Consolidated Financial Results

(April 1, 2005 - March 31, 2006)

May 15, 2006

Listed Company Name: Rinnai Corporation

Listings: First Sections of Tokyo and Nagoya Stock Exchanges (Securities Code: 5947)
Website: www.rinnai.co.jp
Location of Head Office: Aichi, Japan
Representative: Hiroyasu Naito, President & Representative Director
Contact: Tsutomu Miyata, Director; Senior Executive Officer; General Manager of Administration Headquarters
TEL: (052) 361-8211
Date of the Board of Directors' Meeting on the Settlement of Accounts: May 15, 2006
Application of U.S. Accounting Standards: None

1. Performance for the Year Ended March 31, 2006

(April 1, 2005 to March 31, 2006; Amounts less than one million yen are omitted)

(1) Operating Results (Years ended March 31) (¥ millions)

	Net Sales (% change)	Operating Income (% change)	Ordinary Income (% change)
2006	212,947 (+5.4)	10,260 (-5.2)	11.756 (-3.9)
2005	202,034 (+1.0)	10,822 (-33.5)	12,235 (-19.3)

	Net Income (% change)	Net Income per Share (¥)	Fully Diluted Net Income per Share (¥)	Ratio of Net Income to Shareholders' Equity (%)	Ratio of Ordinary Income to Total Assets (%)	Ratio of Ordinary Income to Net Sales (%)
2006	5,242 (–20.3)	96.92	—	4.2	5.7	5.5
2005	6,577 (–23.1)	121.50	—	5.4	6.2	6.1

Notes:
1.Equity in earnings of companies accounted for using the equity method:
Year ended March 31, 2006: ¥45 million
Year ended March 31, 2005: ¥17 million
2. Average number of outstanding shares for period (consolidated):
Year ended March 31, 2006: 54,068,690
Year ended March 31, 2005: 54,116,642
3. Changes in accounting policies: None
4. Percentage figures in net sales, operating income, ordinary income and net income columns indicate increase or decrease from the previous term.

(2) Consolidated Financial Position (at March 31) (¥ millions)

	Total Assets	Shareholders' Equity	Equity Ratio (%)	Equity per Share (¥)
2006	213,777	129,497	60.6	2,390,05
2005	201,737	123,106	61.0	2,292.99

Note: Number of shares outstanding at year-end (consolidated):
March 31, 2006: 54,181,078
March 31, 2005: 53,686,903

(3) Consolidated Cash Flows (Years ended March 31) (¥ millions)

	Cash Flows from Operating Activities	Cash Flows from Investing Activities	Cash Flows from Financing Activities	Cash and Cash Equivalents at End of Period
2006	12,004	(13,190)	(458)	31,899
2005	9,223	(12,890)	75	32,962

(4) Scope of Consolidation and Application of Equity Method
Consolidated subsidiaries: 29
Unconsolidated subsidiaries accounted for under the equity method: None
Affiliates accounted for under the equity method: 1

(5) Changes in Scope of Consolidation and Application of Equity Method
Consolidation:
New: None
Excluded: None
Equity method:
New: None
Excluded: None

2. Forecast for the Fiscal Year Ending March 31, 2007
(April 1, 2006, to March 31, 2007)

(¥ millions)

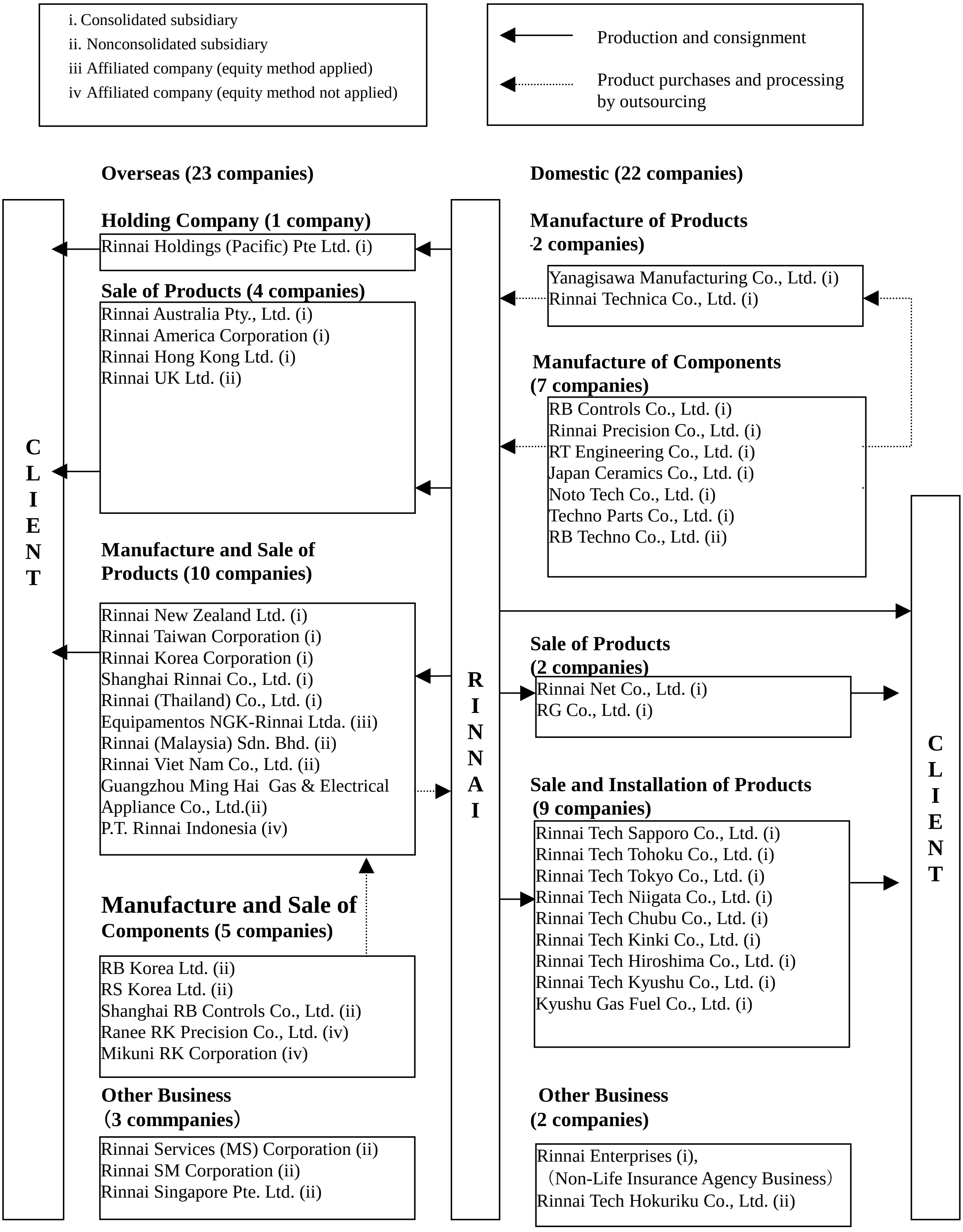
	Net Sales	Ordinary Income	Net Income
Interim	98,000	3,500	2,000
Full year	222,000	12,500	7,000

