

Management's Discussion and Analysis of Operations

Performance

Overview

In the period under review—the year ended March 31, 2007—the world economy was generally favorable. Despite concerns about economic slowdown in the United States stemming from a decline in housing investments, personal consumption in that nation firmed. Economic growth rates in Asia remained high, especially in China and India. The Japanese economy, meanwhile, continued to expand, benefiting from increased capital expenditures on the back of solid corporate performances, as well as higher production output and improved employment conditions.

Consolidated net sales for the year amounted to ¥56,314 million, up 8.6% from the previous fiscal year. Operating income grew 21.0% to ¥3,765 million, and net income climbed 16.5% to ¥2,906 million. Accordingly, the Group posted year-on-year increases in both revenue and earnings for the fourth consecutive year.

Foreign Exchange Effect

In addition to the Japanese yen, the Group is exposed to fluctuations of various foreign currencies, mainly the U.S. dollar. Because the Group's consolidated financial statements are reported in yen, its performance is affected by foreign exchange and transaction risk. In the year under review, the U.S. dollar appreciated against the yen. In general, a weak yen has a beneficial effect on our revenue and earnings.

Our car floor mat business in North

America is showing particularly strong growth. Business expansion and foreign exchange factors had a positive impact on this area of our operations. The exchange rate in the year under review was ¥116.38 per U.S. dollar, up ¥6.12 from the previous year. This change in exchange rate had a ¥71 million positive effect on operating income for the year.

Medium-term Management Plan

Japan Vilene is currently seeking to achieve targets outlined in its medium-term management plan, entitled "Value," covering the three-year period from April 2006 to March 2009. To this end, we are working to rebuild our business structure and strengthen our earnings system in response to changes in the global operating environment.

Specifically, we have classified our operations into four groups: strategic businesses; stable income-earning businesses; structural transformation businesses, and newly developing businesses. We will allocate resources efficiently to develop all four domains according to their respective strategies. We have positioned floor mats and headliners for cars, as well as separators for hybrid car batteries, as strategic businesses, which we will strive to expand.

We have set two consolidated financial targets for the fiscal year ending March 2009: net sales of ¥61.0 billion and operating income of ¥4.7 billion. For the period under review, we exceeded our initial net sales, operating income, and net income targets by 4.3%, 7.5%, and 3.8%, respectively.

Revenue

Consolidated net sales grew 8.6% to

¥56,314 million. Our automotive materials operations, which we have positioned as a strategic business, remained strong. VIAM Manufacturing, Inc., a subsidiary that makes car floor mats in North America, achieved a significant 45.0% jump in sales on a local currency basis. Accordingly, the automotive materials business accounted for 42% of net sales, up from 36%. By geographic segment, sales in North America grew strongly and constituted 23.5% of net sales for the year. However, while sales of nickel-hydrogen batteries used in hybrid vehicles were solid, overall sales of battery separators grew only slightly, due to a decline in sales of products for general consumer use.

Cost of Sales and Expenses

Cost of sales rose 9.7%, to ¥43,736 million, reflecting the increase in net sales. As a result, the gross profit ratio edged down 0.8 point, to 22.3%. This was due to soaring raw materials and energy costs, as well as expansion of our North American car floor mat business, which has a relatively high cost-of-sales ratio.

Selling, general, and administrative (SG&A) expenses edged down 0.9% to ¥8,813 million. Accordingly, the SG&A expense ratio improved 1.5 points to ¥15.6%. This was mainly attributable to a ¥132 million decline in personnel expenses, to ¥2,455 million, as well as a ¥93 million decrease in the retirement benefit expense.

Research and development expenses, which are included in SG&A expenses, grew 0.6%, to ¥1,740 million. The Japan Vilene Group's plan is to continue development of function-enhancing technologies and high-level processing technologies. In the fiscal year ending March 2008, we plan a

slight increase in R&D expenses to ¥1,750 million.

Accordingly, operating income increased 21.0% to ¥3,765 million, and the operating margin improved 0.7 point, to 6.7%.

Other Income/Expenses

Total other income (net of other expenses) amounted to ¥829 million, up ¥114 million from the previous year. This was mainly due to a ¥47 million increase in equity in earnings of associated companies to ¥880 million, owing to favorable performances by equity-method affiliates in East Asia, as well as a ¥31 million rise in interest and dividend income to ¥71 million. Total other expenses for the year declined ¥206 million, due to decreases in, or absence of, items incurred in the previous fiscal year, notably loss on disposal of fixed assets and impairment loss on fixed assets.

Earnings

Income before income taxes and minority interests grew 20.1% to ¥4,594 million. This stemmed from a ¥654 million rise in operating income, as well as a ¥114 million increase in other income (net of other expenses).

After adding the net effects of income taxes and minority interests, net income for the year was up 16.5% to ¥2,906 million.

Financial Position and Liquidity

Balance Sheets

On March 31, 2007, total assets stood at ¥58,360 million, up ¥3,022 million

from a year earlier.

Total current assets grew ¥1,968 million, due mainly to increases in cash and cash equivalents and notes and accounts receivable.

Property, plant, and equipment grew ¥1,105 million, owing mainly to increased investments in car floor mat production facilities and equipment in response to expansion of our car floor mat business in North America.

