**	**$ 143,188**	**$24,122**	**$ 167,310**	**$86**	**$ 167,396**
Segment assets	**$636,072**	**$209,589**	**$13,400**	**$ 859,061**	**$99,227**	**$ 958,288**	**$769,191**	**$1,727,479**
Other items								
Depreciation and amortization	**$ 11,881**	**$ 2,447**	**$ 223**	**$ 14,551**	**$ 1,159**	**$ 15,710**	**$ 2,429**	**$18,139**
Amortization of goodwill	**129**	**4,275**	**—**	**4,404**	**—**	**4,404**	**—**	**4,404**
Interest income	**146**	**275**	**—**	**421**	**1,597**	**2,018**	**(430)**	**1,588**
Interest expense	**52**	**360**	**0**	**412**	**215**	**627**	**(438)**	**189**
Increase in property, plant, and equipment and intangible assets	**24,311**	**26,775**	**266**	**51,352**	**1,339**	**52,691**	**1,133**	**53,824**

(b) Related information

(1) Geographical information

(i) Net sales

	Millions of yen		*Thousands of U.S. dollars*
	Nine months ended December 31, 2016	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Domestic	**¥101,139**	¥116,917	**$ 868,220**
Overseas	**18,913**	20,294	**162,358**
Total	**¥120,052**	¥137,211	**$1,030,578**

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, 2016	March 31, 2016	**December 31, 2016**
Domestic	**¥15,069**	¥13,874	**$129,359**
Overseas	**2,765**	3,313	**23,736**
Total	**¥17,834**	¥17,187	**$153,095**

(2) Information by major customers

	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

	Millions of yen	
	Twelve months ended March 31, 2016	
	Sales	Related segment
PALTAC CORPORATION	¥61,260	Domestic Consumer Products Business
ARATA CORPORATION	¥14,813	Domestic Consumer Products Business

	Thousands of U.S. dollars	
	Nine months ended December 31, 2016	
	Sales	Related segment
PALTAC CORPORATION	**$450,185**	Domestic Consumer Products Business
ARATA CORPORATION	**$112,224**	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 nine months ended December 31, 2016 and the twelve months ended March 31, 2016 was as follows:

	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**

	Millions of yen					
	Twelve months ended March 31, 2016					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Loss on impairment of fixed assets	¥126	¥1	¥ —	¥0	¥ —	¥127

	Thousands of U.S. dollars					
	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	**$10,095**	**$1,425**	**$ —**	**$ —**	**$ —**	**$11,520**

(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 nine months ended December 31, 2016 and the twelve months ended March 31, 2016 were as follows:

	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 period	**¥ 15**	**¥ 498**	**¥ —**	**¥ —**	**¥ —**	**¥ 513**
Balance at the end of the period	**240**	**4,490**	—	—	—	**4,730**

	Millions of yen					
	Twelve months ended March 31, 2016					
	Domestic Consumer Products Business	Overseas Consumer Products Business	Direct Marketing Business	Other	Adjustments and eliminations	Total
Amortization for the year	¥ 4	¥ 481	¥ —	¥ —	¥ —	¥ 485
Balance at the end of the year	—	3,542	—	—	—	3,542

	Thousands of U.S. dollars					
	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 period	**$ 129**	**$ 4,275**	**$ —**	**$ —**	**$ —**	**$ 4,404**
Balance at the end of the period	**2,060**	**38,544**	—	—	—	**40,604**

20. Related Party Transactions

There was no information on related party transactions to be disclosed for the nine months ended December 31, 2016.

Information on a related party transaction between the Company and MEDICON, INC., a former affiliate of the Company, for the twelve months ended March 31, 2016 was as follows:

	Millions of yen
Details of transaction	**Twelve months ended March 31, 2016**
Sales of investment in an affiliate	**¥3,000**
Gain on sales of investment in an affiliate	**1,379**

MEDICON, INC. was not considered to be a related party at March 31, 2016 because all the shares of MEDICON, INC. which the Company held were transferred to MEDICON, INC. on November 2, 2015.

Price was determined based on discussion with the counterparty by reference to the valuation conducted by third-party specialist.

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

		Millions of yen		*Thousands of U.S. dollars*
Name	Details of transaction	**Nine months ended December 31, 2016**	Twelve months ended March 31, 2016	**Nine months ended December 31, 2016**
Kazumasa Kobayashi	Exercise of stock acquisition rights	**¥12**	—	**$103**
Yutaka Kobayashi	Exercise of stock acquisition rights	—	12	—
Satoshi Yamane	Exercise of stock acquisition rights	—	12	—

Kazumasa Kobayashi directly owned 0.25%, and Yutaka Kobayashi and Satoshi Yamane directly owned 0.23% and 0.01% of the share of the Company, respectively.