Reference: Forecast net income per share (full year):¥129.20

Note: The above forecasts were prepared based on information available at the time of the Corporation's financial results announcement. Actual results may differ from such forecasts due to various future factors. Please refer to page 7 for more information about the above forecasts.

I. Outline of Rinnai Group Companies

The Rinnai Group consists of the parent company, 41 subsidiaries, and four affiliated companies, for a total of 46 companies. These include 29 consolidated subsidiaries and one company to which the equity method is applied. The Group is primarily engaged in the manufacture and sale of gas appliances and related businesses. The Group's structure and business flow are shown below.



II. Management Policies

(1) Management Policy at Rinnai

The corporate mission of the Rinnai Group is to use “heat” to enhance the comfort of peoples’ lives. We play close attention to safety, peace of mind, environmental protection, saving energy, health, and the aging population. Our basic management philosophy is founded on four principles: customers’ priority on quality, provision of environmentally friendly products, improving lifestyles, and legal compliance. We are developing our operations globally, building on a stable business foundation supported by advanced heating technologies and sales capabilities. Rinnai is committed to satisfying the needs of customers, shareholders, employees, regional communities, and all other stakeholders. We will target continued steady grow as a comprehensive and integrated heating appliance manufacturer.

(2) Basic Policy for Appropriation of Profit

The Company regards stable return of profits to shareholders as an important management policy. Based on this policy, we intend to meet shareholders’ expectations and pay stable dividends that reflect our business performance.

At the same time, we will allocate retained earnings to domestic and overseas business development aimed at maximizing corporate value, as well as to research and development, capital investment, and reinforcement of market activities, in order to strengthen our corporate foundation.

(3) Key Financial Indicator

By raising our competitiveness as a Group and improving capital efficiency, we are working to attain an ROE of 8% in the long term.

(4) Medium- and Long-Term Management Strategy

The fiscal year ending March 31, 2007, is the first year of V-Shift Plan, Rinnai’s new medium-term business plan, covering the three-year period to March 2009. The plan, which targets further growth in the future, calls for a major shift in the Group’s foundation, centering on core restructuring initiatives.

The plan, formulated amid an increasingly harsh business environment, positions the next three-year period as an important phase for establishing a foundation for renewed growth. It entails “Three Shifts” and “Five Core Reforms” aimed at raising corporate value and improving the Group’s financial performance.

Three Shifts

1. Shift in values
2. Shift in business
3. Shift in personnel

Five Core Reforms

1. Profit-oriented management

We will establish a Group-wide profit management system targeting consolidated net sales of ¥280.0 billion and operating income of ¥20.0 billion for the year to March 31, 2009. Structural reforms will include measures aimed at reducing the number of unprofitable products and product categories. At the same time, a committee will be established to reduce expenses by implementing cost-cutting initiatives across the entire

Group, including reinforcing the cost structure of subsidiaries.

2. Strengthen new product development
We will create best-selling products by reinforcing our marketing capabilities, so that we can successfully anticipate changes in customer needs and the structure of society, such as the aging population, declining birthrate, and growing awareness of environmental issues. We intend to shorten product lead times by further strengthening our technical capabilities in product development and the process of bringing a new product to market.

3. Effectively allocate and optimize management resources
We will strategically allocate the human, material, and financial elements of the Group's management resources by emphasizing investments in markets earmarked for future growth. We will restructure the Group's companies in Japan and strengthen overseas resources, concentrating on our activities in the United States, China, and Europe. Recognizing that people are our most important and effective management resource, we will organize educational programs to train the next generation of global employees.

4. Reinforce corporate social responsibility (CSR)
We will reinforce our compliance activities and legal functions in order to fulfill our corporate social responsibilities. We will strengthen the Group's internal self-monitoring functions and establish a system of internal controls. In addition, we will bolster our public relations and investor relations systems, establish rules for information disclosure, and release information in a timely and appropriate manner.

5. Construct a new business model
We will continue to target advanced, environmentally friendly heating technologies through the early practical application of a gas-electric co-generation system and the development of hybrid products. We will reform our business processes through a range of measures, including updating core information systems, introducing new methods that make use of the Internet, effectively utilizing information technologies, and pursuing initiatives that cut across the entire Group.

III. Performance and Financial Position

(1) Fiscal Year in Review
In the year ended March 31, 2006, the Japanese economy posted a steady recovery underpinned by private-sector demand. Notable improvements were an increase in capital expenditure on the back of healthy corporate earnings and further growth in personal consumption as a result of favorable employment figures. Aided by the recovery in personal consumption, the domestic gas appliance industry benefited from a solid upturn in housing starts, which topped 1.2 million units for the first time in five years. However, conditions remained extremely difficult overall, significantly impacted by declining market prices stemming from more intense competition for energy sources and continuing surges in the price of raw materials.

In response, we placed top priority on safety, peace of mind, environmental friendliness, and energy efficiency as we developed products that help make people's lives more comfortable.

To boost earnings, at the beginning of the year we aggressively launched high-value-added products in the market. However, unable to absorb soaring raw material costs, we faced extremely tough competition to secure domestic market share during the first half of the period. Nevertheless, our performance began to recover in the second half thanks to a series of measures following organizational changes adopted in November 2005. These measures included a renewed focus on high-value-added products, reassessment of unprofitable products, curtailment of expenses, and reduction of inventories.

