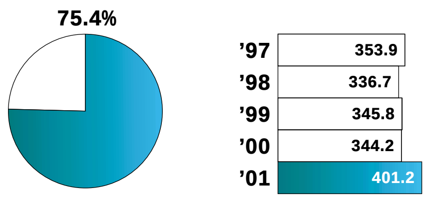
Air Conditioning

Sales (% of net sales, ¥ billion)



In fiscal 2001, sales by Daikin’s Air Conditioning and Refrigeration Equipment Division rose 16.6%, to ¥401.2 billion. The division’s sales accounted for 75.4% of consolidated net sales.

The Japanese Market

Overview

Demand in Japan’s air conditioning market underwent a dramatic recovery during fiscal 2001. In the first half, private sector capital investment rebounded and seasonal demand was strong due to hot weather during the summer season, which offset the relative decline in public works spending. In the second half, as well, private sector capital investment remained strong and demand from the housing market was bolstered by the impending enforcement of the Recycling Law.

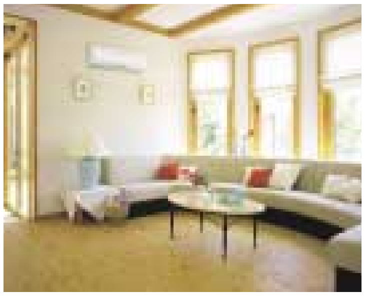
Against this backdrop, increases in Daikin’s unit sales of package air conditioners and room air conditioners substantially exceeded the average growth rate for the industry, proving the effectiveness of Daikin’s efforts to expand its retail focused sales network and its powerful product lineup featuring products unique to Daikin that have proved well suited to the rising demand for air conditioner replacements.

•Commercial-Use Air Conditioners

In the commercial-use air conditioning market, we succeeded in substantially increasing our market share through sales expansion initiatives focused on high-value-added products that easily appeal to our customers. Such products include the SUPER INVERTER SERIES, which contributed greatly to market share expansion in the previous term. In fiscal 2001, we further enhanced the energy efficiency of the series and expanded our lineup into the high-capacity zone with the SUPER INVERTER 70, the FACILITIES INVERTER, which is intended for use in manufacturing plants, and multi-air conditioners for office buildings, which feature independent control of individual units and are designed to meet the demand for building renovation in metropolitan areas.

•Residential-Use Air Conditioners

In the residential-use air conditioner market, the URURU & SARARA air conditioner—now in its second year on the market—proved extremely popular with consumers and



contributed to increased sales. Sales through mass merchandisers of home appliances also grew substantially, boosted by increased demand stemming from the hot summer.

Outlook

The slowdown in the U.S. economy and declining private sector capital investment—the primary driver of market industry demand—owing to deflationary pressures, are cause for concern in the Japanese air conditioning market.

Over the months and years ahead, meeting customer needs with comprehensive solutions will become paramount as the huge stock of package air conditioners installed during the bubble economy era approach replacement age and the majority of commercial-use air conditioners will be converted to HFC coolant in autumn 2001. As such, we are firmly aware that a major factor in marketing strategies in fiscal 2002 will be ensuring the competence and efficacy of the products, services, and sales operations that enable the Company to provide solutions to the problems this situation presents.

Meager prospects for increased demand for room air conditioners are foreseen in fiscal 2002 as new housing starts are expected to stagnate and the increase in demand seen during fiscal 2001 leaves little opportunity for further expansion. Nevertheless, we will continue to strive to expand sales by leveraging our priority product URURU & SARARA, a unique product available only from Daikin.

The Global Market

Overview

The global market for air conditioning equipment saw demand in Europe continuing to expand during fiscal 2001, supported by strong consumer spending and capital investment. However, growth remained stagnant in Asia, where economic conditions have yet to recover. It appears likely to be some time yet before full recovery is achieved in the construction sector. Meanwhile, local makers are coming to the fore in the growing Chinese market and Korean manufacturers are expanding worldwide with a focus on Europe, factors that are driving up prices and market share competition.