21. Business Combination

Business combination through acquisition

(a) Outline of the business combination

(1) Names and business descriptions of acquired companies

– Company name:
Berlin Industries, Inc.
Holding company

Perfecta Products, Inc.
Planning, development and marketing of general medical and pharmaceutical products and cosmetics

(2) Main reason for business combination

The Company decided to acquire Perfecta Products, Inc., wholly owned by Berlin Industries, Inc., in order to provide new value to customers by collaborating in areas such as of technical skill, R&D experience for general drug for external use and marketing skills of the Company and to strengthen the brand and sales channels of Perfecta Products, Inc.

(3) Date of the business combination

September 1, 2016 (Date of stock acquisition)
September 30, 2016 (Date of deemed acquisition)

(4) Legal form of the business combination

A reverse triangular merger under the related laws and regulations in the U.S.A.

(5) Names after the business combination

Berlin Industries, Inc.
Perfecta Products, Inc.

(6) Ratio of acquired voting rights

100%

(7) Main grounds for determining the acquiring company

The Company's consolidated subsidiary Kobayashi Healthcare LLC acquired all the shares of Berlin Industries, Inc. in exchange for cash.

(b) Period for which earnings of the acquired company were included in the consolidated financial statements

As the deemed acquisition date is September 30, 2016, the earnings of the acquired company were included in the period from September 30, 2016 to December 31, 2016.

(c) Acquisition cost and breakdown

Acquisition price:	Cash	¥2,498 million ($21,444 thousand)
Acquisition cost:		¥2,498 million ($21,444 thousand)

(d) Costs directly associated with the acquisition

Advisory fees, etc. ¥162 million ($1,391 thousand)

(e) Amount of goodwill, reason for recognition, amortization method and amortization period

(1) Amount of goodwill

¥1,544 million ($13,254 thousand)
The amount of goodwill is calculated on a tentative basis, because the allocation of acquisition cost has not been completed.

(2) Reason for recognition

Future business activities of the acquired company are expected to generate excess profitability.

(3) Amortization method and amortization period

Straight-line method over 10 years

(f) Assets acquired and liabilities assumed at the date of business combination

Current assets:	¥368 million ($3,159 thousand)
Non-current assets:	¥1,080 million ($9,271 thousand)
Total assets:	¥1,448 million ($12,430 thousand)
Current liabilities:	¥107 million ($919 thousand)
Long-term liabilities:	¥387 million ($3,321 thousand)
Total liabilities:	¥494 million ($4,240 thousand)

(g) Amounts allocated to intangible assets, other than goodwill, breakdown by component and the weighted average amortization period by component

Customer-related intangible assets:	¥556 million ($4,773 thousand) (14 years)
Trademarks:	¥411 million ($3,528 thousand) (10 years)
Marketing-related intangible assets:	¥104 million ($893 thousand) (2 years)

(h) Allocation of acquisition costs

The acquisition costs are allocated on a tentative basis, because the allocation has not been completed as of December 31, 2016.

(i) Approximate effects on the consolidated statement of income for the nine months ended December 31, 2016 assuming that the business combination was completed on April 1, 2016 and method of calculation

This information has been omitted because the effects are not material to the consolidated financial statements. This information has not been audited.

22. Subsequent Events

(a) 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 nine months ended December 31, 2016, was approved at the Board of Directors' meeting held on February 22, 2017:

	Millions of yen	*Thousands of U.S. dollars*
Cash dividends (¥27.00 = $0.23 per share)	**¥2,127**	**$18,259**

(b) Retirement of treasury stock and use of general reserve

At the Board of Directors' meeting held on February 1, 2017, the Company resolved to retire treasury stock in accordance with the provisions of Article 178 of the Companies Act. and to use the general reserve in accordance with the provisions of the articles of incorporation as stipulated by Article 452 and Item 1, Article 459 of the Companies Act. and reverse the general reserve on the same day. The retirement of treasury stock was conducted on February 17, 2017.

(1) Retirement of treasury stock

(i) Type of shares to be retired:	Common stock of the Company
(ii) Number of shares to be retired:	3,000,000 shares (equal to 3.53% of total shares outstanding before the date of retirement)
(iii) Date of retirement:	February 17, 2017
(iv) Number of shares outstanding after retirement:	82,050,000 shares
(v) Purpose:	To enhance shareholders' return through decreasing the total number of shares outstanding

(2) Use of general reserve

(i) Details:	Surplus account to be decreased and amount thereof: General reserve, ¥6,000 million ($51,507 thousand) Surplus account to be increased and amount thereof: Retained earnings carried forward, ¥6,000 million ($51,507 thousand)
(ii) Purpose:	For retirement of treasury stock
(iii) Effective date:	February 1, 2017

(c) Disposal of treasury stock through third party and acquisition of treasury stock

At the Board of Directors' meeting held on February 1, 2017, the Company resolved to establish The Kobayashi Foundation (hereinafter, called "the Foundation"); to dispose of treasury stock (hereinafter, called "disposal of the treasury stock") by allocation to a third party; and to acquire treasury stock (hereinafter, called "the acquisition of treasury stock") as per the provisions of Article 156 of the Companies Act, applied by replacing the phrases pursuant to the provisions of Item 3, Article 165 of the Act.

