

Financial Review

Results of Operations

Net Sales

In fiscal 2004, ended December 31, 2004, the Japanese economy remained on a recovery trend during the first half of the year, supported by exports and private capital investment. Thereafter, economic growth slowed, as a result of a combination of factors, such as steep rises in prices of raw materials, including crude oil; slower growth in overseas economies; and the adverse effects of natural disasters, such as typhoons and earthquakes. Despite the slowdown in the second half of 2004, the economy remained generally firm for the fiscal year as a whole. The number of new housing starts rose 2% over the previous year, but competitive conditions in the market for housing refurbishment became substantially more intense, and conditions in Japan's housing-related industries remained challenging.

Amid this business environment, the Noritz Group renewed its management structure in July 2004, and the newly appointed management team began preparations for its "Create 21 Second-Phase Medium-Term Management Plan," for implementation beginning in 2005. Principal features of the new plan will include the integration of two product segments and the creation of a product headquarters division. Other initiatives include a reorganization to facilitate the expansion of international business operations and the strengthening of the Company's management systems for enhancing customer satisfaction and consolidating the earnings base.

As a result of these and other initiatives, consolidated net sales amounted to ¥171.6 billion, 0.9% higher than for the previous fiscal year. However, as a consequence of declines in sales prices and increases in raw material costs, operating income decreased 4.7%, to ¥7.7 billion. Nevertheless, net income rose a substantial 56.6%, to ¥5.0 billion, because of a sharp decline in special losses in 2004 following completion in 2003 of the amortization of the effect of adopting new accounting standards for retirement benefits.

Cost of Sales and SG&A Expenses

The cost of sales increased 1.5%, to ¥118.9 billion, and the cost of sales to net sales ratio rose 0.4 percentage point, from 68.9% to 69.3%. This was because of the increases in raw material costs, which offset the effects of cost-cutting efforts. The rise in selling, general and administrative (SG&A) expenses was held to only 0.2%, to total ¥45.0 billion, and the ratio of SG&A expenses to net sales recorded an improvement of 0.2 percentage point, to 26.2%. However, operating income was down 4.7%, to ¥7.7 billion, because of declines in sales prices, which more than offset the effects of activities to cut costs. The two principal reasons for the drops in sales prices were a change in the mix of products sold and an increase in the number of moderately priced unit homes (houses built for sale), owing to the activities of leading home builders to promote lower-cost housing. Also, as a result of the rise in all-electric homes in urban areas, sales of higher-priced, gas-related heaters and air conditioners, which the Company supplied to leading gas companies, dropped substantially. On the other hand, construction of built-for-sale unit housing for first-time home owners—which come equipped only with moderately priced gas-related water heaters—increased. As a result of these developments, the ratio of operating income to net sales declined 0.2 percentage point, from 4.7% to 4.5%.

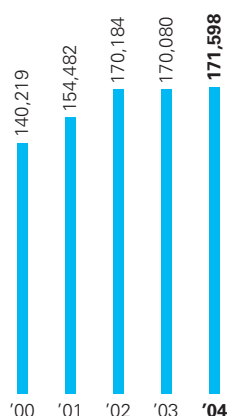
Other Income (Expenses)

Other income (expenses), net, which amounted to expenses of ¥2.0 billion in the previous year, improved to income of ¥1.3 billion in the year under review. The principal reasons for this improvement were the absence of expenses to amortize the effect of adopting a new accounting standard for retirement benefits and a gain on the return of the substitutional portion of the employee pension fund. As a result, income before income taxes increased 46.3%, to ¥8.9 billion.

Reflecting the above-mentioned items, net income rose 56.6%, to ¥5.0 billion, as mentioned previously. Return on sales posted a 1.0 percentage point gain, to 2.9%. Similarly, return on equity increased 2.1 percentage points, from 3.8% in the previous year to 5.9% in fiscal 2004.

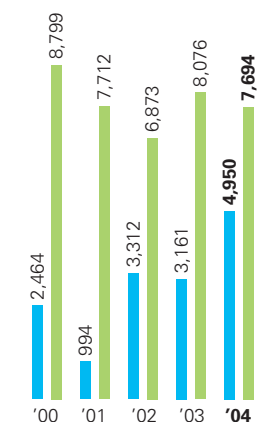
Net Sales

(Millions of yen)



Net Income and Operating Income

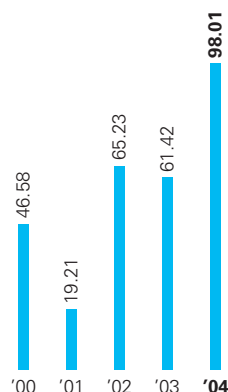
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● Net Income
● Operating Income

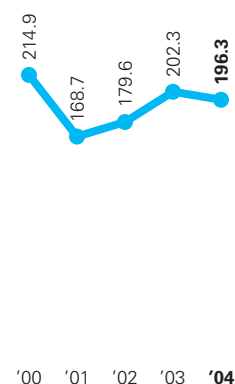
Net Income per Share

(Yen)



Current Ratio

(%)



Financial Position

The Group's total assets at year-end amounted to ¥148.8 billion, ¥5.8 billion lower than at the previous fiscal year-end. Of this total, total current assets declined ¥14.4 billion, while non-current assets increased ¥8.5 billion. Among current assets, cash and time deposits decreased ¥10.5 billion. This was because of the purchases of ¥8.5 billion in Japanese government bonds in view of the scheduled removal of government guarantees on bank deposits. In addition, marketable securities fell ¥6.6 billion, owing to sales of these investments.

