

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Noritz Corporation and Consolidated Subsidiaries

1. BASIS OF FINANCIAL STATEMENTS

Noritz Corporation (the "Company") and its consolidated domestic subsidiaries maintain their official accounting records in Japanese yen and in accordance with the provisions set forth in the Japanese Commercial Code and accounting principles and practices generally accepted in Japan ("Japanese GAAP"). The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile. Certain accounting principles and practices generally accepted in Japan are different from International Accounting Standards and standards in other countries in certain respects as to application and disclosure requirements.

Accordingly, the accompanying financial statements are intended for use by those who are informed about Japanese accounting principles and practices.

The accompanying financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of statements of shareholders' equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying financial statements.

The translations of the Japanese yen amounts into U.S. dollars are included solely for the convenience of readers, using the prevailing exchange rate at December 31, 2002, which was ¥119.9 to U.S.\$1.00. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been or could in the future be converted into U.S. dollars at this or any other rate of exchange.

2. SIGNIFICANT ACCOUNTING POLICIES

(1) Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its 12 (8 in 2001) significant companies over which the Company has power of control through majority voting right or existence of certain conditions evidencing control by the Company. Investments in a nonconsolidated subsidiary and 1 (2 in 2001) affiliate over which the Company has the ability to exercise significant influence over operating and financial policies of the investees are accounted for on the equity method.

In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are evaluated using the fair value at the time the Company acquired control of the respective subsidiaries.

The difference, if considered significant, between the cost of investments and equity in subsidiaries' net assets at dates of acquisition is amortised over five years.

(2) Securities

Prior to January 1, 2001, securities of the Company and its consolidated subsidiaries (the "Companies") were stated at moving-average cost.

Effective January 1, 2001, the Companies adopted the new Japanese accounting standard for financial instruments ("Opinion Concerning Establishment of Accounting Standard for Financial Instruments" issued by the Business Accounting Deliberation Council on January 22, 1999).

Upon applying the new accounting standard, all companies are required to examine the intent of holding each security and classify those securities as (a) securities held for trading purposes (hereafter, "trading securities"), (b) debt securities intended to be held to maturity (hereafter, "held-to-maturity debt securities"), (c) equity securities issued by subsidiaries and affiliated companies and (d) all other securities that are not classified in any of the above categories (hereafter, "available-for-sale securities").

Trading securities are stated at fair market value. Gains and losses realised on disposal and unrealised gains and losses from market value fluctuations are recognised as gains or losses in the period of the change. Held-to-maturity debt securities are stated at amortised cost. Equity securities issued by subsidiaries and affiliated companies which are not consolidated or accounted for using the equity method are stated at moving-average cost. Available-for-sale securities with available fair market values are stated at fair market value. Unrealised gains and unrealised losses on these securities are reported, net of applicable income taxes, as a separate component of shareholders' equity. Realised gains and losses on sale of such securities are computed using moving-average cost.

Debt securities with no available fair market value are stated at amortised cost, net of the amount considered not collectible. Other securities with no available fair market value are stated at moving-average cost.

If the market value of held-to-maturity debt securities, equity securities issued by unconsolidated subsidiaries and affiliated companies and available-for-sale securities declines significantly, such securities are stated at fair market value and the difference between fair market value and the carrying amount is recognised as a loss in the period of the decline. If the fair market value of equity securities issued by unconsolidated subsidiaries and affiliated companies not on the equity method is not readily available, such securities should be written down to net asset value with a corresponding charge in the income statement in the event net asset value declines significantly. In these cases, such fair market value or the net asset value will be the carrying amount of the securities at the beginning of the next year.

As a result of adopting the new accounting standard for financial instruments, income before income taxes in 2001 increased by ¥636 million.

(3) Derivatives and hedge accounting

The new accounting standard for financial instruments, effective from the year ended December 31, 2001, requires companies to state derivative financial instruments at fair value and to recognise changes in the fair value as gains or losses unless derivative financial instruments are used for hedging purposes.

If derivative financial instruments are used as hedges and meet certain hedging criteria, the Companies defer recognition of gains or losses resulting from changes in fair value of derivative financial instruments until the related losses or gains on the hedged items are recognised.

Also, if interest rate swap contracts are used as hedges and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed.