The disposal of treasury stock will be implemented subject to approval by the Company's shareholders meeting in an ordinary general meeting on March 30, 2017, and the acquisition of the treasury stock will be performed subject to approval in the above-mentioned shareholders meeting.

(1) Establishment of the Foundation

(i) Purpose

The purpose of the Foundation is to improve people's lives and contribute to enhancing the "comfort" of the entire society by providing assistance or awarding research and activities widely and consistently, regardless of whether the recipients are individuals or groups, that work toward the goal of "You make a wish and we make it happen" in the areas of health (disease prevention, measures for lifestyle-related diseases, etc.) and welfare (support for the socially vulnerable and the poor).

(ii) General information about the Foundation

1) Name: The Kobayashi Foundation
2) Address: 1-7-27 Roppongi Minato-ku, Tokyo
3) Director: Akihiro Kobayashi
4) Activity: To provide assistance and award research and activities
5) Funding: About ¥40 million ($343 thousand) per year
*Money received as a beneficiary of the Trust from the buyer of treasury stock, mentioned below in (2), will be used for the activities of the Foundation.
6) Date of establishment: May 2017 (planned)

(2) Disposal of the treasury stock

Overview of disposal

1) Number of shares to be disposed:	850,000 shares of common stock of the Company
2) Disposal price:	¥1 ($0) per share
3) Proceeds from disposal:	¥850,000 ($7,297)
4) Method of solicitation or disposal:	Allocation to a third party
5) Buyer (planned):	The Master Trust Bank of Japan, Ltd.
6) Date of disposal:	To be determined
7) Other:	The date and other matters concerning the disposal will be determined at a board of directors' meeting to be held after the Company's shareholders meeting on March 30, 2017.

(3) Purpose and reason for disposal

The Company is working to realize its management principle, "To provide great "comfort" to people and the society," by offering a wide variety of products including pharmaceuticals, air fresheners, skin care products, nutritional supplements, and sundry articles under the brand slogan, "You Make a Wish and We Make It Happen."

Given the rapidly aging population and environmental changes, extending life expectancy has become a major social issue. Additionally, problems concerning poverty and gap issues faced by the socially vulnerable (people with disabilities, single-parent families, etc.) are becoming more serious. In an effort to reinforce environmental, societal, and governance initiatives of the Company, various corporate social responsibility (CSR) activities have been implemented, such as providing food assistance to single-mother families, support for training guide dogs, and reconstruction assistance in earthquake-affected areas.

The Foundation, which will be established as part of the Company's 100th anniversary commemoration, will aim to enrich people's lives and contribute to enhancing the "comfort" of the entire society by providing assistance or awarding research and activities that work for "You make a wish and we make it happen" in the areas of health and welfare. The Company believes these activities will help the Group grow sustainably and improve corporate value in the medium and long term.

To support the Foundation's social contribution activities consistently, a third-party benefit trust (hereinafter called "the Trust") will be established with Mitsubishi UFJ Trust and Banking Corporation as a trustee, The Master Trust Bank of Japan, Ltd. as a joint trustee, and the Foundation as the beneficiary. The Trust will acquire shares of the Company and pay trust income comprising dividends on the Company's shares to the Foundation. The Foundation will use these funds to carry out its activities.

The treasury stock will be disposed to the Trust, which will be created to provide funds for the social contribution activities of the Foundation.

(4) Proceeds from disposal, use of proceeds, and timing (plan)

(i) Amount of proceeds

1) Total amount to be paid: ¥850,000 ($7,297)
2) Estimated placement cost: ¥0 ($0)
3) Net proceeds: ¥850,000 ($7,297)

(ii) Specific use proceeds

We plan to use the aforementioned net proceeds to pay for expenses involved in developing the trust scheme, such as attorney fees.

(5) Acquisition of treasury stock

(i) Reason for acquisition

To avoid dilution of the stock value due to the disposal of the treasury stock mentioned in Section 2, to improve capital efficiency, and to implement an agile capital policy based on the managerial environment.

