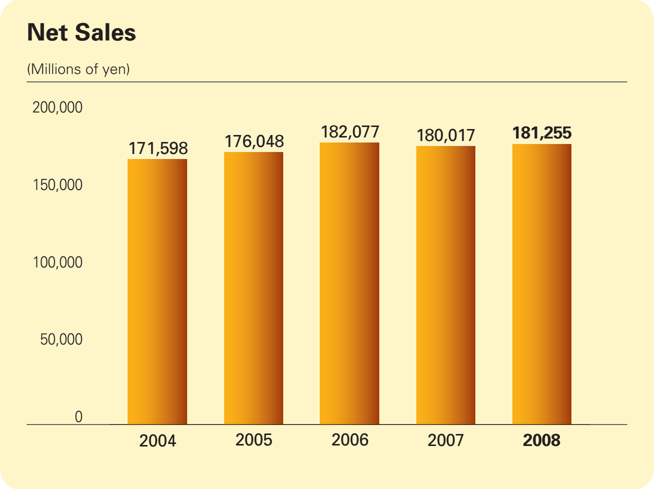
Management's Discussion & Analysis

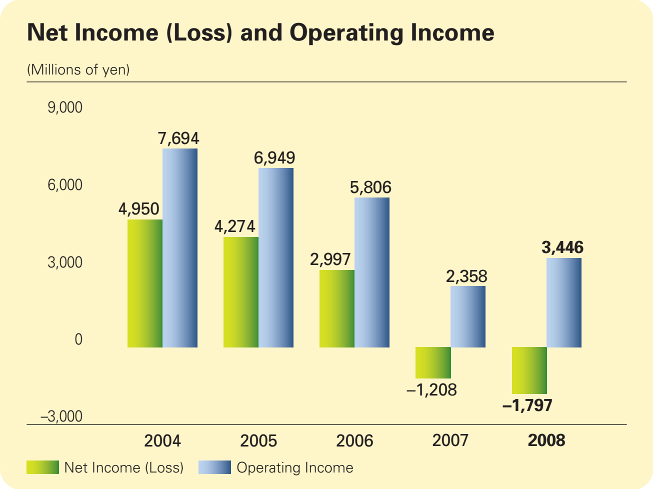
Net Sales

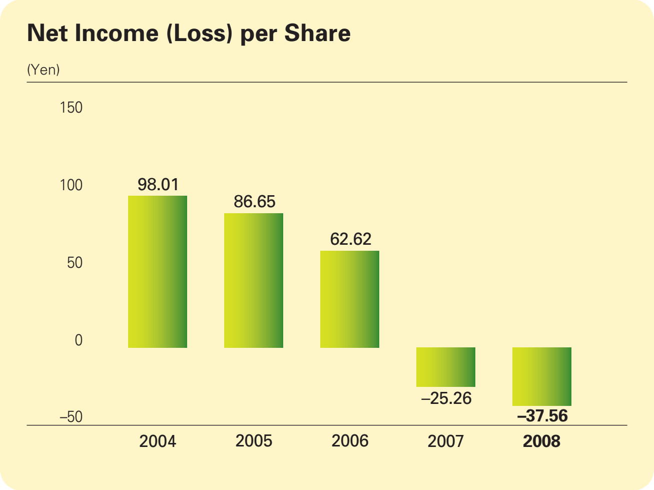
In fiscal 2008, ended December 31, 2008, the real economy in Japan began to experience the adverse effects of rising uncertainty in global financial markets emanating from the United States and sudden fluctuations in stock and foreign exchange markets. Along with these circumstances, the downturn in the economy became clearer as employment conditions began to deteriorate and personal consumption showed signs of stagnating.

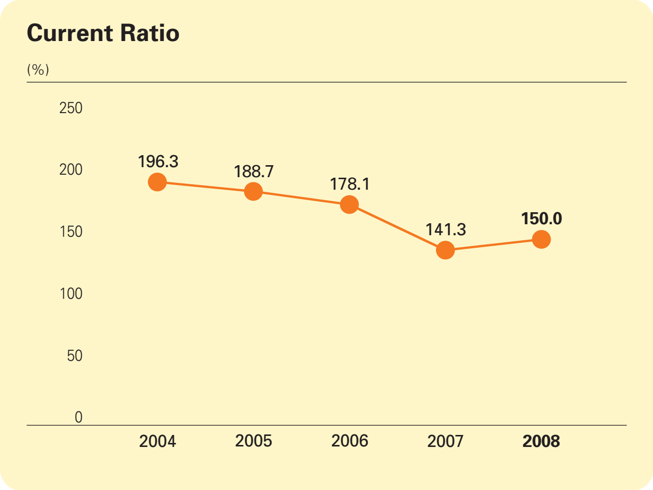
In the housing equipment industry, although the number of new housing starts rose slightly over the previous year, demand for replacement of existing equipment declined, and conditions continued to be extremely difficult as overall demand remained on a downward trend. At the same time, awareness of the natural environment and concern regarding safety and security issues along with our response to these issues in our product development, sales, and service activities became increasingly important.

