A Message from the Management

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During fiscal 2005, ended December 31, 2005, Noritz Corporation reported net sales of ¥176.0 billion, 2.6% higher than for the previous fiscal year. Operating income amounted to ¥6.9 billion, 9.7% lower than a year earlier, and net income decreased 13.7%, to ¥4.3 billion.

Although net sales rose, two principal factors contributed to a decline in profitability. First, the unit sales price ratio declined 3.4% on average. Second, even though we implemented cost reductions amounting to ¥2.5 billion, this was insufficient to absorb an increase of ¥0.45 billion in raw material costs and a decline in unit sales prices. Third, the Company increased expenses deemed necessary for future sales, including active advertising expenditures to win housing refurbishment sales and product development costs, thus leading to an increase in selling, general and administrative expenses of ¥1.4 billion and an increase in the SG&A expense ratio.

Also, in fiscal 2004, the Company reported a gain of ¥0.6 billion from the shifting of a portion of corporate pension funds to 401k-type defined contribution pension plans, but a similar gain was not reported in fiscal 2005. Moreover, largely as a result of the reporting of a loss on sales and disposal of property, plant and equipment amounting to ¥0.7 billion and the previously mentioned factors, net income amounted to ¥4.3 billion, 13.7% lower than in the previous fiscal year.

By business segment, sales of our main business, water heater and air-conditioning related equipment, increased 2.3%, to ¥110.5 billion. The principal reasons for this increase were an increase in overseas sales, to ¥6.5 billion, ¥1.5 billion higher than for the previous fiscal year, and increases in the sales of parts manufacturing subsidiaries Taisei Kogyo Corporation and Noritz Electronics Technology (NET) Corporation accompanying the rise in the sales of water heater and air-conditioning related equipment by Noritz, the parent company. Total market demand for gas-fired and kerosene-fired water heaters amounted to 3.43 million units, a substantial decline of 2.8% from the previous fiscal year. However, demand for electric-powered water heaters rose to 43 thousand units, an increase of 19% over the previous year, and accounted for 11% of water heating units sold. Amid this operating environment, Noritz worked to sell high-efficiency, gas-fired water heating equipment that places a lower burden on the natural environment and produce OEM units for other manufacturers.

In our second major business, system bathrooms and kitchens, demand showed a slight increase. Our sales of bathroom related equipment, including system bathrooms and other items, declined 2.2%, to ¥15.5 billion. The number of units we sold increased, but, as a result of the rise in the percentage of low- and medium-priced units, profitability conditions in the system bathroom business have become more challenging. In the system kitchen business, sales of these units for newly constructed housing were stagnant, but sales of built-in glass-top ranges manufactured by consolidated subsidiary Harman Co., Ltd., were favorable, rising 1.6%, to ¥29.0 billion. In our service business, sales of other businesses increased as a result of the higher sales of parts for after-sales service and a rise in sales to other companies.

→ The Second Medium-Term Plan and Analysis of the Environment

We have positioned fiscal 2006—the second year of our Create 21 Second-Phase Medium-Term Management Plan—as the time for solidifying our foundations to meet the objectives set for fiscal 2007. At present, those goals remain the same, namely ¥185.0 billion in net sales, ¥10.0 billion in recurring income, and ¥5.0 billion in net income, all on a consolidated basis.

To confirm our awareness of the management environment in the home equipment industry, let us look at two key issues. First, let us turn to the markets for new housing units and renovation. The number of new housing starts is forecast to remain steady at the current level. However, issues we must address include the shrinkage in the built-to-order housing area, which is the main target for sales of medium- to higher-priced housing equipment, and growth in the built-for-rental and built-for-sale housing segments, in which price competition is severe.

Without doubt, there is latent demand in the market for housing refurbishment. Certain circumstances, such as severe winter weather, may act to boost demand by encouraging home owners to refurnish their homes with new equipment. An important task is to uncover and stimulate latent demand among those who have a desire to improve the quality of their homes.

Next, let us turn to the second major issue, namely energy. Electric power companies and manufacturers of electrical equipment and appliances are placing emphasis on housing that relies entirely or principally on electric power as a source of energy, and their activities are resulting in a decline in the usage of gas-fired and kerosene-fired water heaters. To counter this trend, we at Noritz are implementing initiatives that draw on our strengths and are introducing products that are differentiated from electric-powered units. In the gas range area, we intend to continue to market glass-top ranges and other high-value-added products.

→ Outlook for Fiscal 2006

We are looking for 3.1% growth in net sales, to ¥181.5 billion, as a result of expansion in overseas sales and other factors. We believe that increases in the prices of raw materials will continue, but we intend to lower costs by cutting back on expenses, standardizing and reducing the number of parts, lowering the number of administrative personnel, and taking other initiatives. As a result of these measures, we are forecasting operating income of ¥7.5 billion, 7.9% higher than for the prior year, and growth in recurring income of 1.1%, to ¥8.5 billion. We are expecting growth in net income of 1.8%, to ¥4.35 billion, and are planning to pay dividends of ¥28 per share for fiscal 2006.

By segment, we are looking for sales of ¥112.8 billion in the water heater and air-conditioning related equipment business, 3.1% higher than in fiscal 2005. This expansion will be supported by growth in overseas sales of 69.5%, to ¥11.0 billion, as sales increase in China and certain overseas subsidiaries, including Noritz America Corporation, are newly consolidated with the parent company, thus offsetting the decline in domestic sales.

We are forecasting 4.1% growth, to ¥46.4 billion, in sales in the system bathroom and kitchen business as a whole. Although sales of the system bathroom business are forecast to decline 9.7%, to ¥14.0 billion, plans call for an 11.4% expansion, to ¥32.4 billion, in system kitchen products, as Harman is expected to increase sales in this area, especially of its top-performing built-in ranges. Sales in the services business are forecast to decrease 0.5%, to ¥16.8 billion, but sales in other business activities are expected to rise 35.6%, to ¥5.5 billion.

→ Three Strategies for Attaining Fiscal 2006 Objectives

We are implementing three basic strategies for attaining our objectives for fiscal 2006. The first of these is aimed at increasing unit sales of our products under our "new value" strategy, which is intended to respond to environmental issues and counter the trend toward use of electric-powered water heaters as well as focus on the theme of health and sales to the institutional market.

Under our second strategic focus, our "Houresh" (house refresh) strategy, we are working to uncover latent demand for replacement and renovation services. This includes strengthening our marketing approach to members of the baby boomer generation, who will be retiring in large numbers in 2007 and may wish to refurbish their homes before doing so, as well as other home owners who may want to undertake home reforms.

Although our competitors may have similar ideas in mind, the strength of our business model lies in three areas. The first of these is that we have ties with powerful dealers that already handle our products. The second is that we are already developing sales channels through gas suppliers that are strengthening their relationships with end users, and the third is that we have our own sales channels.

Under our third strategy, which is to develop further our activities globally, we moved quickly to establish overseas sales bases in 2005. Along with expanding our sales channels in overseas markets, we are working to apply a business model that has proven successful in Japan, which provides for customer centers as well as construction and other services.

Going forward, two major factors will affect our global strategy in the current fiscal year. First, with the required technical permits already in hand, we are positioned to make major leaps forward in sales volume. At the same time, we will complete work on our second manufacturing plant, located in Shanghai, China, and preparations are under way to commence production in 2007.

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