As a result, consolidated net sales amounted to ¥212,947 million, up 5.4% from the previous year. Operating income fell 5.2%, to ¥10,260 million, and ordinary income slipped 3.9%, to ¥11,756 million. Net income fell 20.3%, to ¥5,242 million.

Our results by business segment were as follows:

Kitchen Appliances

In Japan, we released a series of built-in cookers, incorporating glass surface plates and inner-flame burners that meet 2008 targets under Japan's Energy Conservation Law. We also expanded our lineup of offerings with enhanced safety and energy efficiency, including the adoption in all gas cookers of a system that prevents fires caused by over-heated cooking oil. Nonetheless, facing stiff competition arising from a concerted push in Japan to switch to electrical appliances, domestic sales remained mostly unchanged from the previous year. Overseas, by contrast, sales increased in Asian countries, with healthy growth recorded for system kitchens in South Korea. Total sales in this segment increased 2.7%.

Hot-Water Units

Our bathroom heater/dryers, equipped with the industry's smallest mist sauna unit and featuring bacteria-killing cluster ion technologies, performed well in the domestic market. However, a drop in market prices for bath hot-water units and hot water/heating systems had a serious impact on domestic sales. Overseas, sales of instant-heating hot-water units were strong in the United States and Asia. Consequently, overall sales of hot-water units rose 2.0%.

Air-Conditioning and Heating Units

In Japan, this segment performed considerably better than the previous year due to the release of a new, stylish gas fan heater equipped with bacteria-killing cluster ion technologies. The segment also benefited from cold winter temperatures throughout the country. Higher sales of gas heating products both in Japan and overseas contributed to a 20.2% increase in segment sales.

Commercial-Use Equipment

In Japan, sales in this segment struggled due to falling sales of large ovens, which had performed favorably the previous year. Sales of commercial-use equipment were strong in South Korea, resulting in a 7.6% increase in overall sales of commercial-use equipment.

Others

Domestic sales of components by our component manufacturing subsidiaries increased, and revenue from installation services also grew in line with the shift from standalone gas products to integrated systems. Overseas sales of new items also increased. As a result, this segmented posted a 14.4% rise in sales.

(2) Outlook for Year Ending March 31, 2007

The Japanese economy is expected to continue its recovery, underpinned by continuing private-sector demand. However, there are various destabilizing factors, such as a prolonged rises in crude oil and raw materials prices, as well as foreign exchange fluctuations. For these reasons, the business climate will remain severe.

In response to these conditions, we introduced the aforementioned V-Shift Plan, incorporating a series of measures aimed at improving the Rinnai Group's business foundation over the next three years. These include a shift to profit-oriented management, strengthening new product development, and the effective allocation and optimization of management resources. The plan also calls for reinforcement of our CSR initiatives and employee training, as well as the construction of a new business model. Rinnai will continue serving as a comprehensive and integrated heating appliance manufacturer with a strong global presence.

For the year ending March 31, 2007, we forecast consolidated net sales of ¥222.0 billion, up 4.3% from the preceding fiscal year; ordinary income of ¥12.5 billion, up 6.3%; and net income of ¥7.0 billion, up 33.5%.

(3) Financial Position

Cash and cash equivalents at the end of the year under review amounted to ¥31,899 million, down ¥1,063 million, or 3.2%, from a year earlier. This was the net result of ¥12,004 million net cash provided by operating activities, ¥13,190 million net cash used in investing activities, and ¥458 million net cash used in financing activities.

Net cash provided by operating activities amounted to ¥12,004 million, up ¥2,780 million, or 30.2%. Despite a ¥1,681 million (15.1%) fall in income before income taxes compared to the previous year, this stemmed from a ¥3,020 million increase in trade payables and a ¥2,342 million (33.8%) decrease in income taxes.

Net cash used in investing activities amounted to ¥13,190 million, up ¥299 million, or 2.3%. Despite a ¥636 million (11.6%) decline in net outflows from purchases and sales of securities and investments in securities, this was mainly due to a ¥630 million (7.9%) increase in purchases of property, plant, and equipment and a ¥378 million (61.8%) fall in proceeds from sales of property, plant, and equipment.

Net cash used financing activities was ¥458 million, compared with ¥75 million net cash provided by such activities in the previous year. This was mainly due to ¥1,284 million in proceeds from sales of treasury stock and ¥1,455 million in dividend payments.

IV. Risk Factors

Items related to the business performance and financial position of the Rinnai Group that have the potential to significantly affect investors' decisions are outlined below.

(1) Competition

The Rinnai Group is primarily engaged in the manufacture and sale of gas appliances and operates in the market for heating appliances. In Japan, that market is already mature, with multiple manufacturers engaged in fierce competition. In China and Southeast Asia, the market consists mainly of small manufacturers, although there is also strong competition on these markets.

There is no guarantee that the Rinnai Group will be able retain its dominance and position in the industry in the future, even if it succeeds in developing new technologies and enhancing its services. Consequently, it is possible that the Group's sales and earnings will decline, which may affect its business performance and financial position.

Products currently manufactured and marketed by Rinnai are powered primarily by gas. Therefore, our kitchen appliances, hot-water units, heaters, and other offerings currently compete with electrically operated appliances.

We are engaged in research and development that takes into account the future use of not only electricity, but other energy sources. However, if there are breakthroughs or reforms related to energy sources that we have not anticipated, thus preventing us from responding accordingly with minimum time delays, there may be an impact on the Group's business performance and financial position.

(2) Supply of raw materials and components

When manufacturing our products, we procure raw materials and components from a large number of companies outside the Rinnai Group. To ensure the stable supply of these materials and components, our standard practice is to conclude basic business agreements with such non-Group companies. Nonetheless, there is no guarantee that there will be no shortages of raw materials or components as a result of sharp price rises, shortages caused by changes in market conditions, or unforeseen events at a supplier's end. In such cases, it is possible that resulting increases in the prices of our products and production stoppages may have an impact on our business performance and financial position.

(3) Exchange rate fluctuations

The business activities of the Rinnai Group will continue to develop on a global scale through affiliates in 14 overseas countries, including China—a market with considerable future growth potential—as well as other Asian countries, North America, and Oceania. In the year ended March 31, 2006, overseas sales amounted to ¥70,012 million, or 32.9%, of consolidated net sales, a figure that is expected to increase.