Amid this business environment, fiscal 2008 was the first year of the Create 21, Third-Phase Medium-Term Management Plan, which sets three objectives, namely: restructuring of domestic operations, further establishment of overseas activities, and development of new business activities. Accordingly, the Company moved ahead with a number of specific initiatives, which included increasing the sales of high-efficiency water-heating equipment, such as "ECO-JOES" and other units, expanding the Company's overseas sales network, and entering the gas fan heater business. In addition, the Company strengthened its initiatives aimed at structural management reforms, including reducing fixed costs and lowering raw material costs.









As a result, consolidated net sales for fiscal 2008 rose 0.7% over the previous fiscal year, to ¥181.3 billion, and operating income was up 46.1%, to ¥3.4 billion. Despite these improvements, however, the Company reported certain extraordinary losses, including a loss on the write-down of securities of ¥2.5 billion and expenses for the repair of products on recall of ¥0.7 billion in connection with safety inspections of gas-powered bath water heaters undertaken at the Company's own initiative. As a consequence, the Company reported a net loss for the fiscal year of ¥1.8 billion (compared with a net loss of ¥1.2 billion in the previous fiscal year).

Cost of Sales and SG&A Expenses

In fiscal 2008, the cost of sales rose 2.0%, to ¥129.8 billion, and the cost of sales to net sales ratio deteriorated 0.9 percentage point, from 70.7% in fiscal 2007 to 71.6%. This was because efforts to reduce the cost of sales were inadequate to offset the effects of higher raw material prices that resulted in a major rise in costs.

In addition, as a result of certain measures that included cutting personnel costs through reductions in the number of employees, the completion of write-offs of development costs by overseas subsidiaries, and efforts to reduce advertising and promotional expenditures, the Company reported a 4.7% decline in SG&A expenses, to ¥48.0 billion. The ratio of SG&A expenses to net sales dropped 1.5 percentage points, from 28.0% to 26.5%, and the operating profit ratio showed an improvement, rising 0.6 percentage point, from 1.3% to 1.9%.

Other Income (Expenses)

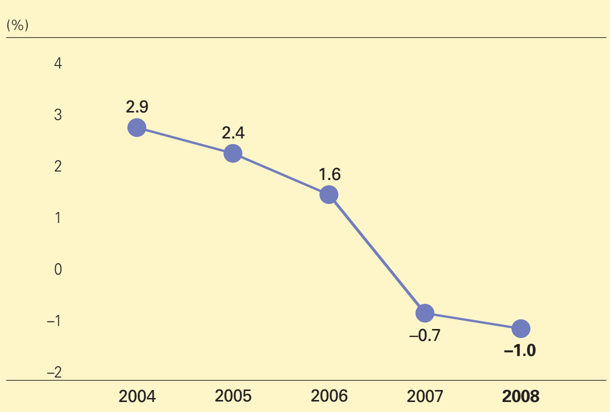
Other income (expenses), net, which amounted to a net loss of ¥3.1 billion in fiscal 2007, slipped ¥0.5 billion, to a net loss of ¥3.6 billion in fiscal 2008. The principal reasons were the reporting of a loss on the write-down of securities of ¥2.5 billion and ¥0.7 billion in expenses for the repair of products on recall for safety inspections of gas-powered bath water heaters. As a result, loss before income taxes amounted to ¥0.1 billion, an improvement of ¥0.6 billion from the ¥0.7 billion loss before income taxes reported in fiscal 2007.

Reflecting the previously mentioned items, the Company reported a net loss of ¥1.8 billion, which represented a deterioration of ¥0.6 billion from the net loss of ¥1.2 billion reported in fiscal 2007. The return on sales amounted to minus 1.0%, which was 0.3 percentage point lower than the minus 0.7% for the previous year. Similarly, ROE slipped 0.8 percentage point, from minus 1.4% in the previous year to minus 2.2% for the fiscal year under review.

