A Message from the Management

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Review of Performance in Fiscal 2006

During fiscal 2006, ended December 31, 2006, Noritz Corporation reported consolidated net sales of ¥182.1 billion, 3.4% higher than for the previous fiscal year. Operating income amounted to ¥5.8 billion, 16.4% lower than a year earlier, and net income decreased 29.9%, to ¥3.0 billion.

The principal factors resulting in an increase in net sales with a decline in net income were as follows. First, sales of gas bath heaters were strong, and the inclusion of Noritz America Corporation within the scope of consolidation also contributed to growth in net sales. The unit sales price of gas bath heaters declined 1.2% on average, which was 0.2 percentage point larger than our planned 1.0%; however, the margin of decline in average prices is shrinking on a period-to-period basis. Second, the most significant factor affecting profitability was the greater-than-anticipated increase in raw material costs, especially copper. We cut costs by ¥2.6 billion, but this was insufficient to offset the ¥3.1 billion increase in raw material prices. Of this total rise, ¥2.5 billion was due to the increase in the price of copper.

Selling, general and administrative (SG&A) expenses rose 3.6%, to ¥48.1 billion. The reason for this ¥1.7 billion expansion in SG&A costs was the inclusion of Noritz America in the consolidated accounts. This subsidiary is making investments for expansion in sales going forward, including the establishment of its third U.S. office, in Dallas, in February 2007. In addition, the recall of bathroom heating, ventilation, and dehumidifying units manufactured by subsidiary Harmanpro Co., Ltd., resulted in an extraordinary loss of ¥752 million, which reduced net income by 29.9%.

By business segment, sales of water heater and air-conditioning related equipment rose 4.1%, to ¥115.0 billion. The principal reasons for this gain were an increase in overseas sales of 47.0%, or ¥3.0 billion, over the previous fiscal year, to ¥9.5 billion, and higher sales of water heater and air-conditioning related equipment by the parent company. Total market demand in Japan for gas-fired and kerosene-fired water heaters was 3.42 million units, a decrease of 2.2%. Nevertheless, demand for electric-powered water heaters rose 30.0%, to approximately 560,000 units, and the share of these units in total water-heating equipment climbed to 14.0%. Amid this operating environment, Noritz focused on selling high-efficiency, gas-fired water heating equipment that places a lower burden on the natural environment and on expanding sales in overseas markets.

Sales of system bathrooms and kitchens overall rose 1.7%, to ¥45.3 billion. Sales of system baths and other bathroom-related equipment were down 15.4%, to ¥13.1 billion. Noritz adopted a policy of selective acceptance of orders to avoid low sales prices. As a result of this policy and the absence of new products, the number of units sold fell 16.3%, to 43,000. Profitability conditions in the system bath field remain challenging. On the other hand, sales of system kitchens and related equipment rose 10.8%, to ¥32.2 billion. Although sales of system kitchen units for detached housing were lackluster, sales of built-in glass top ranges manufactured by subsidiary Harman Co., Ltd., climbed 18.2%, to ¥21.1 billion. In our service business, sales of other businesses rose as a result of the higher sales of parts for after-sales service and an increase in sales to other companies.

Dealing with Quality Issues in Domestic Water Heater Equipment

In Japan, the awareness of safety has risen as a result of accidents involving the gas-fired equipment of other manufacturers (caused by older gas equipment that had been in use for a prolonged period), and Noritz was obliged to deal with issues related to fires caused by bathroom heating and dehumidifying units manufactured by subsidiary Harmanpro. At Noritz, we have divided our products into two categories: namely, those that are in the design stages and units that remain on the market at present. We are moving forward with safety measures for gas-fired equipment, working in close cooperation with gas companies, and, for older units that are in use at present but have no safety equipment installed, we are cooperating with gas companies to encourage users to purchase new units. In addition, we have begun inspections in anticipation of the passage of legislation that will institute a system for periodic inspections. For products that we will develop going forward, we are considering the installation of fail-safe devices that will go into operation without fail when safety systems are out of order. These units will embody time point technology that prevents usage of the units for a set period. Moreover, from an organizational perspective, we formed a Quality Assurance Division in September 2006 that is operating across Group company lines. This division brings together the quality assurance activities formerly spread out into the development, production, sales, installation, and after-sales service functions in Noritz businesses and other Group companies and is working to enhance quality standards throughout the Noritz Group.

Outlook for Fiscal 2007

As a result of expansion in overseas business operations, the revision in our asking retail price system, and other factors, we are forecasting growth of 5.5% in consolidated net sales, to ¥192.0 billion. We anticipate that about ¥4.0 billion of the increase in net sales will come from expansion in overseas operations, ¥2.0 billion will be due to revision in the asking retail price system, ¥2.1 billion will come from growth in high-performance products, and the remainder will come from other sources. We believe that the prices of raw materials—including stainless steel, brass, and other materials—will continue to rise, but we are anticipating that the price of copper, which rose because of speculative demand in 2006, will decline. On an overall basis, we are anticipating an increase in raw material prices for the parent company of ¥1.28 billion. However, we are planning to cut back on manufacturing costs, through changes in design and other measures, by ¥2.95 billion. Therefore, in comparison to 2006, we are looking for an overall reduction in raw material costs of ¥1.67 billion on a parent-company basis. We are forecasting an increase in SG&A expenses of 10.8%, to ¥53.3 billion. Factors accounting for this rise, totaling ¥5.2 billion, will be higher sales, higher retirement and severance payments, and other cost increases. We are anticipating a 36.8% increase in net income, to ¥4.1 billion. We are looking to pay a dividend of ¥28 per common share, the same as for the previous fiscal year.