On the other hand, the balance of investment in securities increased ¥9.2 billion. This was due to the previously mentioned purchases of Japanese government bonds and the reshuffling of the maturities of the Company's bond portfolio to absorb the impact of fluctuations in interest rates. Deferred tax assets declined ¥1.5 billion, owing to the reversal of deferred taxes accompanying the reversal of a portion of the Company's severance and retirement reserves. The increase in the Other category within investments and other assets was due to a rise in callable time deposits of ¥1.0 billion and other factors.

The Group's total liabilities declined 11.6%, or ¥8.2 billion, to ¥63.0 billion. The principal reasons for the reduction in current liabilities, which amounted to ¥5.8 billion, was a change in the system for intra-Group settlements making use of Noritz Capital Corporation, the Group's finance company, and the repayment of outstanding bank borrowings of Group company RB Corporation. Instead, Noritz Capital, as the in-house bank for the Group, extended the necessary loans to RB. Long-term liabilities declined ¥2.5 billion, principally because of a decline in reserves for severance and retirement benefits, accompanying the shift to a defined contribution pension plan. Fifty percent of the reserves intended for the payment of lump-sum pensions were shifted to the defined contribution pension plan.

Shareholders' equity rose 2.9%, or ¥2.4 billion, to ¥85.8 billion. This was mainly due to an increase in retained earnings of ¥3.9 billion, primarily accounted for by the net effect of the

increase in net income for the period, and buybacks of Noritz shares amounting to ¥1.9 billion.

As a result of these developments, the shareholders' equity ratio gained 3.7 percentage points, rising from 53.9% at the end of the previous fiscal year to 57.6% at the end of the year under review. In addition, the Group's liquidity ratio was 196%, substantial strengthening of the Group's financial position.

Cash Flows

In fiscal 2004, net cash provided by operating activities decreased ¥5.2 billion from the level for the previous year. Principal factors accounting for this development included income before income taxes of ¥8.9 billion, a decline in trade notes and accounts receivable of ¥1.3 billion, a decrease in trade notes and accounts payable of ¥4.6 billion, and a reduction in employees' retirement benefits reserves of ¥3.3 billion.

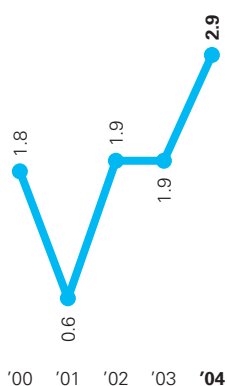
Net cash provided by (used in) investing activities decreased ¥16.3 billion from the previous year to a minus ¥16.3 billion. Principal factors accounting for this decline were net investments in time deposits exceeding proceeds from time deposits amounting to a cumulative minus ¥3.5 billion, additions to securities were a net ¥6.9 billion larger than proceeds from sales of securities, and net additions to property, plant and equipment, after deduction of proceeds from sales of property, plant and equipment, amounted to ¥4.6 billion.

Net cash used in financing activities rose ¥1.3 billion, from ¥2.3 billion in fiscal 2003 to ¥3.6 billion in fiscal 2004. Principal factors accounting for this were a net decrease in short-term bank loans of ¥0.6 billion, payments of ¥1.9 billion for purchases of the Company's outstanding common stock, and dividends paid by the parent company of ¥1.1 billion.

As a result of the above-mentioned trends in cash flow items, cash and cash equivalents at the end of the fiscal year under review amounted to ¥21.1 billion, down ¥14.8 billion from the previous fiscal year.

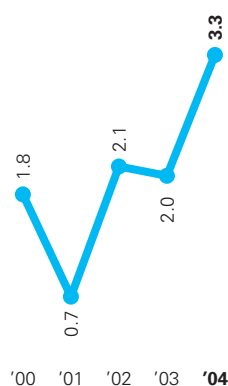
Return on Sales

(%)



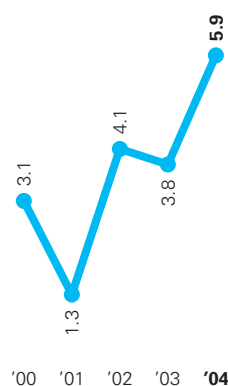
Return on Assets

(%)



Return on Equity

(%)



Equity Ratio

(%)

