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Overview of Fiscal 2002 Results

Although the Chinese market has continued to grow rapidly, the bursting of the IT bubble and the terrorist attacks that occurred in the United States resulted in the rapid deterioration of economies throughout the world, including those of Europe, Japan, and other parts of Asia.

Under these circumstances, Daikin made every effort to achieve the management targets set forth in its strategic management plan, "Fusion 05," in line with the president's policy, for 2001, of "Building a dynamic Daikin through actions of individuals dedicated to change."

During fiscal 2002, ended March 31, 2002, although sales of fluorochemical products decreased due to a sharp drop in global demand for semiconductors and telecommunications products, unit sales in our core Air Conditioning and Refrigeration Equipment Division grew substantially both in Japan and foreign countries. As a result, consolidated net sales amounted to ¥538.8 billion, a 1.3% increase compared with the previous term and an all-time high.

During the term under review, Daikin reduced manu-

facturing costs, expanded sales of distinctive products both in Japan and foreign countries, and cut operating expenses throughout the Group. Thanks to these efforts, earnings in the Air Conditioning and Refrigeration Equipment Division grew substantially and consolidated operating income increased 5.4%, to an all-time high of ¥42.0 billion. This was the eighth consecutive term in which operating income grew. Due to an increase in the write-down of investment securities and other factors, net income fell 10.0%, to ¥17.9 billion.

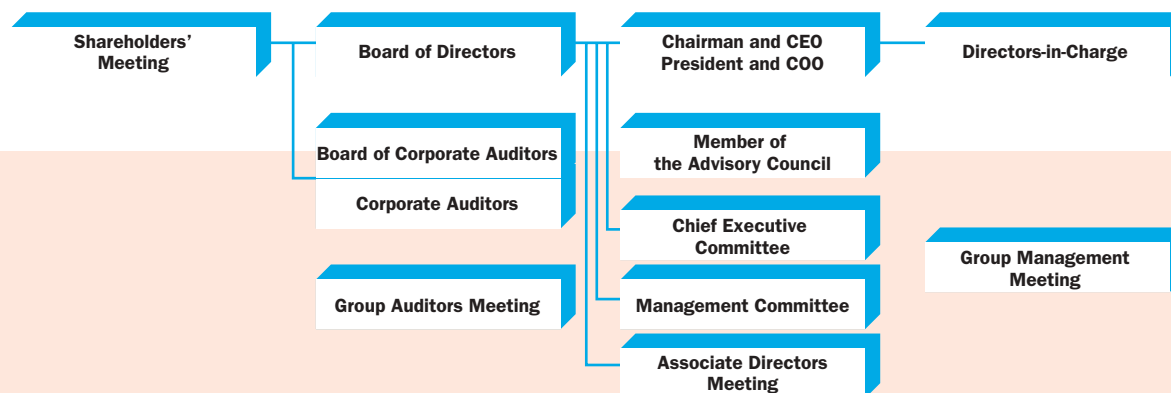
Free cash flow amounted to ¥14.1 billion. This figure is lower than that of the previous term mainly as a result of increased investment outflows. As we used impairment accounting methods that adversely affected profits, return on assets fell 0.6 percentage point, to 3.9%.

At the shareholders' meeting held on June 27, 2002, the Board of Directors resolved to pay cash dividends applicable to the year of ¥12.00 per share.

Overview of Operations

Sales in the Air Conditioning and Refrigeration Equipment Division increased 5.2% compared with the previous term, to ¥422.2 billion, reflecting the positive effects

Daikin's New Management Structure



of the yen's weakness against the dollar and the euro. As sales, helped by the weak yen, increased substantially in the Japanese and overseas markets, operating income surged 31.8%, to ¥32.2 billion.

Daikin expanded its share of the domestic market for commercial air-conditioning systems by 1.6 percentage points and now controls 41.4% of the market, its largest share thus far. This is attributable to the implementation of a sales-expansion policy that, despite a decrease in private-sector capital expenditure, focused on selling replacement units and expanding sales of such high-value-added products as the SUPER INVERTER ZEAS II, the most energy-efficient series in the industry.

In residential air-conditioning systems, we actively promoted a number of unique products, including URURU & SALALA air-conditioning systems, which combine humidity control with minus ion emissions to provide a comfortable room atmosphere, and actively expanded sales through large-scale electronics retailers. As these efforts coincided with an exceptionally hot summer, Daikin sold more air-conditioning systems than any company in the industry and increased its share of the market 1.0 percentage point, to 12.8%. As a result, Daikin now belongs to the group of companies holding the No. 2 position in the domestic market for residential air-conditioning systems.