Against this backdrop, Daikin balanced out a decline in weak markets with stepped-up sales in such markets as Europe, Australia, and Hong Kong, where demand was strong, leading to increased sales of all products in its building-use multi-air conditioner lineup. Sales growth was particularly strong in Hong Kong, where we obtained large purchase orders for compact air conditioners for large-scale housing complex projects. In the growing Chinese market, our local joint venture for manufacturing and sales, Shanghai Daikin Air-Conditioning Co., Ltd., steadily increased sales amid severe competition.

In South America, through the purchase of a local company, we established Daikin Airconditioning Argentina S.A., our first subsidiary in South America.

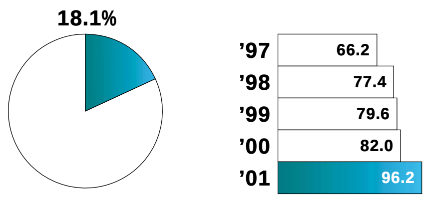
Sales and manufacturing operations were also commenced at Daikin Shriram Airconditioning Pvt. Ltd., the joint venture we established in the previous term in the burgeoning market of India.

Outlook

In our core air conditioning operations, although the Japanese market is expected to stabilize, no prospects for substantial growth in the future are foreseen. While the global market is anticipated to continue to expand in the medium term, price competition is expected to grow increasingly intense worldwide as not only Japanese manufacturers but manufacturers from Korea and China expand into the markets of China, the Middle East, Australia, and Europe, particularly in the markets for compact air conditioners. In the months and years ahead, Daikin will strive for the top world market share by enhancing competitiveness and securing air conditioning revenues on a Groupwide basis by strengthening its overseas operations and expanding its comprehensive air conditioning business, spanning residential-use air conditioners, commercial-use air conditioners, and central air conditioning systems in the world's five major markets. To remain a significant player in the global air conditioning market, we will not only continue to establish new sales subsidiaries of our own through acquisition of other companies but also search for globally based strategic alliance partners. Moreover, we are developing globally complementary business operations with Matsushita Electric Industrial Co., Ltd., with whom we concluded a strategic alliance agreement in autumn 1999. As the first step in these operations, we began marketing compact air conditioners supplied from Matsushita on an OEM basis in China.

Chemicals

Sales (% of net sales, ¥ billion)



During fiscal 2001, sales by Daikin’s Chemicals Division rose 17.4%, to ¥96.2 billion. This figure represented 18.1% of consolidated net sales.

Overview

During the term under review, Daikin succeeded in increasing sales for the sixth consecutive year, owing to expansion in the semiconductor markets of Japan and other countries, global business development, and favorable market conditions in the United States and Europe. Fiscal 2001 was the final year of the Fusion 21 strategic management plan, and we succeeded in meeting the plan’s targets for improving business scale and profitability with a global market share of 20%.

In fluoroplastics and fluoroelastomers, Daikin achieved a 20% increase in sales year on year amid growing demand from the semiconductor industries of Japan and the United States and recovery in the FEP market for LAN cables in the United States.

In fluorocarbons, increased demand for alternative refrigerants led to an increase in net sales for the term.

Demand for R-407C and R-410A surged, especially from Japanese air conditioning manufacturers. In response to these market conditions, in January 2001 Daikin commenced operations at Japan’s first mass production plant for HFC125, the base gas from which these new alternative coolants are derived, and it is now supplying this gas worldwide along with HFC32.

In other chemicals, although sales of fluoroalcohol—a CD-R dye solvent—declined due to changes in the CD-R market, we succeeded in substantially expanding our share of the international market for oil- and water-repellant finishes and significantly increased our sales. We commenced local production of these finishes at Daikin America, Inc., in February 2001 and will work to strengthen the supply capabilities of our plants in Japan and the United States.

Outlook

Fluorochemicals are used in a wide range of industries, including automotive equipment, IT, and semiconductor manufacturing facilities, and, therefore, long-term market stability is expected.

Daikin has instituted a growth strategy for its chemicals business that is aimed at dramatic growth and will be implemented in concert with the new Companywide Fusion 05 strategic management plan.