(4) Inventories

With respect to the Company, finished products and work in process are valued at weighted-average cost, whereas purchased goods, raw materials and supplies are valued at moving-average cost.

With respect to the consolidated subsidiaries, inventories are valued at weighted-average cost, last purchase costs or the first-in, first-out cost method.

(5) Property, plant and equipment

Property, plant and equipment are carried at cost. Depreciation is provided on a declining-balance method over the estimated useful lives of the assets. However, in accordance with changes in the Corporation Tax Law, effective April 1, 1998, the Companies depreciate newly acquired buildings on the straight-line method.

(6) Research and development expenses

Research and development expenses are charged to income as incurred. Such expenses for the years ended December 31, 2001 and 2002 were ¥4,367 million and ¥4,777 million (\$39,841 thousand), respectively.

(7) Software costs

The Companies include software in intangible assets and depreciate it using the straight-line method over the estimated useful lives (five years).

(8) Allowance for doubtful receivables

The allowance for doubtful receivables is provided for in an amount sufficient to cover possible losses on collection. With respect to normal trade accounts receivable, it is stated at an amount based on the actual rate of historical bad debts, and for certain doubtful receivables, the uncollectible amount has been individually estimated.

(9) Bonuses

The Companies follow the general Japanese practice of paying bonuses to employees in July and December. Accrued bonus liabilities of the Companies at the balance sheet date are calculated based upon management's estimate of annual amounts thereof. Accrued bonuses are included in the liability for accrued expenses in the consolidated balance sheets.

Bonuses to directors and statutory auditors, which are subject to approval at the shareholders' meeting, are accounted for as an appropriation of retained earnings.

(10) Reserve for product warranty

The reserve for product warranty is calculated on the basis of sales of products and actual product warranties in the past. The reserve is included in the liability for accrued expenses in the consolidated balance sheets.

(11) Income taxes

The Companies use the asset and liability approach to recognise deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

(12) Retirement benefits

(i) Employees

The Companies provide two types of post-employment benefit plans: unfunded lump-sum payment plans and funded non-contributory pension plans, under which all eligible employees are entitled to benefits based on the level of wages and salaries at the time of retirement or termination, length of service and certain other factors.

Effective January 1, 2001, the Companies adopted the new accounting standard, "Opinion on Setting Accounting Standard for Employees' Severance and Pension Benefits," issued by the Business Accounting Deliberation Council on June 16, 1998 (the "New Accounting Standard").

Under the New Accounting Standard, the liabilities and expenses for severance and retirement benefits are determined based on the amounts actuarially calculated using certain assumptions.

The Companies provided for employees' severance and retirement benefits at December 31, 2001 and 2002 based on the estimated amounts of projected benefit obligation and the fair value of the plan assets at those dates.

The excess of the projected benefit obligation over the total of the fair value of pension assets as of January 1, 2001 and the liabilities for severance and retirement benefits recorded as of January 1, 2001 (the "net transition obligation") amounted to ¥8,583 million and is being recognised in expenses in approximately equal amounts primarily over three years commencing with the year ended December 31, 2001. Prior service costs are recognised in expenses in equal amounts over three years, and actuarial gains and losses are recognised in expenses using the straight-line method over 10 years commencing with the following period.

As a result of the adoption of the New Accounting Standard, in the year ended December 31, 2001, severance and retirement benefit expenses increased by ¥3,052 million and income before income taxes decreased by ¥3,052 million compared with what would have been recorded under the previous accounting standard.

The Company obtained approval from Japan's Ministry of Health, Labour and Welfare for exemption from the future benefit obligation with respect to the portion that the Company operates for the government (the so-called substitutional portion) on November 26, 2002. Pursuant to transitional measures of Paragraph 47-2 of "Practical Guidelines of Accounting for Retirement Benefits (JICPA's Accounting Committee Report No. 13)," the Company recognised a gain on the relinquishment of the substitutional portion of the retirement benefit obligations of welfare pension funds on the date when the exemption was approved. The amount of the relinquished fair value of pension assets for the year ended December 31, 2002 is ¥6,295 million (\$52,502 thousand).

(ii) Directors and statutory auditors

The liability for directors' and statutory auditors' retirement benefits is provided based upon the Company's internally established criteria.

(13) Translation of foreign currencies

Short-term and long-term receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end rates. Prior to January 1, 2001, long-term receivables and payables denominated in foreign currencies were translated at historical rates.