In the European market, which until recently had experienced rapid growth, demand was undermined by highly changeable weather, especially in the south

of the region. However, due to powerful growth in Australia, China, and other countries, overseas air-conditioning sales grew at a double-digit rate.

In November 2001, Daikin supplemented its ongoing alliance with Matsushita Electric Industrial Co., Ltd., by forming a strategic alliance with the Trane Company, the heating, ventilation, air-conditioning, and refrigerating (HVAC) business division of American Standard Inc. The Trane Company is based in the United States, where it is the top rated air-conditioning manufacturer and solutions provider. We believe that this alliance will help us highlight our various strengths and secure the No. 1 position in the global market by facilitating the provision of air-conditioning solutions, improved services, and a full line of air-conditioning systems. For further information regarding this alliance, please refer to the supplementary materials on pages 8 and 9.

In the Chemicals Division, as global demand for semiconductors and telecommunications products dropped sharply and, in the United States, sales of FEP for use in LAN cable insulation decreased, sales and profits from fluoroplastics and related products decreased. As a result, segment sales amounted to ¥81.7 billion, a 15.1% decrease compared with the previous term, and operating income plummeted 41.7%, to ¥9.3 billion.

The entire Group is reforming its operational framework to enhance its earnings power in anticipation of a surge in demand for fluorochemicals in the medium

Aiming

for consolidated net sales of

¥630 billion



term. In addition, one of our most important strategic projects, the construction of a new plant in China to capitalize on China's rapidly growing IT and automotive industries, is progressing according to our investment plan.

The "Fusion 05" Strategic Management Plan

In fiscal 2002, Daikin initiated efforts to become a "global top-tier company" by launching its new strategic management plan, "Fusion 05." Although the principles and policies outlined in the plan have not changed, we have set new short-term goals and revised our implementation schedules in response to major changes in our operating environment. Under our original implementation schedule for the medium term, we planned to make every effort to achieve consolidated net sales of ¥700 billion and consolidated ordinary income of ¥70 billion.

However, major changes have occurred that have forced us to alter our initial forecasts for economic growth. For example, Japan's GDP is now expected to contract in both fiscal 2002 and 2003. In light of these changes, we have revised our targets downward and are now aiming for consolidated net sales of ¥630 billion and consolidated ordinary income of ¥57 billion. If we had simply adjusted our forecast downward in line with the negative changes in the economy, our revised targets would be even lower. In fact, in trying to change our targets as little as possible, we have had to implement additional policies to reduce expenses, expand

sales of priority products by redistributing human resources, and improve the efficiency of indirect departments. Thus, we have actually set ourselves tougher challenges than those embodied in the original targets.

It must be added, however, that we have not entirely given up on our original targets. Instead, we are trying to move beyond the strictures of conventional thought to achieve these extremely high targets, which we have redesignated as "stretch goals." Furthermore, Daikin is accelerating efforts to capitalize on the alliances it has already formed with other companies, increase the number of innovative business initiatives under way, and enter into additional strategic alliances and tie-ups.

In line with its 12 core strategies for becoming a "global top-tier company," Daikin has implemented a range of policies. At present, particular emphasis has been placed on the following four policies.

→ 1. Achieve Technological Preeminence

As a manufacturer, it is imperative that we rapidly develop the best technology in the world. To this end, in March of the term under review, Daikin implemented a plan to facilitate technological innovation in the Air Conditioning and Refrigeration Equipment Division and has named the plan "Daikin's Technology Statement," targeting the No. 1 or No. 2 position in the global air-conditioning industry by the end of fiscal 2006. To do so, it is absolutely necessary that we develop technologies enabling us to continuously distinguish our products from those of our competitors, add value to our products, and provide solutions to our customers'

Developing the best technology in the world



problems. Technological innovations will be achieved by focusing on the following three strategies.

First, we must form a decision-making framework that enables quick, concise decisions to be made regarding the development of products and technologies.

Second, looking three to five years ahead, we must prioritize our development activities, intensifying our focus in some areas and withdrawing from others.

Third, to improve our technology portfolio, we must introduce incentives to encourage our technicians to be more innovative in thought and action.

→ 2. Quickly Capitalize on Corporate Alliances and Form Additional Alliances and Tie-ups

In 1999, we formed an alliance with Matsushita Electric Industrial Co., Ltd. to develop and manufacture ductless air-conditioning systems and, during the term under review, we formed another strategic alliance with the Trane Company. These two alliances will serve as a basis from which to secure the No. 1 position in the global air-conditioning market. During the current term, Daikin must act quickly to integrate its operations with those of its partners and generate positive results.