Our growth strategy can be broken up into three major sections. First, we will develop new applications for fluorochemicals in the strong growth potential areas of IT and semiconductors in order to create a market for these specialty chemicals. Second, we will expand those operations related to products that promote global development. Third, we will create new peripheral businesses that leverage the unique properties of our functional chemicals.

In June 2000, Daikin established the Daikin Institute of Advanced Chemistry and Technology, Inc., in the United States—the center of leading-edge applications development—as a research center for the efficient outsourcing of the latest fluorochemical technological development and applications development to external research institutions and venture corporations. In the months and years ahead, we will expand our global technologies network and accelerate the development of new applications and new products and the establishment of new businesses.

We will strive to raise the ratio to net sales of the products we have developed over the past five years from the current 31%, to 35% by fiscal 2006.

We recognize that alliances are an indispensable tool for swiftly expanding our business and enhancing our competitiveness in response to the rapidly changing times. We will strive to establish competitive business operations by considering alliances in such areas as new business development, technology platform enhancement, applications development, and raw materials procurement.

To respond to sales expansion, our growth strategy calls for an increase in supply capacity over the next five years to 1.5 times the current level by augmenting the production capacity of existing facilities and establishing new manufacturing plants. To help achieve this objective, in fiscal 2002 we will commence the supply of semiconductor etching agents from Formosa Daikin Advanced Chemicals Co., Ltd., a joint venture with Formosa Plastics Corporation of Taiwan, the IT equipment production nexus of the world.

To strengthen fluoroelastomer operations in Europe, we plan to commence fluoroelastomer production in France in fiscal 2003 to follow up on Daikin Chemical Netherlands B.V.'s commencement of precompounding.

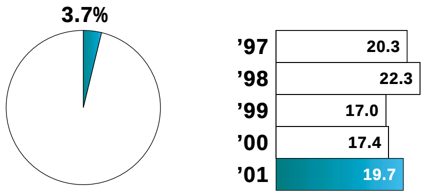
In China, we have broken ground on the construction of a new plant at Daikin Fluorochemicals (China) Co., Ltd., which we established in Changshu, Jiangsu, in April 2001, and plan to commence the supply of fluoroplastics and fluorochemical products in fiscal 2003. The Jiangsu plant will supply highly cost-competitive products—made possible through the application of cutting edge production technologies—to the high growth potential markets of China and other countries in Asia.

By constantly developing and implementing new technologies, Daikin will continue to conduct safe and environmentally sound operations and supply high-quality, reliable products to the entire world.

By maintaining profitability and proactively allocating managerial resources to our fluorochemicals business, we will augment our capabilities and create new markets, and strive to achieve the number two position in the world with a 25% global market share.

Oil Hydraulics

Sales (% of net sales, ¥ billion)



In fiscal 2001, sales for the Oil Hydraulics Division rose 13.6%, to ¥19.7 billion. This amount accounted for 3.7% of consolidated net sales.

Overview

The environment surrounding the oil hydraulics business for the term under review was generally favorable as capital investment recovered, particularly in IT-related sectors, and exports to Asia increased. Overall demand for oil hydraulics equipment increased 7.2%, to ¥232.7 billion.

Against this backdrop, Daikin strove to increase sales of its unique lineup of energy-conserving products, which includes inverter coil cooling units and the ECORICH series of inverter oil hydraulic systems, as well as develop new customers. As a result, we succeeded in increasing division sales and market share for the second consecutive year.

•Parking Systems

Owing to a steady increase in condominium construction, which represents the majority of market demand, mechanical multi-level car-parking systems saw a demand increase of approximately 15% compared with the previous term.

During fiscal 2001, Daikin strove to expand sales of its HIGH SPEED SERIES, which was introduced in fiscal 2000, as well as cultivate latent demand for the renovation and new installation of parking facilities. As a result, we successfully increased both net sales and market share substantially.

•Lubrication

During fiscal 2001, Daikin integrated Daikin Lubrication Products & Engineering Co., Ltd. (DLP), business into the lubrication division of Nabuco, Ltd., and commenced operations under this new configuration in April 2000. Strong results have been obtained and we succeeded in becoming the number one company in the domestic grease lubrication industry and securing a stable revenue base.