Effective January 1, 2001, the Companies adopted the revised accounting standard for foreign currency translation, "Opinion Concerning Revision of Accounting Standard for Foreign Currency Translation," issued by the Business Accounting Deliberation Council on October 22, 1999 (the "Revised Accounting Standard"). Under the Revised Accounting Standard, long-term receivables and payables denominated in foreign currencies are also translated into Japanese yen at the year-end rate.

The effect on the consolidated income statement of adopting the Revised Accounting Standard was immaterial.

Due to the adoption of the Revised Accounting Standard, the Companies report foreign currency translation adjustments in shareholders' equity.

(14) Accounting for leases

Finance leases which do not transfer ownership may be accounted for in the same manner as operating leases under generally accepted accounting principles in Japan.

(15) Net income per share

Computations of net income per share of common stock are based on the weighted average number of shares adjusted for any stock splits. Diluted net income per share is not disclosed because there were no potentially dilutive securities.

(16) Cash and cash equivalents and statements of cash flow

In preparing the consolidated statements of cash flows, cash on hand, readily available deposits and short-term highly liquid investments with maturities not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

3. STATEMENTS OF CASH FLOWS

The reconciliation of cash and time deposits in the consolidated balance sheets and cash and cash equivalents in the consolidated statements of cash flows as of December 31, 2001 and 2002 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
Cash and time deposits in the consolidated balance sheets	¥15,725	¥16,475	\$137,406
Marketable securities	12,485	13,364	111,460
Other (trust)	—	2,000	16,685
Time deposits with maturities exceeding 3 months	(5,795)	(1,849)	(15,419)
Bonds with maturities exceeding 3 months	(4,308)	(2,036)	(16,979)
Cash and cash equivalents in the consolidated statements of cash flows	¥18,107	¥27,954	\$233,153

4. MARKETABLE SECURITIES AND INVESTMENT SECURITIES

The following tables summarise acquisition costs and book values (fair values) of securities with available fair values as of December 31, 2001 and 2002:

Available-for-sale securities

Securities with book values exceeding acquisition costs are as follows:

Type	Millions of yen						Thousands of U.S. dollars		
	2001			2002			2002		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥2,811	¥3,511	¥700	¥1,348	¥1,704	¥356	\$11,243	\$14,212	\$2,969
Bonds	1,526	1,564	38	1,432	1,452	20	11,943	12,110	167
Others	102	109	7	—	—	—	—	—	—
Total	¥4,439	¥5,184	¥745	¥2,780	¥3,156	¥376	\$23,186	\$26,322	\$3,136

Other securities are as follows:

Type	Millions of yen						Thousands of U.S. dollars		
	2001			2002			2002		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥ 1,860	¥ 1,510	¥ (350)	¥ 3,110	¥2,524	¥ (586)	\$25,938	\$21,051	\$(4,887)
Bonds	11,525	10,950	(575)	6,828	6,530	(298)	56,947	54,462	(2,485)
Others	1,931	1,698	(233)	976	761	(215)	8,140	6,347	(1,793)
Total	¥15,316	¥14,158	¥(1,158)	¥10,914	¥9,815	¥(1,099)	\$91,025	\$81,860	\$(9,165)

The following tables summarise book values of securities with no available fair values as of December 31, 2001 and 2002.

Available-for-sale securities

Type	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
Non-listed equity securities	¥ 131	¥ 151	\$ 1,259
Mutual funds	5,658	185	1,543
Commercial paper	1,399	11,794	98,365
Total	¥7,188	¥12,130	\$101,167

Available-for-sale securities with maturities mature as follows:

Type	Millions of yen								Thousands of U.S. dollars					
	2001				2002				2002					
	Within one year	Within five years	Within ten years	Total	Within one year	Within five years	Within ten years	Over ten years	Total	Within one year	Within five years	Within ten years	Over ten years	Total
Bonds	¥4,250	¥5,177	¥500	¥ 9,927	¥1,000	¥5,118	¥700	¥500	¥7,318	\$8,340	\$42,685	\$5,838	\$4,170	\$61,033
Others	—	339	—	339	9	333	—	—	342	75	2,777	—	—	2,852
Total	¥4,250	¥5,516	¥500	¥10,266	¥1,009	¥5,451	¥700	¥500	¥7,660	\$8,415	\$45,462	\$5,838	\$4,170	\$63,885

Total sales of available-for-sale securities in the year ended December 31, 2001 amounted to ¥11,276 million and the related gains and losses amounted to ¥165 million and ¥342 million, respectively.