The sales, expenses, assets, and liabilities of these overseas affiliates are converted to Japanese yen for the compilation of the Group's consolidated financial statements. It is possible that, depending on the exchange rate at the time of conversion, values after conversion to Japanese yen are susceptible to fluctuations in the value of the local currency. The Rinnai Group concludes foreign exchange contracts as a means of hedging to avert risk prompted by fluctuations in future exchange rates. However, this method does not guarantee the elimination of all risks. Therefore, it is possible that exchange rate fluctuations may have an effect on the business performance and financial position of the Rinnai Group.

(4) Entering overseas markets

The Rinnai Group has subsidiaries and affiliates in Asia, North America, and Oceania. Risks are inherent when entering an overseas market. Consequently, it is possible that the risks listed below may have an impact on the Group's business performance and financial position.

1. Unforeseen laws and regulations and changes to tax systems that have a detrimental effect
2. Negative effects on the Group's activities caused by under-developed social infrastructures
3. Occurrence of adverse political or economic factors
4. Social disruption caused by terrorism, war, and other factors

(5) Product quality

The Rinnai Group undertakes a variety of processes, encompassing product development to production, at its plants around the world. When we manufacture products at these plants, we place safety as the number one priority in accordance with quality control standards recognized internationally by the International Organization for

Standardization (ISO) and other entities. We also take utmost care when performing installation and repair of our products. However, there is no guarantee that we will not encounter problems with our products and that there will not be future occasions when a quality-related issue necessitates the recall of products. Although we are covered by product liability insurance, it is possible that compensation may not be sufficient due to the scale of a problem. An event such as a major recall not only incurs considerable costs, but may also lead to a decline in sales stemming from a loss of trust, with the potential for a negative impact on the Group's business performance and financial position.

(6) Natural disasters

When a natural disaster, such as an earthquake, typhoon, or flood, causes damage to a manufacturing plant or facility belonging to the Group, it is possible that operations will be suspended, causing delays to production and shipment. There is no guarantee that such effects can be prevented or mitigated. In the event of a natural disaster, it is possible that there will be an impact on the Group's business performance and financial position.

Note: Forward-looking statements contained in this report were prepared based on information available at the end of the fiscal year under review.

IV. Consolidated Financial Statements

(1) Consolidated Balance Sheets
(At March 31)

(¥ millions)

	2006		2005		Change
	Amount	% of total	Amount	% of total	Amount
ASSETS					
Current assets	¥131,039	61.3	¥123,869	61.4	¥7,170
Cash and deposits	19,029		20,772		(1,743)
Notes and accounts receivable	63,818		57,933		5,884
Marketable securities	20,845		17,601		3,244
Inventories	24,222		24,006		216
Deferred income taxes	1,816		2,166		(350)
Other	2,531		1,687		844
Less allowance for doubtful accounts	(1,224)		(299)		(925)
Fixed assets	82,737	38.7	77,868	38.6	4,868
Property, plant and equipment	43,611	20.4	42,130	20.9	1,481
Buildings and structures	14,928		14,353		575
Machinery and vehicles	8,983		8,580		403
Tools and fixtures	6,297		6,336		(38)
Land	12,499		11,768		730
Construction in progress	901		1,091		(189)
Intangible fixed assets	951	0.4	809	0.4	142
Investments and advances	38,173	17.9	34,928	17.3	3,245
Investments in securities	25,862		23,020		2,841
Investments	519		376		143
Long-term loans	17		26		(8)
Deferred income taxes	2,635		2,523		111
Other	9,391		9,543		(151)
Less allowance for doubtful accounts	(252)		(561)		309
Total assets	¥213,777	100.0	¥201,737	100.0	¥12,039

(¥ millions)

	2006		2005		Change
	Amount	% of total	Amount	% of total	Amount
LIABILITIES					
Current liabilities	¥68,644	32.1	¥62,555	31.0	¥6,089
Notes and accounts payable	42,492		38,284		4,207
Short-term debt	10,844		8,213		2,630
Other payables	8,452		7,833		618
Accrued consumption taxes	344		436		(92)
Accrued income taxes	1,594		2,253		(659)
Accrued employee's bonuses	1,979		1,985		(5)
Other	2,937		3,547		(609)
Long-term liabilities	10,973	5.1	11,817	5.9	(844)
Long-term debt	5,268		6,047		(778)
Deferred income taxes	2		2		0
Accrued employees' retirement benefits	2,956		3,078		(121)
Accrued officers' retirement benefits	1,736		1,761		(25)
Other	1,009		927		81
Total liabilities	79,617	37.2	74,372	36.9	5,244
MINORITY INTERESTS	4,661	2.2	4,258	2.1	403
SHAREHOLDERS' EQUITY					
Common stock	6,459	3.0	6,459	3.2	—
Capital surplus	8,719	4.1	8,719	4.3	—
Retained earnings	112,918	52.8	109,184	54.1	3,733
Unrealized gain on marketable securities	656	0.3	917	0.5	(261)
Adjustment account for foreign exchange losses	838	0.4	(766)	(0.4)	1,605
Treasury stock	(94)	(0.0)	(1,408)	(0.7)	1,313
Total shareholders' equity	129,497	60.6	123,106	61.0	6,391
Total liabilities, minority interests and shareholders' equity	213,777	100.0	201,737	100.0	12,039

(2) Consolidated Statements of Income (Years ended March 31)

(¥ millions)

