A Message from the Management

Consolidated Operating Results and Financial Position for 2003

Noritz is currently implementing its "Create 21 First-Phase Medium-Term Management Plan." Fiscal 2003, ended December 31, 2003, was the second year of this three-year plan, and key initiatives included managing operations from a customer-centric perspective, strengthening our management base to emphasize earnings, implementing policies for environmental coexistence, and enhancing our compliance systems.

Our net sales in 2003 amounted to ¥170.1 billion, approximately the same as for the previous year, and operating income expanded 17.5%, to ¥8.1 billion. Net income amounted to ¥3.2 billion, representing a decline of 4.6% from the previous year. The improvement in certain indicators of profitability was due to the positive results of management reforms placing greater emphasis on income, which we commenced in the previous year.

Although net sales were approximately level with the previous year, overall profitability rose because the substantial improvement in the cost-of-sales ratio led to a 4.4 percentage point rise in the gross profit ratio, to 31.1%. As a consequence of profit-focused marketing activities, the rate of decline in unit prices began to bottom out and was only 0.9% for the year. In addition, costs, principally expenditures for raw materials, were cut ¥4.6 billion. An important factor in reducing costs was the increase in parts sourcing overseas, which influenced domestic parts suppliers to lower their prices, thus leading to an improvement in the cost-of-sales ratio. The parent company, Noritz Corporation, alone reported an increase in operating income of 17.9%, to ¥6.5 billion, and recurring profit expanded 18.8%, to ¥7.2 billion, because of robust performance in the sales of hot-water heating systems and related parts and materials. Moreover, Harman Co., Ltd., which was formerly accounted for by the equity method, became a fully consolidated subsidiary in April 2003, and it reported a return to profitability in the second half of the year because of the strong sales of its built-in glass-top gas ranges.

Reasons for the relatively low rate of growth in operating income compared to the improvement in gross profits included the recording of ¥2.9 billion in expenses related to the full consolidation of Harman from April 2003, in addition to a ¥1.9 billion increase in other selling, general and administrative expenses, including ¥0.5 billion in employee severance and retirement benefits at the parent company. Nonoperating income amounted to ¥1.4 billion and consisted primarily of R&D related outsourcing costs and gains from the sale of securities. Among extraordinary items, the gain on the return of the substitutional portion of the employee pension fund reported in 2002, which amounted to ¥2.3 billion, was not recorded in 2003, and subsidiary RB Corporation reported extraordinary retirement costs of ¥0.4 billion. As a result of these and other factors, net income

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declined 4.6%, to ¥3.2 billion. In addition, the Company reported ¥1.8 billion for the amortization of differences arising as a result of the adoption of new standards for retirement allowances, but these differences were fully amortized in 2003.

By business segment, sales of gas-related water heaters, kerosene-fired water heaters, and air-conditioning equipment amounted to ¥109.2 billion, virtually the same as for the previous year. Sales of bathroom- and kitchen-related equipment totaled ¥44.5 billion, down 0.7% from the prior year, sales in the Company's service businesses slipped 0.3%, to ¥14.7 billion, and other business sales rose 9.7%, to ¥1.6 billion. These performance figures may suggest that no major changes occurred during the year, but, in the bathroom- and kitchen-related equipment segment, sales were down 15%, to ¥16.0 billion, in the bathroom-related area, while sales in the kitchen-related area rose 9%, to ¥28.5 billion. This was because of our policy decision to forego some orders for standard system bathrooms due to strong competition in this field, which led to lower overall sales of bathroom equipment. However, as a result of the full consolidation in April 2003 of subsidiary Harman, which markets built-in gas-fired range units, overall sales of kitchen-related equipment expanded.

In our marketing activities, we adopted a proactive program to approach final consumers and our best distributors as well as other corporate customers that have the closest ties with consumers, with the aim of medium-to-long-term business development. We instituted these marketing activities because one of the challenging features of our industry is that the distribution chain from manufacturers of housing equipment to consumers, who are the ultimate users of these products, is long and complicated. As a result, the voices of end users are more influential in the housing refurbishment market than in the market for new housing. However, to date, we do not believe that these marketing activities have had a major direct effect on our sales and net income. We are confident, though, that the results of this proactive marketing program will emerge in 2004 and subsequently. Along with these activities, we also stepped up our program of television and magazine advertising to increase customer awareness of the Noritz brand.

