1 BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

The accompanying financial statements have been prepared in accordance with the provisions set forth in the Japanese Financial Instruments and Exchange Act and its related accounting regulations and in accordance with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing these financial statements, certain reclassifications and rearrangements have been made to the financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, certain reclassifications have been made in the 2015 financial statements to conform to the classifications used in 2016.

The financial statements are stated in Japanese yen, the currency of the country in which Torii Pharmaceutical Co., Ltd. (the "Company") is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥116.49 to $1, the approximate rate of exchange at December 31, 2016. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

Figures in the Company's financial statements and other items, which were previously rounded off to the nearest unit, are generally rounded down from the fiscal year ended December 31, 2016.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Nonconsolidation—The Company has no subsidiaries as of December 31, 2016.

b. Cash Equivalents—Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits, short-term investments, and deposits in the cash management system, all of which mature or become due within three months of the date of acquisition.

c. Inventories—Inventories are stated at the lower of cost, determined by the weighted-average method, or net selling value.

d. Marketable and Investment Securities—Marketable and investment securities are classified and accounted for, depending on management's intent as available-for-sale securities, which are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of equity.

Nonmarketable available-for-sale securities are stated at cost determined by the moving-average method.

For other-than-temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

e. Property, Plant and Equipment— In June 17, 2016, the Accounting Standards Board of Japan (the "ASBJ") issued ASBJ Practical Issues Task Force ("PITF") No. 32, "Practical Solution on a change in depreciation method due to Tax Reform 2016," which related to the revision of the Corporation Tax Act. The Company applied this PITF effective April 1, 2016, and changed its depreciation method for structures acquired on or after April 1, 2016, from the declining-balance method to the straight-line method. There was no significant impact on the financial statements from this accounting change.

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment of the Company is computed by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998, structures acquired after April 1, 2016. The range of useful lives is from 15 to 50 years for buildings and structures, 8 years for machinery and equipment, and from 2 to 15 years for furniture and fixtures. Equipment held for lease is depreciated by the straight-line method over the respective lease periods.

f. Long-Lived Assets—The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

g. Software—Software is carried at cost less accumulated amortization, which is calculated by the straight-line method principally over 5 years.

h. Retirement and Pension Plans—The Company has a contributory defined pension plan covering substantially all of its employees and an unfunded retirement lump-sum grants plan. In addition to the above, the executive officers are entitled to receive unfunded severance indemnity payments. The Company participates in a contributory multiemployer pension plan, the "Tokyo Pharmaceutical Welfare Pension Fund." For the contributory multiemployer pension plan, contributions to that plan are charged to income when paid. Plan assets contributed to this fund are not recorded in the balance sheet. The defined benefit obligations are attributed to periods on a benefit formula basis. Actuarial gains and losses are amortized on a straight-line basis over 10 years within the average remaining service period. Past service costs are amortized on a straight-line basis over 5 years within the average remaining service period.

In May 2012, the ASBJ issued ASBJ Statement No. 26, "Accounting Standard for Retirement Benefits" and ASBJ Guidance No. 25, "Guidance on Accounting Standard for Retirement Benefits," which replaced the accounting standard for retirement benefits that had been issued by the Business Accounting Council in 1998 with an effective date of April 1, 2000, and the other related practical guidance, and were followed by partial amendments from time to time through 2009.

(a) Under the revised accounting standard, actuarial gains and losses and past service costs that are yet to be recognized in profit or loss are recognized within equity (accumulated other comprehensive income), after adjusting for tax effects, and any resulting deficit or surplus is recognized as a liability (liability for retirement benefits) or asset (asset for retirement benefits).
(b) The revised accounting standard does not change how to recognize actuarial gains and losses and past service costs in profit or loss. Those amounts are recognized in profit or loss over a certain period no longer than the expected average remaining service period of the employees. However, actuarial gains and losses and past service costs that arose in the current period and have not yet been recognized in profit or loss are included in other comprehensive income and actuarial gains and losses and past service costs that were recognized in other comprehensive income in prior periods and then recognized in profit or loss in the current period shall be treated as reclassification adjustments.
(c) The revised accounting standard also made certain amendments relating to the method of attributing expected benefit to periods and relating to the discount rate and expected future salary increases.
(d) In nonconsolidated financial statements, the new requirements for (a) and (b) above would not be applied, with the current requirements remaining applicable.