Total sales of available-for-sale securities in the year ended December 31, 2002 amounted to ¥7,400 million (\$61,718 thousand) and the related gains and losses amounted to ¥49 million (\$408 thousand) and ¥86 million (\$717 thousand), respectively.

The loss on write-down of other securities for the year ended December 31, 2002 was ¥138 million (\$1,150 thousand).

5. DERIVATIVE TRANSACTIONS

The Company entered into interest rate swap contracts to manage risk and reduce exposure to interest rate fluctuations in respect of time certificates and other monetary assets. As a part of investment of available funds, at December 31, 2001 and 2002, the Company also utilises some compound financial investments which include derivatives within the specified limits on the amounts of transactions allowed. The compound financial instruments are exposed to the risk of the fluctuation of the Nikkei Stock Average. To minimise credit risk, the Company uses highly rated financial institutions as counterparties to these transactions. The Company has established policies that restrict dealing in derivatives and that require reviews and reporting to the Board of Directors.

At December 31, 2001 and 2002, the Company had no interest rate swap contracts.

The compound financial instruments, which cannot be evaluated separately from a part of an embedded derivative, are evaluated at market value. This information is included in Note 4.

6. LEASES

Finance leases, except for those in which ownership is deemed to be transferred to the lessee, are accounted for as operating leases. Equivalent purchase amount, accumulated depreciation and future minimum lease payments on an "as if capitalized" basis at December 31, 2001 and 2002 are as follows:

	Millions of yen						Thousands of U.S. dollars
	2001			2002			2002
	Machinery and equipment	Other	Total	Machinery and equipment	Other	Total	Total
Original lease obligation (including finance charges)	¥2,167	¥149	¥2,316	¥2,337	¥137	¥2,474	\$20,634
Payments remaining	1,181	93	1,274	1,156	77	1,233	10,284
Payments due within one year			386			425	3,545
Payments due after one year			888			808	6,739
Total			¥1,274			¥1,233	\$10,284

Total lease payments under non-capitalised finance leases for the years ended December 31, 2001 and 2002 were ¥512 million and ¥468 million (\$3,903 thousand), respectively.

Lease payments and equivalent depreciation for the years ended December 31, 2001 and 2002 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
Lease payments	¥512	¥468	\$3,903
Equivalent depreciation	512	468	3,903

Future minimum rents under non-cancellable operating leases at December 31, 2001 and 2002 consist of the following:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
Due within one year	¥2	¥ 6	\$ 50
Due after one year	3	6	50
	¥5	¥12	\$100

7. BANK LOANS AND LONG-TERM DEBT

Short-term bank loans and long-term debt at December 31, 2001 and 2002 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
1.08% bank loans	¥ —	¥1,046	\$8,724
Short-term bank loans	¥ —	¥1,046	\$8,724
1.5% to 1.68% bank loans	¥600	¥ 900	\$7,506
Less: due within one year	—	200	1,668
Long-term debt due after one year	¥600	¥ 700	\$5,838

8. CONTINGENT LIABILITIES

At December 31, 2002, the Companies were contingently liable as follows:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
As endorser of notes endorsed	¥ 1		\$ 8
As guarantor of indebtedness of an affiliate and other companies	1,712		14,279
	¥1,713		\$14,287

9. INCOME TAXES

The Companies are subject to a number of taxes based on income, which, in the aggregate, indicate a statutory tax rate in Japan of approximately 42% for the years ended December 31, 2001 and 2002.

The following table summarises the significant differences between the statutory tax rate and the Companies' effective tax rate for financial statement purposes for the years ended December 31, 2001 and 2002.

