# Notes to Consolidated Financial Statements

Noritz Corporation and Consolidated Subsidiaries

**1. BASIS OF PRESENTING CONSOLIDATED FINANCIAL STATEMENTS**

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

The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles prevailing in the respective countries of domicile. The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of consolidated 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 consolidated financial statements.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at December 31, 2004, which was ¥104.20 to U.S.$1. 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 16 (14 in 2003) significant companies over which the Company has power of control through majority voting right or existence of certain conditions evidencing control by the Company.

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 amortized over five years.

**(2) Securities**

*Securities to be held to maturity*

Available-for-sale securities that mature within one year are classified in marketable securities.

Held-to-maturity debt securities are stated at amortized cost. Equity securities issued by subsidiaries and affiliated companies which are not consolidated are stated at moving-average cost. Available-for-sale securities with available fair market values are stated at fair market value. Unrealized gains and unrealized losses on these securities are reported, net of applicable income taxes, as a separate component of shareholders' equity. Realized 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 amortized 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 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 recognized as a loss in the period of the decline. If the fair market value of equity securities issued by unconsolidated subsidiaries 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.

**(3) Derivatives and hedge accounting**

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 recognized.

**(4) Inventories**

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

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

*Change in accounting method*

Previously, as the standard and method for evaluating raw materials, the Company employed the moving-average original cost method. However, following a review of the original cost computation system, the Company has adopted the weighted-average method beginning in 2004. The quantitative effect of this change is not material.

**(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, 2003 and 2004 were ¥4,443 million and ¥4,239 million ($40,681 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 recognize 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 three types of post-employment benefit plans: unfunded lump-sum payment plans, funded noncontributory 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 and defined contribution pension plans.

The Companies provided for employees' severance and retirement benefits at December 31, 2003 and 2004 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" at the time of adopting a new accounting standard) is being recognized in expenses in approximately equal amounts primarily over three years commencing with the year ended December 31, 2001. Prior service costs are recognized in expenses in equal amounts over three years, and actuarial gains and losses are recognized in expenses using the straight-line method over 10 years commencing with the following period.

Accompanying the implementation of the Defined Contribution Pension Law, the Company shifted a portion of its unfunded lump-sum payment plans to the defined contribution pension plans, as of April 2004. The Company applies the "Accounting Principles for Transitions among Retirement Benefit Systems (Practical Guideline No. 1 for Corporate Accounting Standards). Accompanying this transition, the Company reported a special gain of ¥612 million.

*(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**
Receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end rates.

**(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 outstanding shares adjusted for any stock splits. Diluted net income per share is not disclosed because there were no potentially dilutive securities.

Effective January 1, 2003, the Company adopted the new accounting standard for earnings per share and related guidance (Accounting Standards Board Statement No. 2, "Accounting Standard for Earnings Per Share" and Financial Standards Implementation Guidance No. 4, "Implementation Guidance for Accounting Standards for Earnings Per Share", issued by the Accounting Standards Board of Japan on September 25, 2002).

**(16) Cash and cash equivalents**
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, 2003 and 2004 is as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2003 | **2004** | **2004** |
| Cash and time deposits in the consolidated balance sheets | ¥30,166 | **¥19,667** | **$188,743** |
| Marketable securities | 9,395 | **2,828** | **27,150** |
| Other (trust) | 1,000 | **3,500** | **33,579** |
| Time deposits with maturities exceeding 3 months | (1,583) | **(4,093)** | **(39,280)** |
| Bonds with maturities exceeding 3 months | (3,106) | **(827)** | **(7,937)** |
| Cash and cash equivalents in the consolidated statements of cash flows | ¥35,872 | **¥21,075** | **$202,255** |

## 4. MARKETABLE SECURITIES AND INVESTMENT SECURITIES

The following tables summarize acquisition costs, book values and market values of securities with available fair values as of December 31, 2003 and 2004:

**Marketable securities to be held to maturity**

| | Millions of yen | | | | | | Thousands of U.S. dollars | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2003 | | | **2004** | | | **2004** | | |
| Type | Consolidated book value | Market value | Difference | Consolidated book value | Market value | Difference | Consolidated book value | Market value | Difference |
| Securities whose market value exceeds book value<br>Japanese government and regional government bonds | — | — | — | **¥5,016** | **¥5,026** | **¥10** | **$48,139** | **$48,231** | **$ 92** |
| Securities whose market value equals or is less than book value<br>Japanese government and regional government bonds | — | — | — | **¥3,518** | **¥3,516** | **¥ (2)** | **$33,766** | **$33,743** | **$(23)** |