This accounting standard and the guidance for (a) and (b) above are effective for the end of annual periods beginning on or after April 1, 2013, and for (c) above are effective for the beginning of annual periods beginning on or after April 1, 2014, or for the beginning of annual periods beginning on or after April 1, 2015, subject to certain disclosure in December 2014, both with earlier application being permitted from the beginning of annual periods beginning on or after April 1, 2013. However, no retrospective application of this accounting standard to financial statements in prior periods is required.

The Company does not apply the revised accounting standard for (a) and (b) above to the financial statements, accordingly.

The liability for retirement benefits is accounted for based on defined benefit obligations and plan assets at the balance sheet date.

i. Asset Retirement Obligations—In March 2008, the ASBJ issued ASBJ Statement No. 18, "Accounting Standard for Asset Retirement Obligations" and ASBJ Guidance No. 21, "Guidance on Accounting Standard for Asset Retirement Obligations." Under this accounting standard, an asset retirement obligation is defined as a legal obligation imposed either by law or contract that results from the acquisition, construction, development and the normal operation of a tangible fixed asset and is associated with the retirement of such tangible fixed asset. The asset retirement obligation is recognized as the sum of the discounted cash flows required for the future asset retirement and is recorded in the period in which the obligation is incurred if a reasonable estimate can be made. If a reasonable estimate of the asset retirement obligation cannot be made in the period the asset retirement obligation is incurred, the liability should be recognized when a reasonable estimate of the asset retirement obligation can be made. Upon initial recognition of a liability for an asset retirement obligation, an asset retirement cost is capitalized by increasing the carrying amount of the related fixed asset by the amount of the liability. The asset retirement cost is subsequently allocated to expense through depreciation over the remaining useful life of the asset. Over time, the liability is accreted to its present value each period. Any subsequent revisions to the timing or the amount of the original estimate of undiscounted cash flows are reflected as an increase or a decrease in the carrying amount of the liability and the capitalized amount of the related asset retirement cost.

j. Stock Options—In December 2005, the ASBJ issued ASBJ Statement No. 8, "Accounting Standard for Stock Options" and related guidance. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006. This standard requires companies to measure the cost of employee stock options based on the fair value at the date of grant and recognize compensation expense over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock options or the goods or services received. In the balance sheet, stock options are presented as stock acquisition rights as a separate component of equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

k. Research and Development Costs—Research and development costs are charged to income as incurred.

l. Leases—In March 2007, the ASBJ issued ASBJ Statement No. 13, "Accounting Standard for Lease Transactions," which revised the previous accounting standard for lease transactions. The revised accounting standard for lease transactions was effective for fiscal years beginning on or after April 1, 2008.

Under the previous accounting standard, finance leases that were deemed to transfer ownership of the leased property to the lessee were capitalized. However, other finance leases were permitted to be accounted for as operating lease transactions if certain "as if capitalized" information was disclosed in the note to the lessee's financial statements. The revised accounting standard requires that all finance lease transactions should be capitalized by recognizing lease assets and lease obligations in the balance sheet. In addition, the revised accounting standard permits leases that existed at the transition date and do not transfer ownership of the leased property to the lessee to be measured at the amount of obligation under finance leases less interest expense at the transition date and recorded as acquisition cost of lease assets.

The Company applied the revised accounting standard effective April 1, 2008. In addition, the Company accounted for leases that existed at the transition date and did not transfer ownership of the leased property to the lessee as acquisition cost of lease assets measured at the amount of obligation under finance leases less interest expense at the transition date.

All other leases are accounted for as operating leases.

m. Bonuses to Directors and Audit & Supervisory Board Members—Bonuses to directors and Audit & Supervisory Board members are accrued at the fiscal year end to which such bonuses are attributable.

n. Income Taxes—The provision for income taxes is computed based on the pretax income included in the statement of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted income tax rates to the temporary differences.

o. Appropriations of Retained Earnings—Appropriations of retained earnings are reflected in the financial statements for the following year upon shareholders' approval.

p. Foreign Currency Transactions—All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the statement of income to the extent that they are not hedged by forward exchange contracts.

q. Derivatives and Hedging Activities—The Company uses derivative financial instruments to manage its exposures to fluctuations in foreign exchange. Foreign exchange forward contracts are utilized by the Company to reduce foreign currency exchange risks. The Company does not enter into derivatives for trading or speculative purposes.