Outlook

The domestic market for oil hydraulics has always been extremely sensitive to economic fluctuations, but the medium- to long-term outlook for the industry is particularly severe due to the globalization of master machinery makers and competition from electric and air pressure formats. The expansion into the Japanese market of other manufacturers further exacerbates future business prospects, and the JFPA (Japan Fluid Power Association) anticipates that overall demand for oil hydraulics equipment in fiscal 2002 will decline 5%, to ¥221.6 billion.

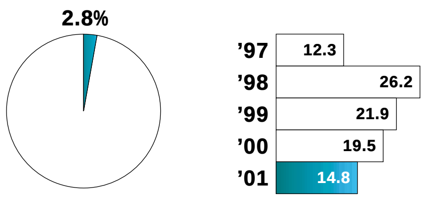
Against this backdrop, Daikin will expand the scope of the business from merely power control to power motion control by fusing such other technologies as electric pressure powered formats with its traditional oil hydraulic technologies and developing new hybrid products. We will also embrace strategic alliances and partnerships and expand our business into the high growth potential markets of Asia. Through these initiatives, Daikin will remain a significant player in the market.

Moreover, in May 2001, Daikin and Sauer Danforth, Inc., of the United States agreed to establish two joint ventures for manufacturing and sales in the mobile hydraulics industry in Japan with the objective of better serving both parties' customers in Japan, China, and other parts of Asia by leveraging each other's strengths and unique features to expand their businesses and improve their operational frameworks. After working out details of the agreement, the joint ventures are scheduled to be established in October 1, 2001. Through these joint ventures and mutual cooperation, we will strive to achieve a top market share of 30% in the mobile hydraulics market of Japan and elsewhere in Asia.

At the same time that demand is expected to stagnate in the medium term, market prices are also anticipated to become increasingly competitive. The oil hydraulic market represents a mere 15% of the overall market for multi-level car parking systems. As such, we are aware that the potential for further business expansion with a lineup restricted only to oil hydraulic products is limited. Therefore, leveraging the industry's top service network, we will develop our multi-level car parking systems service business into a new pillar of revenue and enter into partnerships with electric multi-level car parking systems. Through these and other initiatives, we will strive to expand from our current position as Japan's number three player in the industry to the number two and eventually number one position.

Defense

Sales (% of net sales, ¥ billion)



In fiscal 2001, Daikin's defense-related sales declined 24.3%, to ¥14.8 billion, due to an explosion during the term at one of its subcontractors. This figure represented 2.8% of consolidated net sales, down from 4.2% in the previous term.

Overview

Reflecting the significant role economic reform initiatives took in the Japanese government's market recovery oriented budget for fiscal 2001, a substantial increase of 3.8% compared with the previous year was noted. However, because the defense budget remained the same, at ¥4.93 trillion, no significant improvement in business conditions was gained. Fiscal 2002 is the first year in the government's new five-year New Mid-Term Defense Program. Although this plan represents an approximate 3.8% increase in total spending compared with the previous defense plan, it also includes a minor 1% cut in frontal armaments. Frontal armaments spending for fiscal 2002 is budgeted at ¥767.0 billion, a 0.6% decrease from the previous term, an indication that business conditions will most likely remain severe. Although increases in spending on ammunition and guided missiles—which are supplied by Daikin—have been budgeted for, future business conditions remain uncertain, and management will need to keep a watchful eye on future government budget trends.

Outlook

In fiscal 2001, an accidental explosion at one of Daikin's subcontractors caused net sales in defense-related operations to decline 24.3%, to ¥14.8 billion. We will make up this loss in fiscal 2002 and it is not expected to have any substantial effect on performance for fiscal 2002 and fiscal 2003. Despite efforts to expand demand for fiber-reinforced plastic (FRP) composite vessels and demand oxygen controllers, sales declined slightly during the term due to changes in business conditions.

