

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 Financial Instruments 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 Financial Instruments 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, 2007, which was ¥114.16 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 22 (20 in 2006) significant companies over which the Company has power of control through majority voting rights or the existence of certain other conditions evidencing control by the Company.

In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portions attributable to minority shareholders, are evaluated using the fair value at the time the Company acquired control of the respective subsidiaries.

The difference between the cost of investments in subsidiaries and equity in subsidiaries' net assets at dates of acquisition is, if considered significant, amortized over five years.

(2) Securities

Available-for-sale securities that mature within one year are classified as 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 sales 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 the 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, the 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, 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

Derivative financial instruments, except those used for hedging purposes, are stated at fair market value. Gains and losses realized on maturity or disposal and unrealized gains and losses from market value fluctuations are recognized as gains or losses in the period of the change.

If derivative financial instruments are used as hedges and meet certain hedging criteria, the Companies defer recognition of the gains or losses resulting from changes in the fair value of the 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.

Change in Accounting Policy

Accompanying the implementation of revisions in the corporate income tax laws (as contained in the Law Revising a Portion of the Income Tax Law, March 30, 2007, Law No. 6 and the Ordinance Revising a Portion of the Enforcement Order for the Income Tax Law, March 30, 2007, Ordinance No. 83), the method of depreciation for tangible fixed assets purchased after April 1, 2007, has been changed to the method applicable after the revisions in the corporate income tax laws.

As a result, operating income was ¥335 million lower than it would have been under the previous method of accounting, and loss before income taxes and minority interests was ¥335 million lower than it would have been under the previous method of accounting.

(6) Research and development expenses

Research and development expenses are charged to income as incurred. Such expenses for the years ended December 31, 2006 and 2007 were ¥5,841 million and ¥6,069 million (\$53,162 thousand), respectively.

(7) Software costs

The Companies include software in intangible assets and amortize it using the straight-line method over the estimated useful life of 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 and to directors and statutory auditors in March. Accrued bonus liabilities of the Companies at the balance sheet date are calculated based upon managements' estimates of annual amounts thereof. Accrued bonuses are included in accrued expenses in the consolidated balance sheets.

The Companies have adopted "Accounting Standard for Directors' Bonuses" (issued by the Accounting Standards Board of Japan on November 29, 2005 as "the Corporate Accounting Standard No. 4") beginning with the 2006 fiscal year. As a result of this change in accounting policy, for the year ended December 31, 2006, income before income taxes was ¥34 million lower than it would have been without this change.

(10) Reserve for product warranty

The reserve for product warranty is calculated on the basis of sales of products and actual product warranty liability paid in the past. The reserve is included in the liability for accrued expenses in the consolidated balance sheets.

(11) Provision for the repair of products on recall

The provision for the repair of products on recall is calculated on the basis of the estimated expenses of voluntary inspections of specified water heaters and gas burners. The provision is included in the liability for accrued expenses in the consolidated balance sheets.

(12) Income taxes

The Companies recognize the 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.

(13) 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, 2006 and 2007 based on the estimated amounts of projected benefit obligation and the fair value of 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.

(ii) Directors and statutory auditors

Some of the consolidated subsidiaries, in accordance with their internal rules, have included certain amounts in fiscal year-end figures that will be necessary for the payment of retirement benefits to directors and statutory auditors.

The Company decided to terminate its retirement benefit plan for directors and statutory auditors at the annual general meeting of the shareholders held on March 30, 2006, and the shareholders approved a resolution to make lump-sum payments of their accumulated retirement benefits to the directors and statutory auditors. As a result, the Company has reversed the full amount of accrued retirement benefits for directors and statutory auditors for the year ended December 31, 2006, and the aggregate amount of the outstanding lump-sum payments to the directors and statutory auditors has been included in "other noncurrent liabilities" at December 31, 2006 and 2007, respectively.

(14) Translation of foreign currencies

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

(15) Accounting for leases

Finance leases which do not transfer ownership are accounted for in the same manner as operating leases under generally accepted accounting principles in Japan.

(16) Net income (loss) per share

Computations of net income (loss) per share of common stock are based on the weighted average number of outstanding shares adjusted for any stock splits. Diluted net income (loss) per share is not disclosed because there were no potentially dilutive securities.

(17) 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, 2006 and 2007 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Cash and time deposits in the consolidated balance sheets	¥19,424	¥11,904	\$104,275
Marketable securities	3,682	2,269	19,876
Time deposits with maturities exceeding 3 months	(3,103)	(198)	(1,735)
Bonds with maturities exceeding 3 months	(2,680)	(2,266)	(19,849)
Cash and cash equivalents in the consolidated statements of cash flows	¥17,323	¥11,709	\$102,567

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, 2006 and 2007.