Derivative financial instruments and foreign currency transactions are classified and accounted for as either assets or liabilities and measured at fair value.

Gains or losses on derivative transactions are recognized in the statement of income.

r. Per Share Information—Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period, which was 28,283,414 shares and 28,299,629 shares for the years ended December 31, 2016 and 2015, respectively.

Diluted net income per share is not disclosed because there were no dilutive potential common shares that were outstanding during years ended December 31, 2016 and 2015.

Cash dividends per share presented in the accompanying statement of income are dividends applicable to the respective fiscal years, including dividends to be paid after the end of the year.

s. Accounting Changes and Error Corrections—In December 2009, the ASBJ issued ASBJ Statement No. 24, "Accounting Standard for Accounting Changes and Error Corrections" and ASBJ Guidance No. 24, "Guidance on Accounting Standard for Accounting Changes and Error Corrections." Accounting treatments under this standard and guidance are as follows: (1) Changes in Accounting Policies—When a new accounting policy is applied with revision of accounting standards, the new policy is applied retrospectively unless the revised accounting standards include specific transitional provisions. When the revised accounting standards include specific transitional provisions, an entity shall comply with the specific transitional provisions. (2) Changes in Presentation—When the presentation of financial statements is changed, prior-period financial statements are reclassified in accordance with the new presentation. (3) Changes in Accounting Estimates—A change in an accounting estimate is accounted for in the period of the change if the change affects that period only, and is accounted for prospectively if the change affects both the period of the change and future periods. (4) Corrections of Prior-Period Errors—When an error in prior-period financial statements is discovered, those statements are restated.

t. New Accounting Pronouncements— In December 2015, the ASBJ issued ASBJ Guidance No. 26, "Guidance on Recoverability of Deferred Tax Assets."

(1) Summary

With regard to the treatment of the recoverability of deferred tax assets, the following treatments stated in JICPA Auditing Standards Committee Report No. 66, "Audit Treatment for Determining the Recoverability of Deferred Tax Assets" were reviewed. The process for estimating deferred tax assets stated in this report whereby companies are categorized into five categories and deferred tax assets are calculated based on each of these categories will generally be retained.

i. Treatment of companies that do not fulfill any of the requirements for the classifications from Category 1 to Category 5
ii. Requirements for the classifications of Category 2 and Category 3
iii. Treatment of deductible temporary differences of which timing of the reversal cannot be scheduled for companies classified into Category 2
iv. Treatment concerning the reasonable estimable period of taxable income before adjusting deductible or taxable temporary differences for companies classified into Category 3
v. Treatment when a company fulfilling the requirements of Category 4 also falls under Category 2 or Category 3

(2) Scheduled application date

The Company plans to apply the above guidance from the beginning of the fiscal year ending December 2017.

(3) Impact of the application of the accounting standard and other pronouncements
There was no impact on the financial statements.

3 MARKETABLE AND INVESTMENT SECURITIES

Marketable and investment securities as of December 31, 2016 and 2015, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	December 31, 2016
Current:			
Government and corporate bonds	¥ 1,902	¥ 1,208	$ 16,331
Total	¥ 1,902	¥ 1,208	$ 16,331
Noncurrent:			
Equity securities	¥ 1,273	¥ 1,479	$ 10,930
Government and corporate bonds	2,603	5,320	22,353
Total	¥ 3,877	¥ 6,800	$ 33,283

The costs and aggregate fair values of marketable and investment securities at December 31, 2016 and 2015, were as follows:

	Millions of Yen			
December 31, 2016	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale:				
Equity securities	¥ 357	¥ 805		¥ 1,163
Debt securities	4,511	2	¥ 7	4,506