(ii) Matters concerning acquisition

1) Type of stock to be acquired: Common stock of the Company
2) Number of shares that can be acquired: 1,000,000 shares (max)
(equal to 1.27% of total shares outstanding, excluding treasury stock)
3) Total value of shares that can be acquired: ¥5,000 million ($42,922 thousand) (max)
Period of acquisition: From the end of the ordinary general meeting of the Company's shareholders in March 2017 to June 23, 2017
4) Method of acquisition: Purchase in the market

<Reference>

Treasury stock owned as of December 31, 2016
Number of shares outstanding: 85,050,000 shares
Number of shares of treasury stock: 6,257,437 shares

Independent Auditor's Report

Ernst & Young ShinNihon LLC

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, 2016, and the consolidated statements of income, comprehensive income, changes in net assets, and cash flows for the nine 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, 2016, and their consolidated financial performance and cash flows for the nine months then ended in conformity with accounting principles generally accepted in Japan.

Emphasis of Matter

We draw attention to Note 22 (b) to the consolidated financial statements, which describes that the retirement of treasury stock was carried out and the general reserve was used pursuant to the Board of Directors' meeting held on February 1, 2017. Our opinion is not qualified in respect of this matter.

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 30, 2017
Osaka, Japan

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 unit 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*, an external anti-inflammatory

1969 Launched *Bluelet*, a toilet bowl cleaner, and entered the 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. 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*, 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 nutritional supplements through the mail order sales channel

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 Company to form Kobashou Co., Ltd.

2001 Acquired Kiribai Chemical Co., Ltd., a body warmer manufacturer, as 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. into 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, into a subsidiary in Ireland

Made HeatMax, Inc., a body warmer manufacturer in the U.S., into 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 right for *Bisrat Gold* from Ishihara Chemical Co., Ltd.

2009 Established Kobayashi Pharmaceutical (Singapore) Pte. Ltd. in Singapore

2010 Spun off 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

Transferred 80% of Kobayashi Medical Co., Ltd. (currently Japan Medicalnext Co., Ltd.) shares to Mitsubishi Corporation

2013 Made Rokuyo Pharmaceutical Co., Ltd., a pharmaceutical product, quasi-pharmaceutical product, and cosmetics manufacturer, into 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 Pharmaceutical Co., Ltd.

Dissolved its 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 U.S. company involved in the planning and sale of OTC pharmaceuticals and cosmetics, into a subsidiary.

Corporate Data / Investor Information (As of December 31, 2016)

Corporate Data

Corporate Name:	KOBAYASHI PHARMACEUTICAL CO., LTD.
Foundation:	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
Number of Employees:	2,994 (Consolidated) 1,223 (Non-consolidated)
Consolidated Subsidiaries:	36 (16 domestic, 20 overseas)

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.

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.

Investor Information

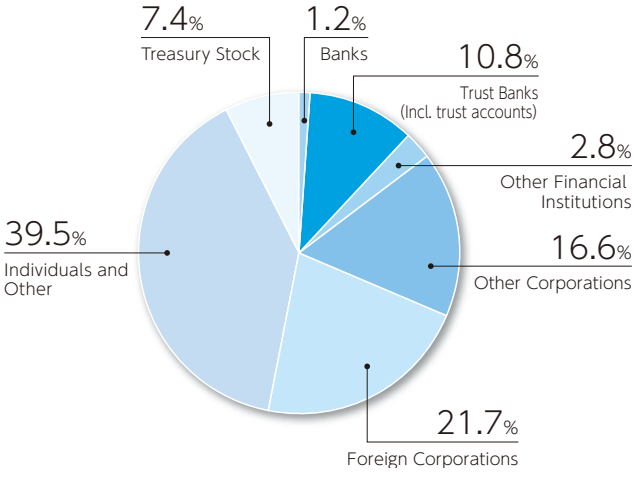
Common Stock:	¥3,450 million
Number of Shares Authorized:	340,200,000
Number of Shares Issued:	85,050,000
Number of Shareholders:	15,714
Stock Exchange Listing:	Tokyo Stock Exchange First Section
Transfer Agent/ Institution Managing Designated:	Mitsubishi UFJ Trust and Banking Corporation

Major Shareholders

Name	Percentage of Total Shares Held (%)
Akihiro Kobayashi	**10.9**
Kobayashi International Scholarship Foundation	**7.1**
Yukako Iue	**6.1**
State Street Bank and Trust Company 505223	**6.0**
Ikuko Watanabe	**3.0**
Ohtori Co., Ltd.	**2.6**
Japan Trustee Services Bank, Ltd.	**2.5**
Forum Co., Ltd.	**2.4**
Teruhisa Miyata	**2.4**
The Master Trust Bank of Japan, Ltd. (trust accounts)	**2.3**

Note: The percentage of total shares held is calculated by deducting 6,257 thousand shares of treasury stock.

Shareholder Composition



KOBAYASHI Pharmaceutical Co., Ltd.

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