	Percentage	
	2001	2002
Statutory tax rate:	42.0%	42.0%
Permanently non-deductible expenses	6.4	1.7
Permanently non-taxable dividend income	(1.0)	(0.5)
Per capita inhabitants' tax	1.9	0.8
Equity in loss of affiliates	4.0	1.0
Other	1.5	1.7
Effective tax rate	54.8%	46.7%

Significant components of the Companies' deferred tax assets and liabilities as of December 31, 2001 and 2002 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
Deferred tax assets:			
Employees' retirement benefits	¥3,635	¥4,039	\$33,687
Excess bad-debt expenses	1,146	1,146	9,558
Directors' and statutory auditors' retirement benefits	268	336	2,802
Accrued enterprise tax	137	200	1,668
Write-down of securities	388	573	4,779
Loss carryforwards (for tax purposes)	—	215	1,793
Other	236	183	1,526
Total deferred tax assets	5,810	6,692	55,813
Valuation allowance	(33)	(158)	(1,318)
Net deferred tax assets	5,777	6,534	54,495
Deferred tax liabilities:			
Land	(199)	(188)	(1,568)
Net deferred tax assets	¥5,578	¥6,346	\$52,927

10. EMPLOYEES' SEVERANCE AND RETIREMENT BENEFITS

As explained in Note 2 (12) Retirement benefits, (i) Employees, effective January 1, 2001, the Companies adopted the new accounting standard for employees' severance and retirement benefits, under which the liabilities and expenses for severance and retirement benefits are determined based on the amounts obtained by actuarial calculations.

The liabilities for severance and retirement benefits included in the liabilities section of the consolidated balance sheet as of December 31, 2001 and 2002 consist of the following:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
Projected benefit obligation	¥29,864	¥24,846	\$207,223
Unrecognised prior service costs	1,099	62	517
Unrecognised actuarial differences	(1,540)	(4,611)	(38,457)
Less fair value of pension assets	(13,309)	(7,043)	(58,741)
Less unrecognised net transition obligation	(5,715)	(1,894)	(15,796)
Liabilities for severance and retirement benefits	¥10,399	¥11,360	\$ 94,746

Included in the consolidated statements of income for the years ended December 31, 2001 and 2002 are severance and retirement benefit expenses comprised of the following:

	Millions of yen		Thousands of U.S. dollars
	2001	2002	2002
Service costs—			
benefits earned during the year	¥1,723	¥1,545	\$12,886
Interest cost on projected benefit obligation	811	799	6,664
Expected return on plan assets	(706)	(416)	(3,469)
Amortisation of prior service costs	(99)	(339)	(2,827)
Amortisation of actuarial differences	5	149	1,243
Amortisation of net transition obligation	2,786	2,687	22,409
Severance and retirement benefit expenses	¥4,520	¥4,425	\$36,906

The discount rates and the rates of expected return on plan assets used by the Company are 2.7%–3.0% and 3.5%–5.5% in 2001 and 2.7% and 3.5% in 2002, respectively. The estimated amount of all retirement benefits to be paid at future retirement dates is allocated equally to each service year using the estimated number of total service years.

11. SHAREHOLDERS' EQUITY

(1) Under the Commercial Code of Japan, the entire amount of the issue price of shares is required to be accounted for as common stock, although a company may, by resolution of its board of directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital.

Effective October 1, 2001, the Japanese Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal reserve until the total amount of the legal reserve and additional paid-in capital equals 25% of common stock. The legal reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalised by resolution of the Board of Directors. On condition that the total amount of the legal reserve and additional paid-in capital remains equal to or exceeding 25% of common stock, they are available for dividends by the resolution of the shareholders' meeting. The legal reserve is included in retained earnings in the accompanying financial statements.

(2) The maximum amount that the Company can distribute as dividends is calculated based on the unconsolidated financial statements of the Company in accordance with the Commercial Code of Japan.

(3) The Company repurchased with aggregate value of ¥1,979 million and retired 1,520,000 shares of its common stock in accordance with resolutions of the directors' meeting held on April 6, 2001.

12. SEGMENT INFORMATION

The Companies primarily are engaged in the manufacture and sale of household-related products, bath heaters, water heaters and bathroom- and kitchen-related products.

As these activities comprise one industry segment, segment information by industry is not disclosed. As sales outside Japan are less than 10% of the Company's consolidated net sales, segment information by geographic area is not disclosed.

13. SUBSEQUENT EVENT

Appropriation of retained earnings

At the ordinary shareholders' meeting of the Company held on March 28, 2003, the following appropriations of retained earnings for the year ended December 31, 2002 were duly approved:

	Millions of yen	Thousands of U.S. dollars
Appropriations:		
Cash dividends	¥380	\$3,169
Bonuses to directors and statutory auditors	42	35