	2006		2005		Change	
	Amount	% of total	Amount	% of total	Amount	%
Net sales	¥212,947	100.0	¥202,034	100.0	¥10,913	5.4
Cost of Sales	157,000	73.7	148,439	73.5	8,560	5.8
Gross Profit	55,947	26.3	53,595	26.5	2,352	4.4
Selling, general and administrative expenses	45,686	21.5	42,772	21.2	2,913	6.8
Operating income	10,260	4.8	10,822	5.4	(561)	(5.2)
Other income:	2,679	1.3	2,354	1.2	325	13.8
Interest income	546		480		65	
Dividends received	160		376		(216)	
Amortization of excess of equity over investment	—		13		(13)	
Equity in earnings of affiliate	45		17		28	
Foreign exchange gain	1,393		914		478	
Other	533		551		(18)	
Other expenses:	1,183	0.6	941	0.5	242	25.7
Interest expenses	855		620		235	
Loss on sale of notes receivable	307		309		(2)	
Other	20		11		9	
Ordinary income	11,756	5.5	12,235	6.1	(478)	(3.9)
Extraordinary income:	656	0.3	46	0.0	610	—
Gain on sales of fixed assets	118		—		118	
Gain on sales of investments in securities	447		4		442	
Reversal from allowance for Doubtful accounts	86		—		86	
Insurance money received	—		40		(40)	
Other	4		1		2	
Extraordinary losses:	2,987	1.4	1,174	0.6	1,812	154.4
Income adjustments	371		—		371	
Loss on sales of fixed assets	247		86		160	
Loss on disposal of fixed assets	241		362		(120)	
Impairment loss	27		—		27	
Loss on devaluation of investments in securities	61		18		43	
Transfer to allowance for doubtful accounts	870		262		608	
After-sales service cost	1,030		—		1,030	
Transfer to allowance for after-sales service	—		360		(360)	
Other	136		84		52	
Income before income taxes	9,425	4.4	11,107	5.5	(1,681)	(15.1)
Income taxes:						
Current	3,605		4,686		(1,080)	
Previous Term	280		—		280	
Deferred	481		(197)		679	
Minority interests (deduction)	(184)		40		(224)	
Net income	5,242	2.5	6,577	3.3	(1,335)	(20.3)

(3) Consolidated Statements of Retained Earnings
(Years ended March 31)

(¥ millions)

	2006		2005	
CAPITAL SURPLUS				
Capital surplus at beginning of year		8,719		8,719
Capital surplus at end of year		8,719		8,719
RETAINED EARNINGS				
Retained earnings at beginning of year		109,184		108,070
Increase:				
Net income	5,242		6,577	
Adjustments deferred taxes of overseas subsidiaries	—		63	
Revaluation of overseas subsidiaries' assets and other	—	5,242	61	6,702
Decrease:				
Dividends	1,456		1,354	
Board of Directors' bonuses	2		46	
Loss on disposal of treasury stock	45		—	
Retirement of treasury stock	—		4,156	
Exclusion of scope of consolidation	—		27	
Other	4	1,508	3	5,589
Retained earnings at end of year		112,918		109,184

(4) Consolidated Statements of Cash Flows

(Years end March 31)

(¥ millions)

	2006	2005	Change
Cash flows from operating activities			
Income before income taxes	¥9,425	¥11,107	
Depreciation and amortization	7,665	7,016	
Amortization of excess of investment over equity	—	(13)	
Increase (decrease) in accrued employees' bonuses	(6)	22	
(Decrease) in accrued employees' retirement benefits	(164)	(1,277)	
Decrease (increase) in prepaid pension costs	(643)	1,403	
Interest and dividends income	(706)	(857)	
Interest expenses	855	620	
Equity in earnings of affiliates	(45)	(17)	
Loss on disposal of fixed assets	241	362	
(Increase) in trade receivables	(3,057)	(2,441)	
Decrease (Increase) in inventories	705	(654)	
Increase in trade payables	3,210	189	
(Decrease) in accrued consumption taxes	(95)	(77)	
Bonuses to officers	(3)	(49)	
Other	(692)	655	
Subtotal	16,688	15,989	698
Interest and dividends received	762	771	
Interest paid	(850)	(600)	
Income taxes paid	(4,595)	(6,937)	
Net cash provided by operating activities	12,004	9,223	2,780
Cash flows from investing activities			
Transfers to time deposits	(8,810)	(7,560)	
Withdrawals from time deposits	9,120	7,740	
Proceeds from sales of investment securities	1,205	—	
Purchases of tangible fixed assets	(8,620)	(7,990)	
Proceeds from sales of tangible fixed assets	233	612	
Purchases of intangible fixed assets	(323)	(230)	
Purchases of investments in securities	(7,554)	(9,111)	
Proceeds from sales of investments in securities	1,514	3,639	
Other	44	9	
Net cash used in operating activities	(13,190)	(12,890)	(299)
Cash flows from financing activities			
Net increase (net decrease) in short-term debt	1,602	1,879	
Increase in long-term debt	—	957	
Repayment of long-term debt	(1,830)	—	
Proceeds from sales of treasury stock	1,284	—	
Purchases of treasury stock	(16)	(1,360)	
Dividends paid	(1,455)	(1,355)	
Dividends paid to minority shareholders	(43)	(44)	
Other	—	(1)	
Net cash provided by (used in) financing activities	(458)	75	(534)
Effect of exchange rate fluctuations on cash and cash equivalents	581	108	472
Net increase (decrease) in cash and cash equivalents	(1,063)	(3,482)	2,419
Cash and cash equivalents at beginning of year	32,962	36,493	(3,531)
Decrease in cash and cash equivalents due to exclusion of subsidiary from consolidation	—	(48)	48
Cash and cash equivalents at end of year	31,899	32,962	(1,063)

Significant Accounting Policies of Consolidated Financial Statements

A. Scope of Consolidation

The accompanying consolidated financial statements have been prepared based on the accounts maintained by Rinnai Corporation (the "Corporation") and its consolidated subsidiaries (the "Corporation" and its consolidated subsidiaries are hereinafter collectedly referred to as the "Corporations")

Consolidated subsidiaries: 29 Companies

Please see the page of "I. Outline of Rinnai Group Companies."

Major unconsolidated subsidiary: Rinnai (Malaysia) Sdn. Bhd.

The above unconsolidated subsidiary is excluded from the scope of consolidation, because its activities have not been deemed material, and assets, net sales, net income, and retained earnings of the unconsolidated company are not significant compared to the consolidated amounts.

B. Application of Equity Method

One affiliated company for which the equity method is applied:

Equipamentos NGK-Rinnai Ltda. (annual closing date: December 31)

Because the fiscal year-end date of the above affiliate differs from the parent company, the financial statements pertaining to the business year of that company are used in the preparation of these financial statements.

Major unconsolidated subsidiary or affiliate for which the equity method was not applied:

Rinnai (Malaysia) Sdn. Bhd.; P.T. Rinnai Indonesia

The above company is excluded from application under the equity method because its net income and retained earnings are not significant compared with the consolidated amounts and its activities are not deemed material.

