

Management's Discussion & Analysis

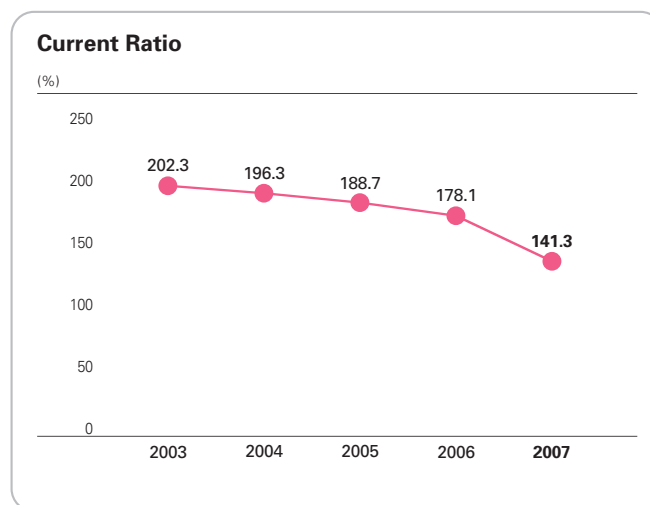
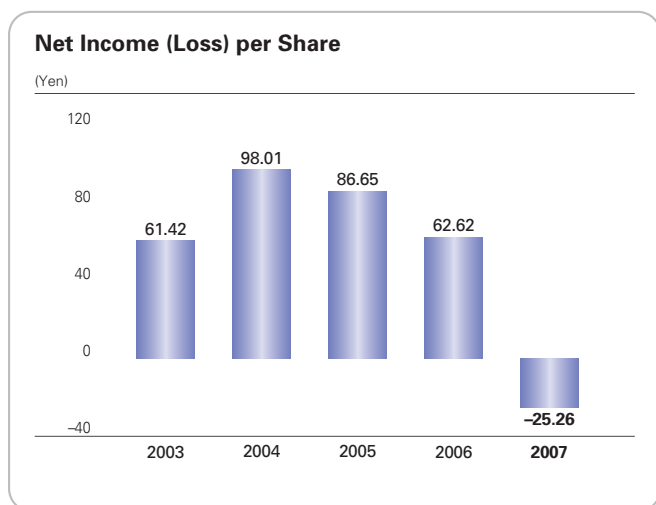
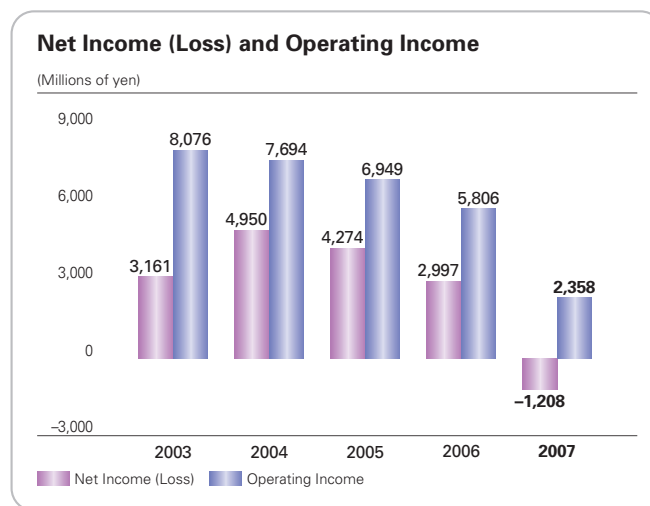
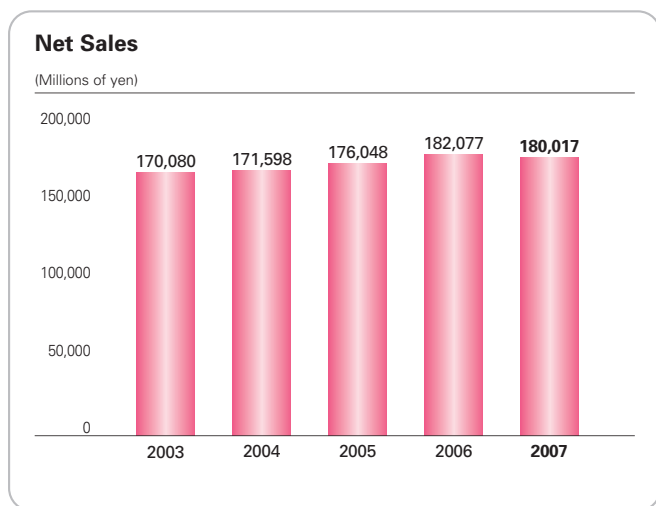
Net Sales

In fiscal 2007, ended December 31, 2007, the Japanese economy continued on a moderate recovery trend, sustained by increases in private capital investment against a background of improvement in corporate profitability and the employment environment. However, as a result of concern about deceleration in the U.S. economy owing to the rise in the price of crude oil, the emergence of the subprime loan issue, and other factors, uncertainties about future trends continued during the year.