December 31, 2015				
Available-for-sale:				
Equity securities	¥ 357	¥ 1,011		¥ 1,369
Debt securities	6,513	19	¥ 3	6,529

	Thousands of U.S. Dollars			
December 31, 2016	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale:				
Equity securities	$ 3,072	$ 6,913		$ 9,985
Debt securities	38,728	19	$ 63	38,684

Available-for-sale securities whose fair value was not readily determinable as of December 31, 2016 and 2015, were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	December 31, 2016
Available-for-sale—Unlisted equity securities	¥ 110	¥ 110	$ 944
Total	¥ 110	¥ 110	$ 944

4 INVENTORIES

Inventories at December 31, 2016 and 2015, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	**December 31, 2016**
Finished products and merchandise	**¥ 6,330**	¥ 6,132	**$ 54,341**
Work in process	**603**	508	**5,180**
Raw materials and supplies	**3,673**	3,195	**31,532**
Total	**¥ 10,606**	¥ 9,836	**$ 91,054**

5 LONG-LIVED ASSETS

The Company reviewed its long-lived assets for impairment as of December 31, 2015. As a result, the Company recognized an impairment loss of ¥142 million as other expense for idle assets of the Sakura Plant due to there being no expectation of used these idle assets were written down to the recoverable amount of "Zero".

No impairment loss was recognized in 2016.

6 INVESTMENT PROPERTY

In November 2008, the ASBJ issued ASBJ Statement No. 20, "Accounting Standard for Investment Property and Related Disclosures" and issued ASBJ Guidance No. 23, "Guidance on Accounting Standard for Investment Property and Related Disclosures."

The Company holds office buildings (including land) used by the Company and rental commercial properties (including land and leased land) in Tokyo and other areas. Parts of the office buildings used by the Company are used as rental office space, and these spaces are included in investment property. Net of rental income and operating expenses for those rental properties were ¥147 million ($1,267 thousand) and ¥220 million for the fiscal years ended December 31, 2016 and 2015, respectively.

The carrying amounts, changes in such balances, and market prices of such properties are as follows:

Millions of Yen			
Carrying Amount			Fair Value
January 1, 2016	Increase(Decrease)	**December 31, 2016**	**December 31, 2016**
¥ 663	¥ (22)	**¥ 641**	**¥ 3,171**

Millions of Yen			
Carrying Amount			Fair Value
January 1, 2015	Increase(Decrease)	December 31, 2015	December 31, 2015
¥ 674	¥ (10)	¥ 663	¥ 3,271

Thousands of U.S. Dollars			
Carrying Amount			Fair Value
January 1, 2016	Increase(Decrease)	**December 31, 2016**	**December 31, 2016**
$ 5,697	$ (194)	**$ 5,502**	**$ 27,226**

Notes: 1. Carrying amount recognized in the balance sheet is net of accumulated depreciation and accumulated impairment losses, if any.

2. Fair values of major properties as of December 31, 2016, are based on written appraisals, etc., by independent real estate appraisers. The values of minor properties are based on specific valuations or indicators that are believed to appropriately reflect market prices.

7 RETIREMENT AND PENSION PLANS

Employees whose service with the Company is terminated are, under most circumstances, entitled to retirement and pension benefits determined by reference to basic rates of pay at the time of termination, length of service and conditions under which the termination occurs. If the termination is involuntary, caused by retirement at the mandatory retirement age or caused by death, the employee is entitled to greater payments than in the case of voluntary termination. Additional retirement benefits which may be paid to employees upon retirement have not been included in the actuarial calculation of the projected benefit obligation. The net liabilities for retirement benefits at December 31, 2016 and 2015, consisted of the following:

(1) The changes in defined benefit obligation for the years ended December 31, 2016 and 2015, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	Year Ended December 31, 2016	Year Ended December 31, 2015	**Year Ended December 31, 2016**
Balance at beginning of period	**¥ 8,301**	¥ 8,413	**$ 71,264**
Current service cost	**446**	461	**3,833**
Interest cost	**49**	50	**427**
Actuarial losses	**(71)**	2	**(613)**
Benefits paid	**(559)**	(627)	**(4,804)**
Balance at end of period	**¥ 8,166**	¥ 8,301	**$ 70,107**