C. Fiscal Year-End of Consolidated Subsidiaries

Subsidiaries for which the closing date of the fiscal year differs from the date of the consolidated term: 10 companies (annual closing date: December 31)

In preparing its consolidated financial statements, the Corporation has used data as of December 31. Major translations that occurred during the period to the consolidated fiscal year-end have been reconciled appropriately in the consolidated accounts.

D. Significant Accounting Policies

(1) Valuation standards and calculation methods for significant assets

(a) Securities

- Of marketable securities and investments in securities, listed securities are stated at market value, based on the fair market value at the end of the period. (Unrealized gain or loss, net of income taxes is reported in shareholders' equity, while any cost of sales is calculated based on a moving-average cost method).
- Non-marketable securities are stated at cost or amortized cost using the moving-average cost method.

(b) Inventories

- Finished goods: Valued at cost using the first-in, first-out method
- Raw materials and supplies: Valued at cost using the last purchase price method

(2) Depreciation of fixed assets

<u>Property, plant and equipment</u>

The Corporation and its domestic consolidated subsidiaries use the declining-balance method.

Consolidated subsidiaries outside Japan use the straight-line method.

Estimated useful lives of principal items are as follows:

Buildings: 7-50 years

Machinery: 10-17 years

Tools, furniture, and fixtures: 2-15 years

(3) Reporting standards for major accruals

Allowance for doubtful accounts:

The Corporations provides for possible loan losses and records on the books the amounts that are unlikely to be recovered. Primarily, this consists of an allowance for general claims, calculated according to historical loss ratios, and an allowance for specific claims, such as bankrupted or doubtful loans calculated based on the potential to recover respective credits.

Accrued employees' bonuses:

Accrued employees' bonuses are provided for at the estimated amounts, which are to be paid for services rendered prior to the term-end.

Accrued employees' retirement benefits:

Pension costs for employees are accrued based on the projected benefit obligations and pension assets at the term-end. The unrealized past employment obligation is expensed as incurred using the straight-line method, over a specified period (5 years) within the average remaining employee work period. Actuarial losses are deferred and amortized, using the straight-line method, over a specified period (10 years) within the average remaining years of service for employees subsequent to the year of occurrence.

Accrued officers' retirement benefits:

Accrued officers' retirement benefits are provided for the amount required at the term-end under each Group company's bylaws to prepare for payment to retiring officers.

(4) Translation of major foreign-currency assets and liabilities

Claims and credits denominated in foreign currencies are translated into yen at spot market exchange rates prevailing on the term-end, and gains or losses are credited or charged to income as incurred. The assets and liabilities of overseas subsidiaries, etc., are translated into yen at the spot rates prevailing at the term-end, while earnings and expenditures are translated into yen amounts at the average exchange rate of the term. Differences arising from translation are recorded in minority interests and in the adjustment account for foreign exchange losses under shareholders' equity on the consolidated financial statements.

(5) Accounting for leasing transactions

Finance leasing transactions other than those of which ownership is fully transferred to the lessee are treated in the same way as ordinary leasing transactions.

(6) Major hedge-accounting methods

(a) Hedge-accounting method

As for operating debts and credits denominated in foreign currencies with exchange contracts, gains or losses are deferred until maturity of the exchange contracts. Exchange contracts on transactions undertaken among consolidated companies are accounted for at fair value and gains or losses are recognized as incurred. There were no applicable items at the end of the fiscal year ended March 31, 2005.

(b) Hedging method and hedging objective

Hedging method: Derivatives transactions (exchange contract transactions)

Hedging objective: To avert possible losses incurred through exchange rate fluctuations.

(c) Hedging policy

The purpose is to avert risk prompted by fluctuating exchange rates and no speculative trading is conducted.

(d) Method for effectively assessing hedge transactions

The Corporations utilize exchange rate contract transactions that ensure effective hedging.

(e) Other

The Corporations execute derivative transactions within limits determined by their corporate rules.

(7) Another important accounting policy

Accounting for consumption taxes

Consumption taxes are not included in revenues and expenses.

E. Evaluation of assets and liabilities in consolidated subsidiaries
All subsidiary assets and liabilities are marked to fair value at the time of acquisition of control.

F. Appropriation of retained earnings
Appropriation of retained earnings or disposition of deficit of the Corporations are recorded in the financial term that a proposed appropriation or disposition is approved by the general meeting of shareholders.

G. Scope of funds in the consolidated statements of cash flows
Cash and cash equivalents in the consolidated statements of cash flows comprise cash on hand, demand deposits and short-term investments that are readily convertible into cash, are exposed to insignificant risk of changes in value and are redeemable in three months or less.

H. Major changes in the rules for the preparation of consolidated financial statements
Accounting Standard for Impairment of Fixed Assets
In accordance with "Opinion Concerning Establishment of Accounting Standard for impairment of Fixed Assets", issued by the Japanese Institute of Certified Public Accountants' Business Accounting Council on August 9, 2002, and "Guideline No.6 for Accounting Standard for Impairment of Fixed Assets", issued by the same council on October 31, 2003, the Corporations have applied the standard and pursuant guidelines to consolidated statements at the fiscal year ended March 31, 2006. As a result, income before income taxes and minority interest fell ¥27 million. The aggregate impairment loss was deducted directly from the assets in question, based on revised rules for the preparation of consolidated financial statements.

Notes to Financial Statements

1. Notes to Consolidated Balance Sheets

(¥ millions)

	March 31, 2006	March 31, 2005
(1) Accumulated depreciation of property, plant, and equipment	66,901	64,494
(2) Items related to unconsolidated subsidiaries and affiliates		
Investments in securities	1,025	953
Investments	485	353
(3) Assets pledged as collateral and related liabilities		
Pledged assets:		
Time deposits	1,879	1,629
Buildings and others	3,902	3,358
Machinery	611	398
Land	2,945	2,392
Total	9,338	7,779
Liabilities related to pledged assets:		
Trade notes discounted	7,114	7,646
Short-term debt	2,694	2,894
Long-term debt	431	391
(4) Liability for guarantee	466	541
(5) Trade notes receivable discounted	7,274	7,728
(6) Trade notes receivable transferred by endorsement	1,722	1,311
(7) Shares issued		
Common stock (shares)	54,216,463	54,216,463
(8) Treasury stock		
Common stock (shares)	35,385	529,560

2. Notes to Consolidated Statements of Income

(¥ millions)

	March 31, 2006	March 31, 2005
(1) Expenses for research and development included in general and administrative expenses and production costs in the current term	6,779	6,345

Impairment Loss

The Corporations recorded impairment losses for the current fiscal year under the following asset group.