Marketable securities to be held to maturity

Type	Millions of yen						Thousands of U.S. dollars			
	2006			2007			2007			
	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	—	—	—	¥1,499	¥1,512	¥ 13	\$13,131	\$13,245	\$ 114	
Securities whose market value is equal to or less than book value										
Japanese government and regional government bonds	¥10,011	¥9,934	¥(77)	¥6,506	¥6,489	¥(17)	\$56,990	\$56,841	\$(149)	

Available-for-sale securities

Securities with book values exceeding acquisition costs were as follows:

Type	Millions of yen						Thousands of U.S. dollars		
	2006			2007			2007		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥8,276	¥13,936	¥5,660	¥10,054	¥13,504	¥3,450	\$88,069	\$118,290	\$30,221
Bonds	914	917	3	406	408	2	3,557	3,574	17
Others	10	17	7	—	—	—	—	—	—
Total	¥9,200	¥14,870	¥5,670	¥10,460	¥13,912	¥3,452	\$91,626	\$121,864	\$30,238

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

Type	Millions of yen						Thousands of U.S. dollars		
	2006			2007			2007		
	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference	Acquisition cost	Book value	Difference
Equity securities	¥2,229	¥2,099	¥(130)	¥8,889	¥7,281	¥(1,608)	\$77,864	\$63,779	\$(14,085)
Bonds	—	—	—	—	—	—	—	—	—
Others	221	174	(47)	222	164	(58)	1,945	1,436	(509)
Total	¥2,450	¥2,273	¥(177)	¥9,111	¥7,445	¥(1,666)	\$79,809	\$65,215	\$(14,594)

The following table summarizes book values of securities with no available fair values as of December 31, 2006 and 2007.

Type	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Non-listed equity securities	¥ 390	¥379	\$3,320
Mutual funds	3	2	17
Venture capital investment in limited partnership	13	10	89
Commercial paper	1,000	—	—
Total	¥1,406	¥391	\$3,426

Available-for-sale securities with maturities become due as follows:

	Millions of yen										Thousands of U.S. dollars				
	2006					2007					2007				
	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	¥2,500	¥7,400	¥1,000	—	¥10,900	¥2,100	¥5,300	¥1,000	—	¥8,400	\$18,395	\$46,426	\$8,759	—	\$73,580
Others	18	—	—	—	18	—	—	—	—	—	—	—	—	—	—
Total	¥2,518	¥7,400	¥1,000	—	¥10,918	¥2,100	¥5,300	¥1,000	—	¥8,400	\$18,395	\$46,426	\$8,759	—	\$73,580

Total sales of available-for-sale securities in the year ended December 31, 2006 amounted to ¥313 million, and the related gains amounted to ¥271 million.

Total sales of available-for-sale securities in the year ended December 31, 2007 amounted to ¥22 million (\$193 thousand), and the related gains amounted to ¥1 million (\$9 thousand).

5. LEASES

Pro forma information of leased property such as acquisition cost, accumulated depreciation, accumulated impairment loss, obligations under finance leases, depreciation expense and other information of finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended December 31, 2006 and 2007 was as follows:

	Millions of yen						Thousands of U.S. dollars
	2006			2007			2007
	Machinery and equipment	Other	Total	Machinery and equipment	Other	Total	Total
Acquisition cost	¥1,196	¥124	¥1,320	¥1,010	¥102	¥1,112	\$9,741
Accumulated depreciation	772	88	860	647	69	716	6,272
Accumulated impairment loss	—	—	—	58	—	58	508
Net leased property	¥ 424	¥ 36	¥ 460	¥ 305	¥ 33	¥ 338	\$2,961

Obligations under finance leases were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Due within one year	¥174	¥153	\$1,340
Due after one year	286	243	2,129
Total	¥460	¥396	\$3,469

The amount of obligations under finance leases includes the imputed interest expense portion.