(2) The changes in plan assets for the years ended December 31, 2016 and 2015, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	Year Ended December 31, 2016	Year Ended December 31, 2015	**Year Ended December 31, 2016**
Balance at beginning of period	**¥ 7,235**	¥ 7,201	**$ 62,110**
Expected return on plan assets	**144**	144	**1,242**
Actuarial losses	**32**	147	**280**
Contributions from the employer	**338**	331	**2,908**
Benefits paid	**(527)**	(588)	**(4,526)**
Balance at end of period	**¥ 7,224**	¥ 7,235	**$ 62,014**

(3) Reconciliation between the liability recorded in the balance sheet and the balances of defined benefit obligation and plan assets is as follows:

	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	**December 31, 2016**
Funded defined benefit obligation	**¥ 7,980**	¥ 7,833	**$ 68,510**
Plan assets	**(7,224)**	(7,235)	**(62,014)**
	756	598	**6,495**
Unfunded defined benefit obligation	**185**	467	**1,596**
Unrecognized actuarial loss	**(58)**	(339)	**(498)**
Unrecognized prior service cost	**(246)**	(333)	**(2,117)**
Net liability arising from defined benefit obligation	**¥ 637**	¥ 393	**$ 5,475**

	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	December 31, 2016
Liability for retirement benefits	¥ 637	¥ 393	$ 5,475
Net liability arising from defined benefit obligation	¥ 637	¥ 393	$ 5,475

(4) The components of net periodic benefit costs for the years ended December 31, 2016 and 2015, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2016
Service cost	¥ 446	¥ 461	$ 3,833
Interest cost	49	50	427
Expected return on plan assets	(144)	(144)	(1,242)
Recognized actuarial losses	177	133	1,521
Amortization of prior service cost	87	87	747
Net periodic benefit costs	¥ 615	¥ 588	$ 5,287

(5) Plan assets
a. Components of plan assets
Plan assets consisted of the following:

	December 31, 2016	December 31, 2015
Debt investments	64%	68%
Equity investments	27	24
General account of life insurance companies	7	7
Others	2	1
Total	100%	100%

b. Method of determining the expected rate of return on plan assets
The expected rate of return on plan assets is determined considering the long-term rates of return which are expected currently and in the future from the various components of the plan assets.

(6) Assumptions used for the years ended December 31, 2016 and 2015, were set forth as follows:

	Year Ended December 31, 2016	Year Ended December 31, 2015
Discount rate	0.6%	0.6%
Expected rate of return on plan assets	2.0	2.0

(7) Multiemployer pension plan
Contributions to the multiemployer pension plan of ¥254 million ($2,188 thousand) and ¥257 million are disclosed in cost of sales and selling, general and administrative expenses for the years ended December 31, 2016 and 2015, for which plan assets could not be allocated to each participating employer.

The funded status of the multiemployer pension plan at December 31, 2016 (based on information available as of March 31, 2016) and December 31, 2015 (based on information available as of March 31, 2015) to which contributions were recorded as net periodic retirement benefit costs, was as follows:

	Millions of Yen		Thousands of U.S. Dollars
	March 31 2016	2015	March 31, 2016
Fair value of plan assets	¥ 531,916	¥ 571,380	$ 4,566,201
Sum of actuarial liabilities of pension plan and minimum actuarial reserve	538,160	561,736	4,619,799
Difference	¥ (6,243)	¥ 9,644	$ (53,598)

The Company's contribution percentage for the multiemployer pension plan at December 31, 2016 and December 31, 2015, was as follows:

	December 31, 2016	December 31, 2015
Contribution percentage	1.5%	1.4%

Notes (March 31, 2016):

1. The difference mainly resulted from prior service cost of ¥(34,540) million ($(296,510) thousand), deficiency brought forward of ¥(21,454) million ($(184,176) thousand) and special reserve fund of ¥49,751 million ($427,089 thousand).
2. Prior service cost is the present value of the amount of special contributions and the method of amortization is equal payment method. The ratio of employer contribution is 15.5‰. The remaining term of amortization is 6 years and 0 months as of March 31, 2016.