In the housing equipment industry, the number of new housing starts dropped sharply because of the lengthening of the time required to obtain approval for new building permits as a result of the revision of Japan's building code. In addition, demand for the replacement of existing housing was

stagnant, and these developments, combined with the trend toward using more electrical appliances, resulted in the continuation of extremely difficult market conditions.

Amid this business environment, the Noritz Group expanded sales of high-efficiency water heating units that reduce CO₂ emissions and other environmentally friendly products and responded to demand for home refurbishment with products having original features, such as system bathrooms featuring bathtubs with automatic cleaning functions. In addition, in overseas operations, the Companies aggressively introduced new products in the U.S. and Chinese markets, expanded their network of sales locations, established new showrooms, and began operations at a new plant located in Shanghai. By implementing these measures and other initiatives, the Companies worked to expand net sales and



net income during the year under review, which was the final year of the Create 21 Second-Phase Medium-Term Management Plan.

However, consolidated net sales were substantially below the planned levels, standing at ¥180.0 billion (down 1.1% year on year) because of the decline in domestic demand and the adverse impact of intense competition. Moreover, profitwise, although the Company revised its asking prices at the retail level in the wake of higher prices of raw materials, principally copper, and worked to lower costs, it was unable to cover the decline in net sales. As a consequence, operating income amounted to ¥2.4 billion (down 59.4% year on year). In addition, as a result of extraordinary items, mainly an impairment loss of fixed assets, expenses for the repair of products on recall, and other factors, Noritz reported a net loss of ¥1.2 billion (compared with net income of ¥3.0 billion in the previous fiscal year).

Cost of Sales and SG&A Expenses

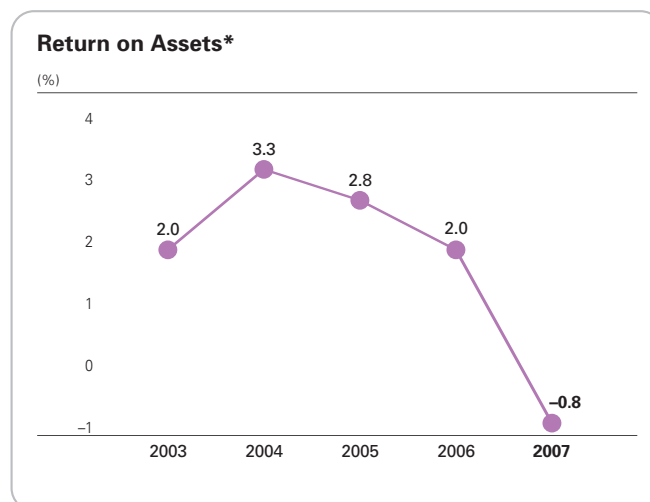
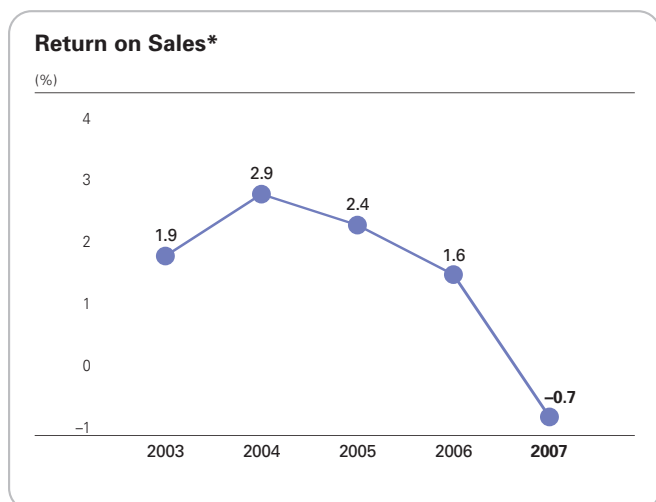
The cost of sales declined 0.7%, to ¥127.2 billion, and the cost of sales to net sales ratio deteriorated 0.3 percentage point, from 70.4% in the previous fiscal year to 70.7% in the fiscal year under review. The deterioration in the cost of sales to net sales ratio was due to the difficulty of revised asking prices at the retail level to cover the rise in raw materials prices, principally copper, and difficulty in lowering the cost of sales. As a result, the Companies experienced a marked rise in costs.

