

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 translations 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, 2005, which was ¥118.07 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 18 (16 in 2004) 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

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.

(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, 2004 and 2005 were ¥4,239 million and ¥5,126 million (\$43,415 thousand), respectively.

(7) Software costs

The Companies include software in intangible assets and amortize 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 recognize tax effects of loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting.

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 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, and defined contribution pension plans.

The Companies provided for employees' severance and retirement benefits at December 31, 2004 and 2005 based on the estimated amounts of projected benefit obligation and the fair value of the plan assets at those dates.

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.

(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.

(17) Enterprise taxes

Commencing in the year ended December 31, 2005, the value-added and capital portions of enterprise taxes amounting to ¥240 million (\$2,033 thousand) are treated as selling, general and administrative expenses in accordance with Practical Guidance Report No. 12, "Treatment of the Pro Forma Standard Tax Portion of Corporate Tax in the Statement of Income," announced by the Accounting Standards Board of Japan on February 13, 2004.

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, 2004 and 2005 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2005	2005
Cash and time deposits in the consolidated balance sheets	¥19,667	¥18,980	\$160,752
Marketable securities	2,828	3,185	26,976
Other (trust)	3,500	—	—
Time deposits with maturities exceeding 3 months	(4,093)	(3,095)	(26,213)
Bonds with maturities exceeding 3 months	(827)	(3,183)	(26,959)
Cash and cash equivalents in the consolidated statements of cash flows	¥21,075	¥15,887	\$134,556

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, 2004 and 2005:

Marketable securities to be held to maturity

Type	Millions of yen						Thousands of U.S. dollars		
	2004			2005			2005		
	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									
Japanese government and regional government bonds	¥5,016	¥5,026	¥10	¥5,508	¥5,512	¥ 4	\$46,650	\$46,684	\$ 34
Securities whose market value equals or is less than book value									
Japanese government and regional government bonds	¥3,518	¥3,516	¥ (2)	¥4,514	¥4,497	¥(17)	\$38,232	\$38,088	\$(144)

Available-for-sale securities

Securities with book values exceeding acquisition costs are as follows:

Type	Millions of yen						Thousands of U.S. dollars		
	2004			2005			2005		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥4,166	¥5,884	¥1,718	¥ 9,241	¥14,829	¥5,588	\$78,267	\$125,595	\$47,328
Bonds	2,723	2,781	58	1,927	1,945	18	16,321	16,473	152
Others	36	39	3	10	26	16	85	220	135
Total	¥6,925	¥8,704	¥1,779	¥11,178	¥16,800	¥5,622	\$94,673	\$142,288	\$47,615

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

Type	Millions of yen						Thousands of U.S. dollars		
	2004			2005			2005		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥ 457	¥ 428	¥ (29)	¥ 27	¥ 26	¥ (1)	\$ 229	\$ 220	\$ (9)
Bonds	500	444	(56)	500	497	(3)	4,235	4,209	(26)
Others	250	177	(73)	222	171	(51)	1,880	1,449	(431)
Total	¥1,207	¥1,049	¥(158)	¥749	¥694	¥(55)	\$6,344	\$5,878	\$(466)

The following table summarizes book values of securities with no available fair values as of December 31, 2004 and 2005.

Available-for-sale securities

Type	Millions of yen		Thousands of U.S. dollars
	2004	2005	2005
Non-listed equity securities	¥ 151	¥165	\$1,397
Mutual funds	52	2	17
Venture capital investment limited partnership	14	14	119
Commercial paper	2,000	—	—
Total	¥2,217	¥181	\$1,533

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

	Millions of yen										Thousands of U.S. dollars				
	2004					2005					2005				
	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	¥618	¥10,600	—	¥500	¥11,718	¥3,000	¥8,900	—	¥500	¥12,400	\$25,408	\$75,379	—	\$4,235	\$105,022
Others	—	12	—	—	12	—	25	—	—	25	—	212	—	—	212
Total	¥618	¥10,612	—	¥500	¥11,730	¥3,000	¥8,925	—	¥500	¥12,425	\$25,408	\$75,591	—	\$4,235	\$105,234

Total sales of available-for-sale securities in the year ended December 31, 2004 amounted to ¥32,678 million and the related gains and losses amounted to ¥52 million and ¥109 million, respectively.

Total sales of available-for-sale securities in the year ended December 31, 2005 amounted to ¥793 million (\$6,716 thousand) and the related gains and losses amounted to ¥38 million (\$322 thousand) and ¥3 million (\$26 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, 2004 and 2005 are as follows:

	Millions of yen						Thousands of U.S. dollars
	2004			2005			2005
	Machinery and equipment	Other	Total	Machinery and equipment	Other	Total	Total
Original lease obligation (including finance charges)	¥1,929	¥227	¥2,156	¥1,549	¥170	¥1,719	\$14,559
Payments remaining	683	66	749	548	47	595	5,039
Payments due within one year			319			219	1,855
Payments due after one year			430			376	3,184
Total			¥ 749			¥ 595	\$ 5,039

Total lease payments under non-capitalized finance leases for the years ended December 31, 2004 and 2005 were ¥478 million and ¥335 million (\$2,837 thousand), respectively.