From fiscal 2002, in the manufacture of ammunition, processes formerly used for ammunition will be switched to mass production. Seizing this opportunity, we will configure efficient production systems and work to strengthen our business capacity. We will strive to expand business in new private sector operations and convert our operational structure to suit the changing needs of the market.

• Defense

Starting in fiscal 2002, Daikin will receive purchase orders from Japan's Self Defense Agency for new types of ammunition that can be used in training drills even in the cramped confines of the Japanese archipelago. Because these will be mass-produced, we will consolidate and streamline our production systems and convert our operations into a stable business structure capable of fulfilling the requirements of the cost reductions demanded by the Self Defense Agency. We will also pursue greater efficiency in the development of high-value-added products and strive to maximize Self Defense Agency purchase orders.

• New Private Sector Business

In 1996, Daikin first applied its defense-related technologies to the private sector market by developing Japan's first FRP composite vessels. Since then, they have found a wide range of uses, including home oxygen therapy, demand oxygen controllers, and breathing apparatus cylinders for use in fire fighting, and have steadily increased in sales. In the months and years ahead, we will do our utmost to develop such new private sector businesses into major pillars of our operations on a par with defense.

Computer Graphics

In the Japanese market, with demand stimulated by investment in IT, sales of Daikin's network computing software increased steadily. Demand for LSF, which optimizes the burden shared by computers by allocating data processing over a network, grew dramatically, particularly in the semiconductor design sector. Our newly introduced network management system, KINNETICS, also contributed to sales expansion as its use by universities and research institutions helped boost recognition of its product value. However, overall sales stagnated due to a falloff of demand for our SOFTIMAGE 3-D computer graphics animation software, recent computer downsizing, and shrinkage in the market due to the widespread conversion to the Windows NT operating system.

Daikin's Computer Graphics Division is currently positioning itself in close proximity to the IT industry, an industry that has brought about enormous upheaval in recent years and is the current leader of industry trends. In the months and years ahead, the Company will strive to convert its Computer Graphics Division into an IT-related business and thereby expand its operations. Specifically, we will work to obtain profitable business results at the earliest possible date for such new businesses as network solutions, which we brought to market in the second half of fiscal 2001, our virtual digital broadcast studio business, and our application service provider (ASP), which is centered around time rentals of equipment CAD software.

Furthermore, although we developed our SCENARIST DVD authoring system, which we introduced in June 1996, into a global business with sales in the United States, Europe, and Asia, overseas organizational management costs proved to be prohibitive and we sold off the business. From now on, we will merge our DVD authoring software with that of Sonic Solutions Inc. of the United States, continue to act as the central representative in Japan, and conduct marketing, sales, and support operations. Sonic Solutions will continue to develop new DVD authoring software and conduct marketing, sales, and support for the global market.

Semiconductor Manufacturing Equipment

In our cryogenics business during fiscal 2001, we focused on expanding sales of our cryo-pumps to producers of manufacturing equipment, including semiconductors, and sales of our cryo-coolers, introducing new products to market. Daikin posted an all-time high in unit sales of cryo-pumps, thanks to strong demand in semiconductor markets and successful efforts to expand sales of these pumps in Korea and Taiwan. On the other hand, a delay in new product development prevented us from realizing an increase in sales of cryo-coolers. Nevertheless, overall sales in our cryogenics business exceeded our targets.

Amid a rapid recession of the semiconductor market, in the current fiscal year we plan to maintain sales at the same level as in the previous fiscal year by focusing on sales of cryo-pumps for use in the manufacturing of electronic devices other than semiconductors and by targeting sales of cryo-coolers for use in linear motors on Japan Railways trains.

Regarding cluster tools for semiconductor manufacturing, we achieved a more than fourfold rise in sales by stepping up marketing activities aimed at our targeted users and introducing products in the market for compact cluster tools. Despite these efforts, we were unable to attain the targets of our initial plans for increasing sales volume mainly owing to a lag in repeat orders from users.

In the current fiscal year, we will work to increase sales by concentrating on securing repeat orders from current customers, carrying out horizontal marketing activities among them, and developing new products for use in the production of 300mm wafers.