**Available-for-sale securities**

Securities with book values exceeding acquisition costs are as follows:

| | Millions of yen | | | | | | Thousands of U.S. dollars | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2003 | | | **2004** | | | **2004** | | |
| Type | Acquisition cost | Book value | Difference | Acquisition cost | Book value | Difference | Acquisition cost | Book value | Difference |
| Equity securities | ¥2,431 | ¥3,586 | ¥1,155 | **¥4,166** | **¥5,884** | **¥1,718** | **$39,981** | **$56,467** | **$16,486** |
| Bonds | 2,802 | 2,830 | 28 | **2,062** | **2,096** | **34** | **19,789** | **20,115** | **326** |
| Others | 11 | 13 | 2 | **697** | **724** | **27** | **6,689** | **6,948** | **259** |
| Total | ¥5,244 | ¥6,429 | ¥1,185 | **¥6,925** | **¥8,704** | **¥1,779** | **$66,459** | **$83,530** | **$17,071** |

Securities with book values less than acquisition costs are as follows:

| | Millions of yen | | | | | | Thousands of U.S. dollars | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2003 | | | **2004** | | | **2004** | | |
| Type | Acquisition cost | Book value | Difference | Acquisition cost | Book value | Difference | Acquisition cost | Book value | Difference |
| Equity securities | ¥1,372 | ¥1,272 | ¥(100) | **¥ 457** | **¥ 428** | **¥ (29)** | **$ 4,385** | **$ 4,107** | **$ (278)** |
| Bonds | 1,785 | 1,670 | (115) | **—** | **—** | **—** | **—** | **—** | **—** |
| Others | 790 | 601 | (189) | **750** | **621** | **(129)** | **7,198** | **5,960** | **(1,238)** |
| Total | ¥3,947 | ¥3,543 | ¥(404) | **¥1,207** | **¥1,049** | **¥(158)** | **$11,583** | **$10,067** | **$(1,516)** |

The following table summarizes book values of securities with no available fair values as of December 31, 2003 and 2004.

**Available-for-sale securities**

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| Type | 2003 | **2004** | **2004** |
| Non-listed equity securities | ¥ 147 | **¥ 151** | **$ 1,449** |
| Mutual funds | 50 | **52** | **499** |
| Commercial paper | 7,697 | **2,000** | **19,194** |
| Total | ¥7,894 | **¥2,203** | **$21,142** |

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

| | Millions of yen | | | | | | | | | | Thousands of U.S. dollars | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2003 | | | | | **2004** | | | | | **2004** | | | | |
| | 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 | Within one year | Within five years | Within ten years | Over ten years | Total |
| Bonds | ¥1,350 | ¥2,418 | ¥300 | ¥500 | ¥4,568 | **¥618** | **¥10,600** | **—** | **¥500** | **¥11,718** | **$5,931** | **$101,727** | **—** | **$4,798** | **$112,456** |
| Others | — | 282 | — | — | 282 | **—** | **12** | **—** | **—** | **12** | **—** | **115** | **—** | **—** | **115** |
| Total | ¥1,350 | ¥2,700 | ¥300 | ¥500 | ¥4,850 | **¥618** | **¥10,612** | **—** | **¥500** | **¥11,730** | **$5,931** | **$101,842** | **—** | **$4,798** | **$112,571** |

Total sales of available-for-sale securities in the year ended December 31, 2003 amounted to ¥30,548 million and the related gains and losses amounted to ¥149 million and ¥13 million, respectively.

Total sales of available-for-sale securities in the year ended December 31, 2004 amounted to ¥32,678 million ($313,608 thousand) and the related gains and losses amounted to ¥52 million ($499 thousand) and ¥109 million ($1,046 thousand), respectively.

## 5. LEASES

Finance leases, except for those in which ownership is deemed to be transferred to the lessee, are accounted for as operating leases. Original lease obligations and future minimum lease payments at December 31, 2003 and 2004 are as follows:

| | Millions of yen | | | | | | Thousands of U.S. dollars |
|---|---|---|---|---|---|---|---|
| | 2003 | | | **2004** | | | **2004** |
| | Machinery and equipment | Other | Total | Machinery and equipment | Other | Total | Total |
| Original lease obligation (including finance charges) | ¥2,143 | ¥230 | ¥2,373 | **¥1,929** | **¥227** | **¥2,156** | **$20,681** |
| Payments remaining | 956 | 114 | 1,070 | **683** | **66** | **749** | **7,188** |
| Payments due within one year | | | 464 | | | **319** | **3,061** |
| Payments due after one year | | | 606 | | | **430** | **4,127** |
| Total | | | ¥1,070 | | | **¥ 749** | **$ 7,188** |

Total lease payments under non-capitalized finance leases for the years ended December 31, 2003 and 2004 were ¥509 million and ¥478 million ($4,587 thousand), respectively.

Future minimum rents under non-cancellable operating leases at December 31, 2003 and 2004 consist of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2003 | **2004** | **2004** |
| Due within one year | ¥3 | **¥2** | **$19** |
| Due after one year | 2 | **1** | **1** |
| | ¥5 | **¥3** | **$20** |

## 6. BANK LOANS

Short-term bank loans at December 31, 2003 and 2004 consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2003 | **2004** | **2004** |
| Short-term bank loans—5.15% | ¥1,960 | **¥462** | **$4,434** |

## 7. CONTINGENT LIABILITIES

At December 31, 2004, the Companies were contingently liable as follows:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| As endorser of notes endorsed | ¥ 5 | $ 48 |
| As guarantor of indebtedness of an affiliate and other companies | 630 | 6,046 |
| | ¥635 | $6,094 |

## 8. 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% and 40.7% for the years ended December 31, 2003 and 2004, respectively.