Future minimum rents under non-cancellable operating leases at December 31, 2004 and 2005 consist of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2005	2005
Due within one year	¥2	¥ 1	\$ 1
Due after one year	1	—	—
	¥3	¥ 1	\$ 1

6. BANK LOANS

Short-term bank loans at December 31, 2004 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2005	2005
Short-term bank loans—4.70%	¥462	¥540	\$4,574

7. CONTINGENT LIABILITIES

At December 31, 2005, the Companies were contingently liable as follows:

	Millions of yen	Thousands of U.S. dollars
As endorser of notes endorsed	¥ 1	\$ 1
As guarantor of indebtedness of an affiliate and other companies	604	5,116
	¥605	\$5,117

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 40.7% for the years ended December 31, 2004 and 2005.

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, 2005.

	Percentage
	2005
Statutory tax rate:	40.7%
Permanently non-deductible expenses	2.1
Permanently non-taxable dividend income	(0.3)
Per capita inhabitants' tax	1.7
Amortization of consolidation goodwill	(0.6)
Other	(0.7)
Effective tax rate	42.9%

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, 2004 and 2005 are as follows:

	Millions of yen		Thousands of
	2004	2005	U.S. dollars
			2005
Deferred tax assets:			
Employees' retirement benefits	¥3,921	¥ 3,705	\$31,380
Excess bad-debt expenses	389	303	2,566
Directors' and statutory auditors' retirement benefits	347	217	1,838
Accrued enterprise tax	97	179	1,516
Write-down of securities	239	110	932
Loss carryforwards (for tax purposes)	245	309	2,617
Other	553	614	5,200
Total deferred tax assets	5,791	5,437	46,049
Valuation allowance	(219)	(377)	(3,193)
Deferred tax assets	5,572	5,060	42,856
Deferred tax liabilities:			
Net unrealized holding gains on securities	(632)	(2,265)	(19,184)
Land	(294)	(315)	(2,668)
Deferred tax liabilities	(926)	(2,580)	(21,852)
Net deferred tax assets	¥4,646	¥ 2,480	\$21,004

	Millions of yen		Thousands of
	2004	2005	U.S. dollars
			2005
Short-term deferred tax assets	¥ 719	¥ 830	\$ 7,030
Short-term deferred tax liabilities	—	(1)	(9)
Long-term deferred tax assets	4,221	1,966	16,651
Long-term deferred tax liabilities	(294)	(315)	(2,668)
	¥4,646	¥ 2,480	\$21,004

9. EMPLOYEES' SEVERANCE AND RETIREMENT BENEFITS

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, 2004 and 2005 consist of the following:

	Millions of yen		Thousands of
	2004	2005	U.S. dollars
			2005
Projected benefit obligation	¥22,236	¥ 23,314	\$197,459
Unrecognized prior service costs	2,011	1,006	8,520
Unrecognized actuarial differences	(4,966)	(3,281)	(27,788)
Less fair value of pension assets	(8,443)	(11,304)	(95,740)
Prepaid pension cost	91	119	1,008
Liabilities for severance and retirement benefits	¥10,929	¥ 9,854	\$ 83,459

Included in the consolidated statements of income for the years ended December 31, 2004 and 2005 are severance and retirement benefit expenses comprised of the following:

	Millions of yen		Thousands of
	2004	2005	U.S. dollars
			2005
Service costs—			
benefits earned during the year	¥ 918	¥ 983	\$8,326
Interest cost on projected benefit obligation	509	461	3,904
Expected return on plan assets	(139)	(166)	(1,406)
Amortization of prior service costs	(1,032)	(1,005)	(8,512)
Amortization of actuarial differences	479	584	4,946
Other	—	240	2,033
Severance and retirement benefit expenses	¥ 735	¥ 1,097	\$9,291

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

The Commercial Code of Japan 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. ADOPTION OF ACCOUNTING POLICY FOR IMPAIRMENT OF FIXED ASSETS

Companies have been allowed to apply Accounting Principles for Impairment of Fixed Assets (contained in the "Opinion Regarding Accounting Principles for Impairment of Fixed Assets" issued by the Business Accounting Council on August 9, 2002) and "Guidelines for Application of Accounting Principles for Impairment of Fixed Assets" (issued by the Business Accounting Standards Committee on October 31, 2003 as "Guideline No. 6 for Application of Corporate Accounting Standards") in preparing financial statements for fiscal years ending after March 31, 2004. Accordingly, the Company has applied these principles and guidelines beginning with the 2005 fiscal year. As a result of this change in accounting policy, income before income taxes was ¥20 million (\$169 thousand) lower than it would have been without this change.

Accumulated losses on impairment of fixed assets were deducted directly from the amount of land.

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 30, 2006, the following appropriations of retained earnings for the year ended December 31, 2005 were duly approved:

	Millions of yen	Thousands of U.S. dollars
Appropriations:		
Cash dividends—¥14.0 per share	¥670	\$5,675
Bonuses to directors and statutory auditors	34	288