Total investments and other assets down ¥51 million, due mainly to decreases in deferred tax assets.

Total liabilities grew ¥535 million to ¥22,846 million. Current liabilities rose ¥2,585 million, due mainly to increases in current maturities of long-term debt and in notes and accounts payable. During the year, ¥2,206 million of the Group's long-term debt became due within one year and thus was converted to short-term debt.

Long-term liabilities were down ¥2,050 million, due mainly to declines in long-term debt and liability for retirement benefits.

Over the past few years, sustained increases in earnings have led to declines in interest-bearing liabilities and increases in net assets. The ratio of interest-bearing liabilities to total assets was 12.6%.

Net Assets

Due to a change in rules for preparing consolidated financial statements, the "Shareholders Equity" section was changed to the "Net Assets" section in the year under review. Major changes include separation of shareholders' equity from valuation, translation adjustments, and others, as well as inclusion of subscription rights for new stock and minority interests.

Net assets at fiscal year-end stood at ¥35,514 million, up ¥2,487 million

from the previous year-end figure of ¥33,027 million (sum of shareholders' equity and minority interests, used for comparison purposes). This was mainly due to increases in retained earnings and foreign currency translation adjustments.

Capital Expenditures and Depreciation

In the year under review, the Group had total capital expenditures of ¥3,114 million, up 40.7%. A large portion of this amount was used to expand car floor mat production facilities in North America. The Group invested a total of ¥1,427 million in its North American operations during the year, and plans to make a similar level of investment in the year ending March 2008.

Depreciation and amortization rose 8.1% to ¥2,068 million. Due to the effects of changes in accounting standards, depreciation and amortization figures are expected to move higher in the current fiscal year and thereafter.

Cash Flows

At the end of the year, cash and cash equivalents stood at ¥4,118 million on a consolidated basis, up ¥1,075 million from a year earlier.

Net cash provided by operating activities amounted to ¥4,470 million, up ¥1,056 million from the previous year. The increase stemmed mainly from a ¥768 million rise in income before income taxes and an increase in notes and accounts payable.

Net cash used in investing activities totaled ¥3,120 million, up ¥1,110 million, due mainly to a ¥1,220 million increase in payment for purchase of property, plant, and equipment.

Net cash used in financing activities was ¥278 million, down ¥1,664 million.

This was attributable mainly to an increase in short-term bank loans — net.

Business Risks

The various risks that may potentially affect the business performance and financial position of the Japan Vilene Group are summarized below. Information contained therein is based on the Group's interpretation of information available at the time of its results announcement. Readers are advised that the following does not cover all of the risks that could influence the Group's operations.

Economic Conditions

Practically all of the Japan Vilene Group's revenues are generated by sales of nonwoven fabrics and items processed from nonwoven fabrics, which in turn are affected by economic conditions in the countries and regions of sale. Similarly, demand for the Group's products and for Vilene-brand products made by other companies is affected by economic conditions in the various markets where such products are sold. For these reasons, economic recessions in the Group's major markets, including Japan, North America, and Asia, could cause a decline in demand, which may have a negative impact on the Group's business performance and financial position.

Foreign Exchange Fluctuations

The Japan Vilene Group's business includes production and sales

operations in North America and Asia. Sales, expenses, assets, and other items relevant to each region are translated into yen in the course of preparing the Group's consolidated financial statements. Even if the local value of such items does not change, therefore, the value after translation into yen may be affected. In general, an appreciating yen has a negative effect on the Group's business, and a depreciating yen has a positive effect. Over the medium and long terms, however, fluctuating exchange rates make it impossible to undertake procurement, manufacturing, distribution, and sales activities exactly as planned. Therefore, exchange rate fluctuations can potentially have a negative influence on the Group's business performance and financial position.

Product Development Capabilities

The Group is confident of its ability to continue developing innovative and appealing products. However, product development and sales processes, due to their nature and complexity, involve uncertainties and various risks. For example, there is no guarantee that the Group can adequately obtain the capital and resources required to invest in new products and technologies. In addition, the Group cannot predict without fail that its new products and technologies will win market support, and also cannot guarantee that the sale of such products will be successful. Moreover, rapid technological advances and changes may cause the Group's products to be superseded. Due to the aforementioned risks, the Group may not be able to adequately foresee changes to its industry and markets. This could prevent it from developing attractive new products, which could

cause future growth and profits to decline. The Group's business performance and financial position could be affected as a result.

Foreign Country Conditions

Outside of Japan, the Group is engaged in production and sales in such regions as North America and Asia. For example, the Group has consolidated subsidiaries in the United States, mainland China, and Hong Kong, as well as equity-method affiliates in the United States, mainland China, Hong Kong, and Taiwan. Establishing operations in such overseas markets involves a number of risks, including unpredictable changes in laws and other regulations, unfavorable political and other internal factors, difficulties in hiring and keeping staff, potentially unfavorable tax regimes, and social upheaval caused by terrorist and other acts. The Group's business performance and financial position could be affected as a consequence.

Retirement Benefit Obligations

The Group's employee retirement benefit expenses and obligations are computed based on discount rates and other preconditions for actuarial calculations, as well as expected return on pension assets. Actual results achieved may differ from such expectations, and preconditions themselves may also change. The Group's business performance and financial position could be affected as a result.