In principle, the Corporations consider business property in management accounting, and leased assets and unutilized assets individually in grouping assets. As a result, the book value of unutilized assets is deducted to the collectable amounts due to the decline in land prices, and the impairment loss amounted to ¥27 million as extraordinary losses.

Nanao-shi, Ishikawa	Unutilized asset	Land	¥24 million
Iwate-gun, Iwate	Unutilized asset	Land	¥2 million

The collectable amounts are determined by the net sale value, and the appraisal value is calculated based on the official announcement of land price, because it not was deemed material.

3. Amounts less than one million yen are omitted on the consolidated financial statements,

Notes to Statements of Cash Flows

(¥ millions)

Reconciliation of cash and cash equivalents, and balance-sheet items at end of terms

	March 31, 2006	March 31, 2005
Cash and deposits	19,029	20,772
Securities	20,845	17,601
Time deposits exceeding 3 months	(4,672)	(4,210)
Liabilities exceeding 3 months to maturity	(3,303)	(1,201)
Cash and cash equivalents at end of year	31,899	32,962

1. Segment Information

A. Business segment information

The Corporations are engaged in the manufacturing and marketing of gas appliances. In consideration of similarity in product type, characteristics, production method and sales market, the business segment information was omitted.

B. Geographic segment information

Year ended March 31, 2006 (¥ millions)

	Japan	Asia	Others	Total	Inter-regional or corporate	Consolidated total
I. Net sales and operating results						
(1) Sales for clients	149,346	42,021	21,579	212,947	—	212,947
(2) Intersegment sales	13,390	1,914	471	15,776	(15,776)	—
Total	162,737	43,935	22,050	228,724	(15,776)	212,947
Operating expenses	155,984	43,244	19,402	218,632	(15,945)	202,687
Operating income	6,752	691	2,647	10,091	168	10,260
II. Assets	168,534	40,789	15,319	224,642	(10,865)	213,777

Year ended March 31, 2005 (¥ millions)

	Japan	Asia	Others	Total	Inter-regional or corporate	Consolidated total
II.Net sales and operating results						
(1) Sales for clients	148,956	35,414	17,663	202,034	—	202,034
(2) Intersegment sales	10,832	2,170	358	13,360	(13,360)	—
Total	159,788	37,584	18,022	215,395	(13,360)	202,034
Operating expenses	152,233	37,027	15,339	204,599	(13,387)	191,212
Operating income	7,555	557	2,683	10,796	(26)	10,822
II. Assets	164,084	35,944	11,785	211,814	(10,077)	201,737

Notes: 1. Classification of the above regions is based on geographical proximity.
2. Composition of Asia, excluding Japan: South Korea, China, Taiwan, Thailand, and Singapore
Composition of Others: Australia, New Zealand, and United States.

C. Overseas sales

Year ended March 31, 2005 (¥ millions)

	Asia	Other regions	Total
I. Overseas sales	46,903	23,109	70,012
II. Consolidated net sales	—	—	212,947
III. Composition ratio of overseas sales to consolidated net sales	22.0%	10.9%	32.9%

Year ended March 31, 2005 (¥ millions)

	Asia	Other regions	Total
I. Overseas sales	40,524	18,552	59,076
II. Consolidated net sales	—	—	202,034
III. Composition ratio of overseas sales to consolidated net sales	20.1%	9.2%	29.2%

Notes: 1. Classification of the above regions is based on geographical proximity.
2. Composition of Asia: South Korea, China, Taiwan, Thailand, Singapore, Indonesia, Malaysia, and Vietnam
Composition of Others: Australia, New Zealand, and United States.
3. Net sales of the above indicates sales of the Corporations in overseas countries or regions.

2. Lease transactions

Details of lease transactions are disclosed on EDINET.

3. Transactions with affiliates

No applicable transactions.

4. Tax-effect accounting

Composition of assets and liabilities of deferred income taxes：

	(¥ millions) March 31, 2006
Deferred income tax assets:	
Non-deductible valuation loss on inventories	269
Overdepreciation of fixed assets	619
Accrued enterprise taxes	115
Accrued employees' bonuses	802
Accrued employees' retirement benefits	1,393
Accrued officer's retirement benefits	698
Elimination between consolidated companies	407
Other	860
Sub-total	5,167
Loss allowance	(252)
Total	4,914
Deferred income tax liabilities:	
Unrealized gain on marketable securities	433
Other	31
Total	465
Deferred income taxes (Net)	4,448

(2) Reason for difference in legal effective tax rate and corporate tax rate after applying tax-effect accounting

Statutory tax rate	40.2%
(Adjustments)	
Perpetually nondeductible expenses, such as entertainment expenses	2.1
Permanently nontaxable income, such as dividends received	(1.6)
Inhabitant tax on capita basis	1.1
Tax deduction	(2.7)
Income taxes at previous term	2.9
Effects of elimination in consolidation of dividends received	3.2
Other	0.9
The Group's effective income tax rate	46.3

5.Securities

As of March 31, 2006

(1) Securities with market value (¥ millions)

		Acquisition cost	Balance sheet amount	Unrealized gain (loss)
Where balance-sheet amounts exceed acquisition costs	(1) Stocks	2,288	5,041	2,753
	(2) Bonds	3,553	3,562	9
	(3) Others	500	501	0
	Total	6,342	9,105	2,762
Where balance-sheet amounts do not exceed acquisition costs	(1) Stocks	55	40	(15)
	(2) Bonds	18,124	16,501	(1,622)
	(3) Others	2,538	2,496	(42)
	Total	20,718	19,038	(1,680)
Total		27,061	28,143	1,082

Note: The Corporations recorded a impairment loss of ¥61 million in the consolidated fiscal year ended March 31, 2006.