By principal product, because we adopted a profit-oriented policy in the water heater area, growth in the number of units sold was lower than the 2.7% rise in demand, resulting in a slight decline in our market share. However, sales of water heaters on an OEM basis expanded.

In the system bath, system kitchen, and vanity unit product areas, our share of units sold declined because of our emphasis on profitability. However, we sold 6,000 system bath units in our newly introduced Fine series, which is targeted at the medium-to-upper price segments. We expect this robust performance to continue.

In the kitchen-related equipment area, sales of system kitchens with built-in glass-top gas ranges were strong. These have relatively high unit prices, and sales rose to over 80,000 units, accounting for more than half the unit sales of system kitchens with built-in ranges. In addition, sales of Stylish Blink, our top-of-the-line system kitchens with built-in glass-top gas ranges, were extremely robust, rising to more than 1,000 units a month. Osaka Gas Co., Ltd., Toho Gas Co., Ltd., and Tokyo Gas Co., Ltd., have decided to market these units on an OEM basis, and each of these gas companies will begin a TV advertising campaign in 2004.

In production activities, we believe we are seeing the best results at present from the full-scale implementation of the Noritz Production System (NRPS) throughout the Noritz Group. We have completed the introduction of production systems that enable us to make shipments of all water heater equipment on the day following receipt of the order. As a result of this next-day delivery system, customer satisfaction has soared. Among environment-related activities, we have completed the development of the ECOWILL energy-conserving cogeneration system in partnership with Osaka Gas and have begun to market it. Moreover, we are pleased to report that eight of our production plants, including all plants in Japan, have attained zero-emission status.

Outlook for 2004

The current year will be the final year of Create 21. We at Noritz intend to place top priority on profitability. We are working to increase net sales 1.1%, to ¥172.0 billion; operating income 18.9%, to ¥9.6 billion; current income 6.0%, to ¥10.0 billion; and net income 58.2%, to ¥5.0 billion.

By operating segment, in the water heating equipment area, we are aiming for an increase in sales of ¥800 million, to ¥110.0 billion, by boosting our exports to the Americas and other overseas markets and strengthening our OEM operations. Beginning in 2003, production of all gas-fired water heating equipment sold under the TOTO brand of TOTO Ltd. was shifted to Noritz on an OEM basis. In addition, in 2004, production of TOTO's kerosene-fired water heating equipment will also be shifted to Noritz. However, since the exact date when TOTO's subsidiaries will suspend production has not been set, we have not included the effect of this shift in our outlook for 2004. In the Americas, demand for tank storage water heating equipment is about 9 million units on an annual basis and about half of these units are gas-fired. Consumers are gradually becoming aware of the superiority of Japan's instantaneous gas-fired water heaters, and the number of units sold last year doubled to 6,200. We are planning to boost this total to approximately 15,000 in 2004. In China, we are planning to raise the number of gas-fired water heaters sold in Shanghai from 120,000 units in 2003 to 150,000 this year. In the bath- and kitchen-related equipment segment, we are targeting an increase of ¥500 million, to ¥45.0 billion, through expansion in sales of Harman's system kitchen units with built-in ranges.

One of the factors that will help us meet our target for operating income will be a reduction in retirement benefit expenses of about ¥1.4 billion resulting from the introduction of a defined contribution pension plan at Noritz, beginning in April 2004. We are also anticipating an extraordinary gain arising from the transition to the defined contribution plan. Among other factors contributing to improvement in profitability in 2004 will be the completion in 2003 of the amortization of differences arising from the adoption of new standards for retirement allowances.

In summary, we are aiming to maintain profit-oriented management policies in 2004 and continue to increase net income, but, on the other hand, we do not intend to allow our market share to decline further. Instead, we will expand sales of our targeted product groups and aim for increases in net sales and net income.

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