Also, as a net result of the completion in the previous year of the amortization of liabilities for employee severance payments related to the past years' services, increases in personnel costs because of the hiring of additional personnel, principally at overseas subsidiaries, and other factors, SG&A expenses rose 4.8%, to ¥50.4 billion. In addition, the ratio of SG&A expenses to net sales increased 1.6 percentage points, from 26.4% in the previous fiscal year to 28.0% in the year under review. The operating profit ratio deteriorated 1.9 percentage points, from 3.2% to 1.3%.

Other Income (Expenses)

Other income (expenses), net, which amounted to net income of ¥0.2 billion in fiscal 2006, slipped ¥3.3 billion, to a net loss of ¥3.1 billion. The principal reasons for this were the reporting of an impairment loss of ¥1.2 billion on manufacturing equipment for system bath and kitchen equipment and costs of ¥2.2 billion for safety inspections of gas-powered bath water heaters undertaken at the Company's own initiative. As a consequence, the loss before income taxes amounted to ¥0.7 billion for the fiscal year under review. This loss before income taxes represented a decline of ¥6.7 billion from the ¥6.0 billion income before income taxes reported in fiscal 2006.

Reflecting the previously mentioned items, the Company reported a net loss of ¥1.2 billion for the fiscal year under review, which was ¥4.2 billion lower than the net income of ¥3.0 billion reported in fiscal 2006. Return on sales deteriorated 2.3 percentage points, from 1.6% in the previous fiscal



*Although a loss was reported in fiscal 2007, figures have been shown for the convenience of the reader.

year to -0.7% in fiscal 2007. Similarly, ROE slipped 4.7 percentage points, from 3.3% in fiscal 2006 to -1.4% in the year under review.

Financial Position

The total assets of the Noritz Group at fiscal year-end amounted to ¥156.7 billion, ¥1.5 billion higher than at the previous fiscal year-end. Of this total, total current assets decreased ¥9.0 billion, to ¥80.8 billion, mainly owing to declines in cash and time deposits as well as trade notes and accounts.

Total noncurrent assets expanded ¥10.6 billion, to ¥75.9 billion. This increase was due mainly to increases in buildings and structures in connection with the construction of a housing equipment plant at Shanghai Noritz Co., Ltd., investment in securities, and long-term deferred tax assets.

The Noritz Group's total liabilities increased ¥6.6 billion, to ¥69.6 billion. Of this total, current liabilities rose ¥6.7 billion, to ¥57.2 billion. This was mainly due to an increase in short-term bank loans. Long-term liabilities declined ¥0.1 billion, to ¥12.4 billion, but the principal reason for this was a decrease in the reserve for employees' severance and retirement benefits.

The Group's net assets, including minority interests in consolidated subsidiaries, amounted to ¥87.1 billion, down ¥5.1 billion from the previous fiscal year-end. The principal causes of this decline were a drop in retained earnings accompanying the reporting of a net loss for the fiscal year and a decline in net unrealized holding gains on securities, resulting from the drop in stock prices.

As a result of these developments, the Group's shareholders' equity ratio slipped 3.2 percentage points, to 55.1%, and shareholders' equity per share decreased from ¥1,890.54 at the end of fiscal 2006 to ¥1,804.72 at the end of the year under review.

Cash Flows

As a consequence of the movement in cash flow items described below, cash and cash equivalents at the end of the fiscal year under review amounted to ¥11.7 billion, ¥5.6 billion lower than at the end of the previous fiscal year.

Net cash provided by operating activities decreased ¥5.9 billion, to ¥2.8 billion. The principal items influencing this decline were a loss before income taxes of ¥0.7 billion, depreciation of ¥6.0 billion, an impairment loss on fixed assets of ¥1.2 billion, an increase in the provision for the repair of products on recall of ¥0.7 billion, a decrease in employees' retirement benefits of ¥0.4 billion, a decrease in trade notes and accounts receivable of ¥1.9 billion, an increase in inventories of ¥2.5 billion, and a decline in trade notes and accounts payable of ¥3.6 billion.

Net cash used in investing activities increased ¥11.5 billion, to ¥18.0 billion. The main factors accounting for this increase were additions to securities of ¥9.4 billion and additions to property, plant and equipment of ¥7.7 billion.

Net cash provided by (used in) financing activities rose ¥10.0 billion, to ¥8.8 billion. This increase was mainly owing to a net increase in short-term bank loans of ¥10.2 billion.