Notes (March 31, 2015):

1. The difference mainly resulted from prior service cost of ¥(40,107) million, surplus brought forward of ¥14,310 million and special reserve fund of ¥35,440 million.
2. Prior service cost is the present value of the amount of special contributions and the method of amortization is equal payment method. The ratio of employer contribution is 15.5‰. The remaining term of amortization is 7 years and 0 months as of March 31, 2016.

8 EQUITY

Japanese companies are subject to the Companies Act of Japan (the "Companies Act"). The significant provisions in the Companies Act that affect financial and accounting matters are summarized below:

a. Dividends

Under the Companies Act, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders' meeting. Additionally, for companies that meet certain criteria including (1) having a Board of Directors, (2) having independent auditors, (3) having an Audit & Supervisory Board, and (4) the term of service of the directors being prescribed as one year rather than the normal two-year term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) at any time during the fiscal year if the Company has prescribed so in its articles of incorporation. However, the Company cannot do so because it does not meet all the above criteria.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. The Companies Act provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

b. Increases/Decreases and Transfer of Common Stock, Reserve and Surplus

The Companies Act requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends, until the aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Companies Act, the total amount of additional paid-in capital and legal reserve may be reversed without limitation. The Companies Act also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts within equity under certain conditions upon resolution of the shareholders.

c. Treasury Stock and Treasury Stock Acquisition Rights

The Companies Act also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by a specific formula. Under the Companies Act, stock acquisition rights are presented as a separate component of equity. The Companies Act also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of equity or deducted directly from stock acquisition rights.

9 STOCK OPTIONS

The stock options outstanding as of December 31, 2016, are as follows:

Stock Option	Persons Granted	Number of Options Granted	Date of Grant	Exercise Price	Exercise Period
2016 Stock Option	6 Directors 6 Executive Vice Presidents	28,000 shares	2016.4.8	¥ 2,736 ($ 23)	From April 9, 2018 to April 8, 2021

The stock option activity is as follows:

Year Ended December 31, 2016	2016 Stock Option (Shares)
Non-vested	
December 31, 2015—Outstanding	
Granted	28,000
Canceled	
Vested	
December 31, 2016—Outstanding	28,000
Vested	
December 31, 2015—Outstanding	
Vested	
Exercised	
Canceled	
December 31, 2016—Outstanding	
Exercise price	¥ 2,736 ($ 23)
Average stock price at exercise	
Fair value price at grant date	¥ 427.70 ($ 3.67)

The Assumptions Used to Measure the Fair Value of the 2016 Stock Option

Estimate method:	Black-Scholes option pricing model
Volatility of stock price:	30.87%
Estimated remaining outstanding period:	Three and a half years
Estimated dividend:	¥48 per share
Risk free interest rate:	(0.228)%

10 INCOME TAXES

The Company is subject to Japanese national and local income taxes, which, in the aggregate, resulted in a normal effective statutory tax rate of 33.1% and 35.6% for the year ended December 31, 2016 and 2015, respectively.

The tax effects of significant temporary differences, which resulted in deferred tax assets and liabilities at December 31, 2016 and 2015, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	December 31, 2016
Deferred tax assets:			
Prepayment of research and development costs	¥ 878	¥ 599	$ 7,543
Deferred charges for tax purposes	498	523	4,282
Accrued bonuses to employees	208	218	1,793
Liabilities for retirement benefits	195	126	1,675
Overdepreciation	116	113	1,001
Accrued enterprise taxes	72	164	623
Other	296	430	2,541
Less valuation allowance	(21)	(53)	(187)
Total	2,245	2,123	19,274
Deferred tax liabilities:			
Unrealized gain on available-for-sale securities	241	328	2,076
Other	5	6	47
Total	247	335	2,124
Net deferred tax assets	¥ 1,997	¥ 1,788	$ 17,150

A reconciliation between the normal effective statutory tax rate and the actual effective tax rate as reflected in the accompanying statement of income for the year ended December 31, 2016, with the corresponding figures for 2015, is as follows:

	Year Ended December 31, 2016	Year Ended December 31, 2015
Normal effective statutory tax rate	33.1%	35.6%
Expenses not deductible for income tax purposes	2.1	1.4
Dividend income deductible for income tax purposes	(0.0)	(0.1)
Per capita levy	1.7	1.3
Tax credits	(9.1)	(8.7)
Valuation allowance	2.7	3.6
Other—net	(0.5)	(0.2)
Actual effective tax rate	30.0%	32.9%

New tax reform laws enacted in 2016 in Japan changed the normal effective statutory tax rate for the fiscal year beginning on or after January 1, 2017, to approximately 30.9% and for the fiscal year beginning on or after January 1, 2019, to approximately 30.6%. The effect of these changes was to decrease deferred tax assets, net of deferred tax liabilities, by ¥98 million ($841 thousand) and increase unrealized gain on available-for-sale securities by ¥13 million ($115 thousand) in the balance sheet as of December 31, 2016, and to increase income taxes—deferred by ¥111 million ($956 thousand) in the statement of income for the year then ended.

11 RESEARCH AND DEVELOPMENT COSTS

Research and development costs charged to income were ¥4,654 million ($39,952 thousand) and ¥5,237 million for the year ended December 31, 2016 and 2015, respectively.

12 LEASES

The Company leases certain office space and other assets under operating leases.

Total rental expenses including lease payments under finance leases for the year ended December 31, 2016 and 2015, were ¥1,345 million ($11,547 thousand) and ¥1,287 million, respectively.

Obligations under finance leases and the minimum rental commitments under noncancelable operating leases were as follows:

	Millions of Yen		Thousands of U.S. Dollars	
	2016		2016	
	Finance Leases	Operating Leases	Finance Leases	Operating Leases
Due within one year	¥ 199	¥ 56	$ 1,714	$ 489
Due after one year	571	¥ 223	4,909	1,917
Total	¥ 771	¥ 280	$ 6,624	$ 2,406

13 FINANCIAL INSTRUMENTS AND RELATED DISCLOSURES

(1) Policy for Financial Instruments

To provide for a new business investment, the Company invests surplus funds in financial instruments, which are selected primarily for liquidity and security. Derivatives are used, not for speculative purposes, but to manage exposure to financial risks as described in (2) below.

(2) Nature of Financial Instruments and Related Risks, and Risk Management Systems

Receivables, such as trade notes and trade accounts, are exposed to customer credit risk. The Company manages due dates and outstanding balances for individual customers in accordance with its credit management rules. The Company has also established a system to monitor the credit status of major customers on a biannual basis.

Marketable and investment securities consist mainly of bonds, held with the aim of investing surplus funds and shares in companies with which the Company has business relationships. These bonds and shares are exposed to the credit risk of the issuers and to the risk of market price fluctuation.

Most trade accounts and accrued payments, which are operating liabilities, have due dates within one year. Some of these items are denominated in foreign currencies and are therefore exposed to the risk of exchange rate fluctuations. Derivatives are forward foreign currency contracts, which are used to manage exposure to financial risks from changes in foreign currency exchange rates of payables.

(3) Fair Values of Financial Instruments

The fair values of financial instruments are based on market prices and prices calculated using reasonable methods when no market prices are available.

(a) Fair values of financial instruments

	Millions of Yen		
December 31, 2016	Carrying Amount	Fair Value	Unrealized Gain/Loss
Cash and cash equivalents	**¥ 38,685**	**¥ 38,685**	
Receivables:			
Trade accounts	**26,514**	**26,514**	
Parent	**192**	**192**	
Marketable and investment securities—Available-for-sale securities	**5,669**	**5,669**	
Total	**¥ 71,062**	**¥ 71,062**	
Payables:			
Trade accounts	**¥ 3,861**	**¥ 3,861**	
Parent	**3,006**	**3,006**	
Other	**3,008**	**3,008**	
Income taxes payable	**767**	**767**	
Total	**¥ 10,643**	**¥ 10,643**	

December 31, 2015			
Cash and cash equivalents	¥ 36,210	¥ 36,210	
Receivables:			
Trade accounts	27,849	27,849	
Parent	68	68	
Marketable and investment securities—Available-for-sale securities	7,899	7,899	
Total	¥ 72,027	¥ 72,027	
Payables:			
Trade accounts	¥ 4,275	¥ 4,275	
Parent	2,615	2,615	
Other	3,250	3,250	
Income taxes payable	1,915	1,915	
Total	¥ 12,056	¥ 12,056	