By business segment, we are forecasting an increase in sales of water heater and air-conditioning related equipment of 4.1%, to ¥119.7 billion, with overseas sales in China and the United States expanding 42.6%, to ¥13.6 billion. In China, we will realign our sales route in Shanghai for supplying volume discount stores and will establish marketing bases on the East Coast and Midwestern areas of the United States. In the system bathroom and kitchen product sector, we are looking for 11.4% growth in sales, to ¥50.5 billion. Within this total, we are forecasting growth in bathroom-related equipment of 7.5%, to ¥14.1 billion. Among kitchen-related equipment, we are also planning to expand sales of built-in, glass-top ranges manufactured by subsidiary Harman, which are currently experiencing firm growth, to achieve overall growth in kitchen-related equipment of 13.0%, to ¥36.4 billion. In our service business, we are planning to expand sales by 3.5%, to ¥17.6 billion, and expect a decrease of 11.1%, to ¥4.2 billion, in other businesses.

Report on Progress under the Medium-Term Plan

Since 2002, Noritz has been implementing its 10-year Create 21 management plan, which provides direction for the development of the Noritz Group. The four key elements of this plan are to (1) implement management to win customer satisfaction, (2) strengthen the Group's business structure, (3) implement initiatives to achieve symbiosis with the natural environment, and (4) establish the Noritz Group as a vital and robust set of enterprises.

At present, we are moving forward with the second-phase of the medium-term management plan of Create 21, covering the period from fiscal 2005 through fiscal 2007. Under this plan, we have established three policies: namely, our "new value" strategy, our "Houresh" (house refresh) strategy, and our global strategy. Our Houresh strategy aims to promote our housing refurbishment business activities, and our global strategy seeks to expand our water heater related operations into overseas markets. Our new value strategy supports these two other strategies from the perspectives of product development and the creation of new production technologies.

Initiatives under the Create 21 Second-Phase Medium-Term Management Plan

(Billions of yen)

Consolidated Performance Indicators		2005			2006			2007		
		Planned	Actual	Difference	Planned	Actual	Difference	Planned	Target	Difference
Accounting Items	Net sales	175.0	176.0	1.0	180.0	182.0	2.0	185.0	192.0	7.0
	Operating income	7.5	6.9	(0.6)	8.0	5.8	(2.2)	9.0	7.5	(1.5)
	Recurring income	7.7	8.4	0.7	9.0	7.0	(2.0)	10.0	8.3	(1.7)
	Net income	4.0	4.2	0.2	4.5	2.9	(1.6)	5.0	4.1	(0.9)
	ROE	4.8%	4.9%	0.1P	5.4%	3.3%	(2.1P)	6.0%	4.5%	(1.5P)
	ROA*	4.9%	5.6%	0.7P	5.8%	4.6%	(1.2P)	6.5%	5.3%	(1.2P)
Sales by Segment	Water heater and air-conditioning related equipment	110.5	110.5	0.0	113.1	115.0	1.9	115.8	119.7	3.9
	[Overseas]	7.1	6.5	(0.6)	10.0	9.5	(0.5)	13.0	13.6	0.6
	System bathrooms and kitchens	45.1	44.6	(0.5)	47.1	45.3	(1.8)	49.2	50.5	1.3
	Bathroom and other bathroom-related equipment	16.4	15.5	(0.9)	17.3	13.1	(4.2)	18.2	14.1	(4.1)
	System kitchens and other kitchen-related equipment	28.7	29.0	0.3	29.8	32.2	2.4	31.0	36.4	5.4
	[System kitchens and related equipment]	17.4	17.9	0.5	18.3	21.1	2.8	19.3	25.1	5.8
	Service business	16.2	16.9	0.7	16.4	17.0	0.6	16.4	17.6	1.2
	Other business	3.2	4.0	0.8	3.4	4.7	1.3	3.6	4.2	0.6
	Capital expenditure	7.0	6.1	(0.9)	9.6	6.6	(3.0)	7.9	10.7	2.8

* ROA=Recurring income/Average total assets
P= Percentage points

Objectives and Results

Fiscal 2007 will be the final year of our Create 21 Second-Phase Medium-Term Management Plan. Under the plan, we have been working to achieve consolidated net sales of ¥185 billion, operating income of ¥9 billion, recurring income of ¥10 billion, net income of ¥5 billion, ROE of 6.0%, and ROA of 6.5% by 2007. However, in view of the implications for the operating environment of the sharp rise in raw material prices in 2006, we have revised our profit targets for fiscal 2007 down to the level we achieved in fiscal 2006.

As we continue to work toward the objectives of Create 21 from a 10-year perspective, we look forward to your continuing advice and support.

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