

# Management's Discussion and Analysis of Operations

## Performance

### Overview

During the year ended March 31, 2008, the Japanese economy showed robust performance, supported by favorable exports and capital expenditures. However, business confidence ebbed, particularly from the third quarter, as a result of rising oil and raw material prices, depressed share prices stemming from the U.S. sub-prime loan problem and progressive appreciation of the yen.

In the United States, the housing market cooled and personal consumption stagnated, leading to a clear slowdown in the economy. Economic growth rates in Asia remained high, led by China and India, but knock-on effects of the sub-prime loan problem cast uncertainties on future expansion trends.

### Sales

Consolidated net sales increased ¥2,707 million, or 4.8%, to ¥59,021 million. Principal contributors to this gain were expansion of our car floor mat operations in North America.

With a triad of production bases in Japan, the United States and China, our car floor mat business now accounts for approximately 80% of the department's automotive materials sales. Moreover, Japan Vilene's North American car floor mat operations, which command a 23% stake in the U.S. market, posted a 12.8% increase in sales from the previous year on a local currency basis. The Group's overall car floor mat sales, spurred by

this success, recorded an 11.4% advance year on year.

Our other strategic focus, battery separators, achieved a 9.2% increase in sales from the preceding fiscal year.

Note: The primary exchange rate used to convert the dollar-denominated performance of overseas subsidiaries into yen for the period from January through December 2007 was ¥117.85 = US\$1.00. A rate of ¥116.38 = US\$1.00 was used for the previous year.

### Cost of Sales, SG&A and Operating Income

Cost of sales rose ¥2,513 million, or 5.7%, to ¥46,249 million, resulting in an increase of 0.7 percentage point in the cost of sales ratio, to 78.4%. The growth was attributable to rises in raw material and energy expenses and the expansion of North American car floor mat operations, which have a relatively high cost of sales ratio. Raw material price hikes constrained Japan Vilene's business by ¥274 million.

Selling, general and administrative (SG&A) expenses rose ¥90 million, or 1.0%, to ¥8,903 million. Revisions to Japan's corporate tax code led to a ¥289 million rise in depreciation costs for manufacturing and SG&A expenses. R&D costs, which are included in general and administrative expenses and manufacturing expenses, were ¥1,836 million, an increase of ¥96 million, or 5.5% from the preceding year. The ratio of R&D expenses to net sales remained largely unchanged, at 3.1%. As a result of these factors, operating income edged up only ¥104 million, or 2.8% from the previous year.

### Other Income/Expenses

Total other income (net of other expenses) amounted to ¥288 million, down ¥541 million, or 65.3%, from the previous year.

Equity in earnings of associated companies led this fall, with a ¥246 million, or 28.0% decline from the previous year, to ¥634 million. Although equity-method affiliates in East Asia posted overall sales gains for the year, raw material price increases and intensified competition resulted in lower net income.

The Company posted impairment losses on operating assets in the apparel materials segment, owing to a worsening operating environment, as well as on idle assets and lease assets, as a result of downturns in market prices. These factors had a ¥281 million negative impact on the year's results.

### Income before Income Taxes and Minority Interests/Net Income

Income before income taxes and minority interests shrank ¥437 million, or 9.5%, to ¥4,157 million, and net income decreased ¥472 million, or 16.2%, to ¥2,434 million.

Earnings per share fell ¥7.26, to ¥37.5, and return on equity (ROE) decreased 1.8 percentage points, to 6.8%.

## Financial Position and Liquidity

### Assets, Liabilities and Shareholders Equity

On March 31, 2008, total assets stood at ¥55,789 million, down ¥2,571 million, or 4.4%, from a year earlier. This was primarily due to progress with repayment of interest-bearing debt, which the Company reduced by ¥2,130 million, to ¥5,248 million. Accordingly,

the ratio of interest-bearing debt to total assets improved 3.2 percentage points, from 12.6% to 9.4%.