	Thousands of U.S. Dollars		
December 31, 2016	Carrying Amount	Fair Value	Unrealized Gain/Loss
Cash and cash equivalents	**$ 332,094**	**$ 332,094**	
Receivables:			
Trade accounts	**227,612**	**227,612**	
Parent	**1,656**	**1,656**	
Marketable and investment securities—Available-for-sale securities	**48,670**	**48,670**	
Total	**$ 610,033**	**$ 610,033**	
Payables:			
Trade accounts	**$ 33,145**	**$ 33,145**	
Parent	**25,811**	**25,811**	
Other	**25,827**	**25,827**	
Income taxes payable	**6,587**	**6,587**	
Total	**$ 91,371**	**$ 91,371**	

Cash and Cash Equivalents, Receivables, Payables, and Income Taxes Payable

The carrying values of cash and cash equivalents, receivables, payables, and income taxes payable approximate fair value because of their short maturities.

Marketable and Investment Securities

The fair values of marketable and investment securities are measured at the quoted market price of the stock exchange for the equity instruments, and at the quoted price obtained from the financial institution for certain debt instruments. The information on the fair values of marketable and investment securities by classification is included in Note 3.

(b) Financial instruments whose fair value cannot be reliably determined

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	December 31, 2016
Unlisted shares	¥ 110	¥ 110	$ 944

There are no market prices for these items and it is likely that the cost of estimating future cash flows would be excessive.

(4) Maturity Analysis for Financial Assets and Securities with Contractual Maturities

	Millions of Yen		
December 31, 2016	Due in 1 Year or Less	Due after 1 Year through 5 Years	Due after 5 Year through 10 Years
Cash and cash equivalents	¥ 38,685		
Receivables:			
Trade accounts	26,514		
Parent	192		
Marketable and investment securities—Available-for-sale securities with contractual maturities	1,902	¥ 1,503	¥ 1,100
Total	¥ 67,295	¥ 1,503	¥ 1,100

	Thousands of U.S. Dollars		
December 31, 2016	Due in 1 Year or Less	Due after 1 Year through 5 Years	Due after 5 Year through 10 Years
Cash and cash equivalents	$ 332,091		
Receivables:			
Trade accounts	227,612		
Parent	1,656		
Marketable and investment securities—Available-for-sale securities with contractual maturities	16,331	$ 12,909	$ 9,443
Total	$ 577,692	$ 12,909	$ 9,443

Since the quantitative materiality of lease obligations decreased during this fiscal year ended December 31, 2016, lease obligations are not disclosed. Due to the change in the presentation method, the relevant amounts for the years ended December 31, 2015 are not disclosed.

14 RELATED PARTY TRANSACTIONS

Transactions of the Company with the parent company for the year ended December 31, 2016 and 2015, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2016
Purchases	¥ 12,320	¥ 10,974	$ 105,762
Forward exchange contracts		2,009	

The balances due to or from the parent company at December 31, 2016 and 2015, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	December 31, 2016	December 31, 2015	December 31, 2016
Deposits included in cash and cash equivalents	¥ 7,091	¥ 4,348	$ 60,879
Trade accounts payable	2,837	2,578	24,355

15 SEGMENT INFORMATION

Under ASBJ Statement No. 17, "Accounting Standard for Segment Information Disclosures" and ASBJ Guidance No. 20, "Guidance on Accounting Standard for Segment Information Disclosures," an entity is required to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available and such information is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, segment information is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments.

Information relating to business segments is omitted as the Company operated solely in the pharmaceutical business for the year ended December 31, 2016 and 2015.

Sales to major customers were as follows:

	Millions of Yen		Thousands of U.S. Dollars
Name of Customer	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2016
Mediceo Corporation	¥ 14,714	¥ 14,334	$ 126,316
Alfresa Corporation	13,793	13,949	118,405
Suzuken Co., Ltd.	12,300	13,903	105,590
Toho Pharmaceutical Co., Ltd.	6,124	6,338	52,574