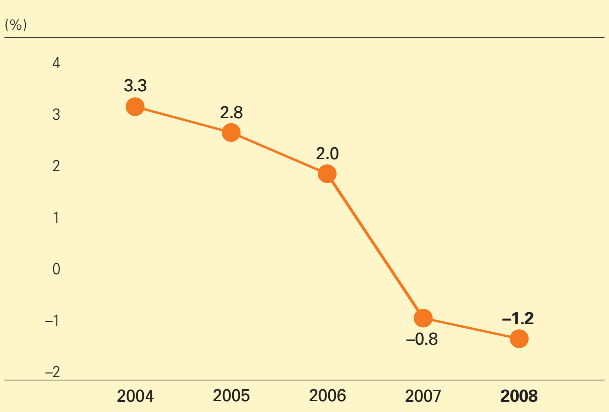
Financial Position

The total assets of the Noritz Group at the fiscal year-end amounted to ¥145.0 billion, ¥11.7 billion lower than at the end of the previous fiscal year. Of this total, total current assets decreased ¥1.6 billion, to ¥79.3 billion, mainly owing to declines in cash and time deposits and trade notes and accounts receivable. Total noncurrent assets decreased ¥10.1 billion, to ¥65.8 billion at the end of the fiscal year. This decline was mainly due to decreases in tangible fixed assets and investment in securities.

Return on Sales*



Return on Assets*



*Although losses were reported in fiscal 2007 and 2008, figures have been shown for the convenience of the reader.

In fiscal 2008, the Noritz Group's total liabilities decreased ¥4.5 billion from the previous year to ¥65.0 billion. Of this total, current liabilities decreased ¥4.3 billion, to ¥52.9 billion, mainly because of the reduction in short-term borrowings, and noncurrent liabilities declined ¥0.2 billion, to ¥12.2 billion, mainly because of a decline in the employees' severance and retirement benefit reserve.

The Group's net assets, including minority interests in consolidated subsidiaries, amounted to ¥80.0 billion, down ¥7.1 billion from the previous fiscal year-end. This decline was mainly due to a decrease in the retained earnings account from the reporting of a net loss for the period and a drop in net unrealized holding gains on securities resulting from the drop in the market value of stock prices.

As a result of these developments, the Group's shareholders' equity ratio slipped 0.1 percentage point, compared with the ratio at the end of the previous fiscal year, and amounted to 55.0%. Net assets per share were down from ¥1,804.72 at the end of the previous fiscal year to ¥1,666.23.

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 ¥10.8 billion, ¥0.9 billion lower than at the end of the previous fiscal year.

Net cash provided by operating activities rose ¥5.1 billion, to ¥7.9 billion. The principal items influencing this increase included the reporting of loss before income taxes of ¥0.1 billion, depreciation of ¥6.6 billion, a loss on the write-down of securities of ¥2.5 billion, a decrease in employees' retirement benefits of ¥0.5 billion, a decrease in trade notes and accounts receivable of ¥0.3 billion, an increase in inventories of ¥0.8 billion, and a decrease in trade notes and accounts payable of ¥0.3 billion.

Net cash used in investing activities declined ¥14.3 billion, to ¥3.7 billion. The main factors accounting for this decline were proceeds from sales of securities amounting to ¥2.1 billion, additions to securities amounting to ¥0.5 billion, and additions to property, plant and equipment amounting to ¥5.0 billion.

Net cash provided by (used in) financing activities decreased ¥13.6 billion, to ¥4.7 billion in cash used. This was principally due to a net decrease in short-term bank loans of ¥3.4 billion.

Return to Shareholders

Noritz's basic policies for providing a return to shareholders are to pay continuing, stable cash dividends and maintain a dividend payout ratio of 35% on a consolidated basis. Basic policies for the use of retained earnings are

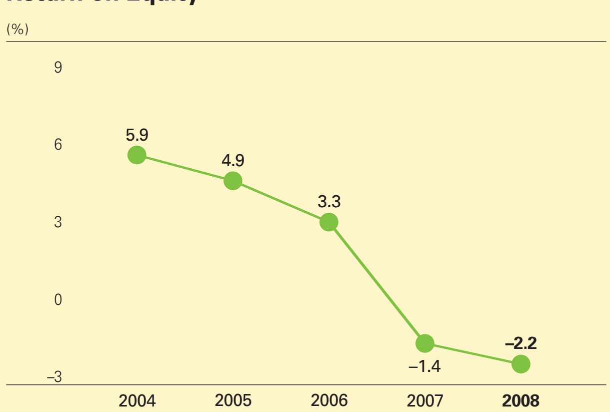
—Developing new technologies for addressing environmental issues,

—Improving and expanding the quality assurance system and responding proactively to market quality risk, and

—Developing new business activities.

A year-end dividend of ¥14 per share was approved at the 59th Annual General Meeting of Shareholders held on March 30, 2009. Combined with the interim dividend, the annual dividend for the year ended December 31, 2008 was ¥28 per share.

Return on Equity*



Equity Ratio