Total current assets diminished ¥2,082 million, or 7.8%, due mainly to a reduction in cash and cash equivalents arising from repayment of debt and clearance of an extraordinary surge in notes and accounts receivable caused by the final day of the previous term falling on a non-business day.

Total fixed assets fell ¥489 million, or 1.5%. Although capital investment caused an increase in property, plant and equipment, investment securities for overseas equity-method affiliates decreased due to the receipt of dividend income from retained earnings.

Total liabilities fell ¥3,847 million, or 16.8%, to ¥18,999 million. A reduction of ¥3,221 million, or 18.5%, in current liabilities largely arose from repayment of long-term debt, which had become due within one year, and clearance of an extraordinary surge in notes and accounts payable that was caused by the final day of the previous term falling on a non-business day.

Long-term liabilities were down ¥626 million, or 11.6%, due mainly to declines in long-term debt and liabilities for retirement benefits.

### **Net Assets**

Net assets at fiscal year-end stood at ¥36,790 million, up ¥1,276 million, or 3.6%, from the previous year-end figure. Although progressive yen appreciation reduced foreign currency translation adjustments ¥351 million, retained earnings grew ¥1,655 million. The equity ratio rose 5.1 percentage points from the previous year, to 65.4%.

### **Capital Expenditures and Depreciation**

In the year under review, the Group had total capital expenditures of ¥3,146 million, roughly the same as the previous year's figure of ¥3,114 million. A large portion of this amount was used to expand car floor mat production facilities in North America.

Japan Vilene is implementing a fundamental strategy of centralization of efficient management resources based on its medium-term management plan, known as "Value," which extends from April 2006 to March 2009. Accordingly, the Group is promoting investments targeted on elimination and consolidation of production facilities, on labor-saving and rationalization initiatives and on growth areas. A planned ¥3.6 million, or 14.4%, increase is slated for capital expenditures for the year ending March 31, 2009. The requisite funding is to be raised from owned resources and borrowings.

Depreciation and amortization climbed 24.1%, to ¥2,565 million. The growth in depreciation and amortization arising from the effects of changes in accounting standards is set to continue, rising an estimated ¥3.1 billion in the next fiscal year.

### **Cash Flows**

Net cash provided by operating activities amounted to ¥4,765 million, up ¥295 million from the previous year. The increase stemmed mainly from a decrease in equity in earnings of associated companies after being offset by dividend income, growth in depreciation and amortization, and higher payments of income taxes.

Net cash used in investing activities totaled ¥3,215 million, up ¥96 million,

due mainly to increases in acquisition of intangible fixed assets and of investment securities arising from establishment of equity-method affiliates.

Net cash used in financing activities was ¥2,887 million, up ¥2,609 million, due mainly to increases in repayment of long-term debt.

As a result of the above, cash and cash equivalents stood at ¥2,739 million at year-end on a consolidated basis, down ¥1,379 million from a year earlier.

## **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 list 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 its materials used in other companies' products is affected by economic conditions in the markets where the Group sells such products. 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, primarily in North America and Asia. Sales, expenses, assets, and other items relevant to each region that are denominated in local currencies 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, 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, exchange rate fluctuations can 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: (1) There is no guarantee that the Group can adequately obtain the capital and resources required to invest

in new products and technologies; (2) 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; and (3) rapid technological advances and changes may cause the Group's products to be superseded. This could prevent the Group 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**

The Group's production and sales activities also extend outside Japan to such regions as North America and Asia. The Group has consolidated subsidiaries in the United States, China and Hong Kong, as well as equity-method affiliates in the United States, China, Hong Kong, South Korea, Taiwan and Thailand. Establishing operations in such overseas markets involves a number of risks: (1) unpredictable changes in laws and other regulations; (2) unfavorable political and other internal factors; (3) difficulties in hiring and keeping staff; (4) potentially unfavorable tax regimes; and (5) 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.