(2) Securities sold during the year (¥ millions)

Sales Amount	Gain on sale	Loss on sale
1,520	447	5

(3) Major non-marketable securities (¥ millions)

	Balance sheet amount
Securities:	
Unlisted stocks	2,894
Money management fund and others	14,578

(4) Redemption schedule of securities with maturities (¥ millions)

	Less than 1 year	1-5 years	5-10 years	More than 10 years
Bonds:				
Corporate bonds	3,128	8,530	548	7,657

As of March 31, 2005

(1) Securities with market value (¥ millions)

		Acquisition cost	Balance sheet amount	Unrealized gain (loss)
Where balance-sheet amounts exceed acquisition costs	(1) Stocks	2,270	4,033	1,763
	(2) Bonds	9,518	9,579	61
	(3) Others	79	119	40
	Total	11,867	13,732	1,865
Where balance-sheet amounts do not exceed acquisition costs	(1) Stocks	102	63	(38)
	(2) Bonds	6,605	6,325	(279)
	(3) Others	—	—	—
	Total	6,707	6,389	(318)
Total		18,574	20,121	1,547

Note: The Corporations recorded a valuation loss of ¥18 million in the consolidated fiscal year ended March 31, 2005.

(2) Securities sold during the year (¥ millions)

Sales Amount	Gain on sale	Loss on sale
3,639	4	0

(3) Major non-marketable securities (¥ millions)

	Balance sheet amount
Securities:	
Unlisted stocks (excluding over-the counter transactions)	2,881
Money management fund and others	16,599

(4) Redemption schedule of securities with maturities (¥ millions)

	Less than 1 year	1-5 years	5-10 years	More than 10 years
Bonds:				
Corporate bonds	1,001	8,552	723	5,627

6. Derivative Transactions

Details of derivative transactions are disclosed on EDINET.

7. Retirement Benefits

(a) Summary of the Corporations' Retirement Benefits Programs

The Corporation and some of its domestic consolidated subsidiaries have provided as defined benefits systems an Employee's Pension Fund, a Tax-Qualified Pension Fund and a lump-sum retirement program. On May 1, 2004, they transformed the Employee's Pension Fund into a Defined Contribution Corporate Pension Fund, and integrated the Tax-Qualified Pension Fund into that fund.

At the same time, the Corporation shifted to a cash balance plan.

Under the new scheme, retiring employees with three or more years of service will receive 90% of their retirement benefit from Defined Contribution Corporate Pension Fund and 10% from the lump-sum retirement program.

In certain cases, employees will receive an additional payment upon retirement, which is not calculated arithmetically based on retirement benefit accounting standards.

(b) Retirement Benefits Obligation (¥ millions)

	March 31, 2006	March 31, 2005
(1) Retirement benefit obligation	(27,077)	(25,712)
(2) Pension assets (market value)	29,202	23,193
(3) Unfunded retirement benefits obligation (1+2)	2,125	(2,518)
(4) Unrealized actuarial loss	(2,212)	1,645
(5) Unrealized obligation for past employment	62	82
(6) Net amount recognized on the balance sheets (3+4+5)	(24)	(790)
(7) Prepaid pension costs	2,932	2,288
(8) Accrued retirement benefits (6–7)	(2,956)	(3,078)

Notes: Consolidated subsidiaries apply simplified method to calculate pension benefits obligation.

(c) Expenses for Pension Benefits (¥ millions)

	March 31, 2006	March 31, 2005
(1) Service cost	1,540	1,725
(2) Interest expenses	453	482
(3) Projected investment income	(175)	(36)
(4) Amortization of unrealized actuarial loss	358	528
(5) Amortization of unrealized past employment obligation	20	18
(6) Additional supplementary severance payments	0	32
(7) Retirement benefit expenses (1+2+3+4+5+6)	2,197	2,751

Notes: Expenses for pension benefits of consolidated subsidiaries applying simplified method are included in employment expenses.

(d) Calculation Basis for Retirement Benefits Obligation

	March 31, 2006	March 31, 2005
(1) Distribution method of projected amount of retirement benefits	Fixed Amount	Fixed Amount
(2) Discount rate	2.0%	2.0%
(3) Ratio of projected investment income	—	—
(4) Amortization of prior service obligation	5 years	5years
(5) Amortization of unrealized actuarial loss	10 years	10 years

V. Production and Sales Information

(1) Production value (¥ millions)

Division	Year ended March 31, 2006		Year ended March 31, 2005		Increase (Decrease)	
	Amount	% of total	Amount	% of total	Amount	% change
Kitchen appliances	63,842	36.3	63,529	37.8	312	0.5
Hot-water units	80,124	45.5	77,236	46.0	2,887	3.7
Air-conditioning and heating units	16,365	9.3	14,159	8.4	2,205	15.6
Commercial-use equipment	2,723	1.5	2,667	1.6	56	2.1
Others	12,974	7.4	10,265	6.1	2,709	26.4
Total	176,030	100.0	167,858	100.0	8,172	4.9

Notes: 1. Above amounts are based on sales prices.
2. Above amounts do not include consumption tax.

(2) Product purchases (¥ millions)

Division	Year ended March 31, 2006		Year ended March 31, 2005		Increase (Decrease)	
	Amount	% of total	Amount	% of total	Amount	% change
Kitchen appliances	3,559	9.6	2,786	7.9	773	27.7
Hot-water units	14,287	38.4	14,875	42.3	(588)	(4.0)
Air-conditioning and heating units	3,355	9.0	2,237	6.4	1,118	50.0
Commercial-use equipment	3,758	10.1	3,195	9.1	563	17.6
Others	12,202	32.8	12,080	34.3	122	1.0
Total	37,164	100.0	35,174	100.0	1,989	5.7

Notes: 1. Above amounts are based on sales prices.
2. Above amounts do not include consumption tax.

(3) Order status

The Group practices a production method based on order projections. Therefore, no order status is available for the current term.

(4) Sales performance (¥ millions)

Division	Year ended March 31, 2006		Year ended March 31, 2005		Increase (Decrease)	
	Amount	% of total	Amount	% of total	Amount	% change
Kitchen appliances	66,049	31.0	64,328	31.8	1,720	2.7
Hot-water units	92,860	43.6	91,058	45.1	1,801	2.0
Air-conditioning and heating units	22,455	10.5	18,679	9.2	3,776	20.2
Commercial-use equipment	6,396	3.0	5,945	2.9	450	7.6
Others	25,186	11.8	22,022	10.9	3,163	14.4
Total	212,947	100.0	202,034	100.0	10,913	5.4

Note: Above amounts do not include consumption tax.