The following table summarizes the significant differences between the statutory tax rate and the Companies' effective tax rate for financial statement purposes for the year ended December 31, 2003.

| | Percentage |
|---|---|
| | 2003 |
| Statutory tax rate: | 42.0% |
| Permanently non-deductible expenses | 2.3 |
| Permanently non-taxable dividend income | (0.4) |
| Per capita inhabitants' tax | 2.1 |
| Equity in losses of affiliates | (0.5) |
| Decrease in deferred tax assets due to change in tax rate | 3.0 |
| Other | 3.3 |
| Effective tax rate | 51.8% |

No reconciliation for the year ended December 31, 2004 has been presented because the difference between the statutory tax rate and the Companies' effective tax rate was immaterial.

Significant components of the Companies' deferred tax assets and liabilities as of December 31, 2003 and 2004 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2003 | **2004** | **2004** |
| Deferred tax assets: | | | |
| Employees' retirement benefits | ¥5,332 | **¥3,921** | **$37,630** |
| Excess bad-debt expenses | 319 | **389** | **3,733** |
| Directors' and statutory auditors' retirement benefits | 286 | **347** | **3,330** |
| Accrued enterprise tax | 152 | **97** | **931** |
| Write-down of securities | 274 | **239** | **2,294** |
| Loss carryforwards (for tax purposes) | 226 | **245** | **2,351** |
| Other | 330 | **553** | **5,307** |
| Total deferred tax assets | 6,919 | **5,791** | **55,576** |
| Valuation allowance | (145) | **(219)** | **(2,102)** |
| Deferred tax assets | 6,774 | **5,572** | **53,474** |
| Deferred tax liabilities: | | | |
| Net unrealized holding gains on securities | (258) | **(632)** | **(6,065)** |
| Land | (422) | **(294)** | **(2,821)** |
| Net deferred tax assets | ¥6,094 | **¥4,646** | **$44,588** |

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2003 | **2004** | **2004** |
| Short-term deferred tax assets | ¥ 737 | **¥ 719** | **$ 6,900** |
| Long-term deferred tax assets | 5,657 | **4,221** | **40,509** |
| Long-term deferred tax liabilities | (300) | **(294)** | **(2,821)** |
| | ¥6,094 | **¥4,646** | **$44,588** |

The aggregate statutory income tax rate will be reduced for the years commencing on January 1, 2005 and later due to the revised local tax law. At December 31, 2003, the Company and consolidated domestic subsidiaries applied the reduced aggregate statutory income tax rate of 40.7% for calculating deferred tax assets and liabilities that are expected to be recovered or settled in the years commencing on January 1, 2005 or later. As a result, deferred tax assets decreased by ¥170 million, net unrealized holding gains on securities increased by ¥11 million and provision for deferred income taxes increased by ¥181 million compared with what would be reported using the currently applicable tax rate of 42.0%.

## 9. 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, 2003 and 2004 consist of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2003 | **2004** | **2004** |
| Projected benefit obligation | ¥22,821 | **¥22,236** | **$213,397** |
| Unrecognized prior service costs | 3,043 | **2,011** | **19,300** |
| Unrecognized actuarial differences | (4,381) | **(4,966)** | **(47,658)** |
| Less fair value of pension assets | (7,262) | **(8,443)** | **(81,027)** |
| Prepaid pension cost | 47 | **91** | **873** |
| Liabilities for severance and retirement benefits | ¥14,268 | **¥10,929** | **$104,885** |

Included in the consolidated statements of income for the years ended December 31, 2003 and 2004 are severance and retirement benefit expenses comprised of the following:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | 2003 | **2004** | **2004** |
| Service costs—benefits earned during the year | ¥1,384 | **¥ 918** | **$8,810** |
| Interest cost on projected benefit obligation | 618 | **509** | **4,885** |
| Expected return on plan assets | (138) | **(139)** | **(1,334)** |
| Amortization of prior service costs | (35) | **(1,032)** | **(9,904)** |
| Amortization of actuarial differences | 490 | **479** | **4,597** |
| Amortization of net transition obligation | 1,812 | **—** | **—** |
| Severance and retirement benefit expenses | ¥4,131 | **¥ 735** | **$7,054** |

The discount rates and the rates of expected return on plan assets used by the Company are 2.7% and 2.3% in 2003 and 2.3% and 2.3% in 2004, 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.

### 10. 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 capitalized 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 and additional paid-in capital is included in capital surplus 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.

### 11. 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.

### 12. SUBSEQUENT EVENT

**Appropriation of retained earnings**

At the ordinary shareholders' meeting of the Company held on March 30, 2005, the following appropriations of retained earnings for the year ended December 31, 2004 were duly approved:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Appropriations: | | |
| Cash dividends—¥14.0 per share | ¥686 | $6,583 |
| Bonuses to directors | | |
| and statutory auditors | 39 | 374 |