Depreciation expense under finance leases was as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Depreciation expense	¥239	¥194	\$1,699

Obligations under non-cancellable operating leases were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Due within one year	—	¥1	\$ 9
Due after one year	—	2	17
Total	—	¥3	\$26

6. BANK LOANS

Short-term bank loans at December 31, 2006 and 2007 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Short-term bank loans—1.94%	¥907	¥11,191	\$98,029

7. CONTINGENT LIABILITIES

At December 31, 2007, the Companies were contingently liable as follows:

	Millions of yen		Thousands of U.S. dollars
			2007
As guarantor of indebtedness of an affiliate or other companies	¥330		\$2,891

Included in the consolidated statements of income for the years ended December 31, 2006 and 2007 are severance and retirement benefit expenses comprising the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2007	2007
Service costs—			
benefits earned during the year	¥1,184	¥1,258	\$11,020
Interest cost on projected benefit obligation	494	515	4,511
Expected return on plan assets	(241)	(290)	(2,540)
Amortization of prior service costs	(1,006)	—	—
Amortization of actuarial differences	500	464	4,064
Other	179	261	2,286
Severance and retirement benefit expenses	¥1,110	¥2,208	\$19,341

Both the discount rate and the rate of expected return on plan assets used by the Company were 2.3%. 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.

11. SHAREHOLDERS' EQUITY

(1) Under the Company Law 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 Company Law requires that an amount equal to at least 10% of cash dividends and other cash appropriations are appropriated and set aside as legal reserve until the total amount of 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. If the total amount of the legal reserve and additional paid-in capital remains equal to or exceeding 25% of common stock, the legal reserve and additional paid-in capital are available for dividends by resolution of the shareholders' meeting. In the accompanying financial statements, the legal reserve is included in retained earnings and additional paid-in capital is included in capital surplus.

(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 Company Law.

12. ACCOUNTING STANDARD FOR PRESENTATION OF NET ASSETS IN THE BALANCE SHEETS

For the consolidated financial statements for the fiscal year under review, the Company has adopted "Accounting Standard for Presentation of Net Assets in the Balance Sheets" (Corporate Accounting Standard No. 5 issued by the Accounting Standards Board of Japan on December 9, 2005) and "Implementation Guidance on Accounting Standard for Presentation of Net Assets in the Balance Sheets" (Implementation Guidance on Corporate Accounting Standard No. 8, issued by the Accounting Standards Board of Japan on December 9, 2005).

Please note that as a result of revisions in the Rules for Presentation of Consolidated Financial Statements, the revised Rules for Presentation of Consolidated Financial Statements have been applied in preparing the Net Assets section of the consolidated balance sheets.

13. ACCOUNTING STANDARD FOR STATEMENT OF CHANGES IN NET ASSETS

For the consolidated financial statements for the fiscal year under review, the Company has adopted "Accounting Standard for Statement of Changes in Net Assets" (Corporate Accounting Standard No. 6, issued by the Accounting Standards Board of Japan on December 27, 2005) and "Implementation Guidance on Accounting Standard for Statement of Changes in Net Assets" (Implementation Guidance on Corporate Accounting Standard No. 9, issued by the Accounting Standards Board of Japan on December 27, 2005). Previously, consolidated statements of shareholders' equity were prepared for purposes of inclusion in the consolidated financial statements although such statements were not required in Japan.

14. ACCOUNTING STANDARD FOR BUSINESS COMBINATIONS

Beginning with the consolidated accounting statements for the fiscal year under review, the Company has adopted "Accounting Standard for Business Combinations" (issued by the Business Accounting Council on October 31, 2003) and "Accounting Standard for Business Divestitures" (Corporate Accounting Standard No. 7, issued by the Accounting Standards Board of Japan on December 27, 2005) as well as Implementation Guidance on "Accounting Standard for Business Combinations" and "Accounting Standard for Business Divestitures" (Implementation Guidance on Corporate Accounting Standard No. 10, issued by the Accounting Standards Board of Japan, which was revised to its final form and issued on December 22, 2006).

On May 24, 2007, the Company made agreements with Taisei Kogyo Corporation and Shinwa Kogyo Corporation regarding the exchange of shares. As a result, both companies became wholly owned subsidiaries of the Company on July 15, 2007.

15. SEGMENT INFORMATION

The Companies are engaged primarily in the manufacture and sale of household related products, including bath heaters, water heaters and other bathroom and kitchen related products.

As the Companies' primary activities make up only one industry segment, segment information by industry is not disclosed. As sales outside Japan are less than 10% of the Companies' consolidated net sales, segment information by geographic area is not disclosed.

16. SUBSEQUENT EVENT

Appropriation of retained earnings

At the ordinary shareholders' meeting of the Company held on March 27, 2008, the following appropriations of retained earnings for the year ended December 31, 2007 were duly approved:

	Millions of yen	Thousands of U.S. dollars
Appropriations:		
Cash dividends—¥14.0 per share	¥670	\$5,869