Daikin is forming policies in conjunction with the Trane Company to generate major synergies. At present, the two companies are working together to supply products to the European market, and these efforts will be expanded to Asia and South America. In addition, plans are on track to supply air-conditioning solutions in Japan and develop ductless air-conditioning systems for the North American market.

→ 3. Develop Strategies for the Chinese Market

With a population of 1.3 billion, China not only serves as the “world’s factory,” but also comprises an enormous potential market. In light of these considerations, Daikin has designated China as the most important element in its strategic framework for global development. Daikin is acting quickly to expand sales in China while the country’s market is still being shaped by rapid growth.

To facilitate these efforts, Daikin is developing a new Chinese holding company, which was established in 2001 and will have comprehensive oversight of the Company’s Chinese operations, including engineering, manufacturing, and services. This company will help Daikin expand sales of residential air-conditioning systems and provide services based on knowledge gained in its Japanese operations. In fluorochemicals, Daikin is concentrating on developing applications and generating local demand in preparation for a new fluorochemical plant scheduled for construction in the second half of fiscal 2004.

→ 4. Innovation Business

The “Convenience Pack” is a revolutionary new product for *convenience stores* that combines air conditioning, refrigeration, and freezing functions in a single system and that reduces energy consumption by 50% and occupies 30% less space. We anticipate substantial growth for this solutions business, which will not only sell products tailored to the needs of customers but also provide after-sales maintenance services.

Reducing energy consumption by 50%



This is one of Daikin's 21 innovative business initiatives, designed to reshape the Company's business structure. During the current term, Daikin is establishing goals and policies for each of these initiatives and is aiming for 30% of its sales to come from such businesses by fiscal 2004.

Reinforcing Our Management System

In the current era of intense competition, structural innovation and consolidated management are becoming increasingly important. In light of this, it is imperative that Daikin raises the quality of its management system, which will require the Company to make quick decisions and implement them effectively across business units. To meet this challenge, we have carried out an extensive review of our management system and made changes where necessary. The changes comprise six main points:

- 1. We want to operate in a way that reflects all our strengths. To accomplish this without introducing a corporate officer system, we are integrating our management functions so that executives share responsibility for both making and executing decisions.
- 2. As the issues facing management are becoming more complicated, we have established a "Chief Executive Committee" to facilitate faster decision making and problem solving. This committee functions as the Company's highest deliberative body, overseeing Groupwide policies, management strategies, business restructuring, the implementation of new management

paradigms, and other issues that are beyond the scope of divisional and departmental management responsibilities.

- 3. We have divided management responsibilities between the CEO and COO to expedite the execution of management decisions and strengthen our consolidated management framework. The CEO is responsible for making decisions that affect the entire Group, while the COO is in charge of executing those decisions. With both of these functions operating in concert, our management framework is significantly more powerful. The chairman functions as the CEO, and the president functions as the COO. There are many issues related to business development and the enhancement of corporate value, and dividing responsibilities between the CEO and COO facilitates high-speed decision making and execution, thus increasing both the breadth and depth of our Group management.
- 4. In addition, we are forming a body called the "Group Management Meeting" to improve our consolidated management capabilities and accelerate the execution of management decisions on a global scale. The Group Management Meeting will help promote Groupwide strategies for IT, financing, human resources, and other important functions.
- 5. We have drawn on external sources to enhance our management capabilities. Ms. Chiyono Terada, the president and CEO of Art Corporation, and Mr. Tadasu Tachi, the counsellor of Kaneka Corporation, serve as Daikin's first external board members and take part in

Reinforcing our management system



the decision-making processes starting in the current term. These two board members provide high-quality advice regarding weaknesses in our operations from an independent point of view. We have also continued to benefit from advice given by members of “The Advisory Council,” which was formed in 1999 and has been enhanced to function even more effectively.

- 6. We have strengthened the auditing function to improve transparency and public disclosure. In line with revisions to the Commercial Code of Japan, we have increased the number of highly professional auditors, and established a “Group Auditors Meeting” to improve the auditing function at the Group level. This auditing system will give us immediate feedback regarding the specific issues faced by each company in the Group and enable us to pool our mental resources to solve any problems.

To Our Shareholders

The outlook for the current term remains grim. Although a partial recovery is under way in the United States among semiconductors, telecommunications, and other IT-related industries, the Japanese economy remains weighed down by structural problems, especially bad debts in the financial sector. That said, in the current term we will maintain the same intense focus that enabled us to come close to meeting the targets set forth in our previous strategic management plan, “Fusion 21,” and strive for increased growth and development under “Fusion 05.” In addition to the six points mentioned,

Daikin will strive to ensure that all of the Group’s operations are running according to a customer-centric management paradigm to facilitate the realization of nine consecutive terms of increased operating income and the targets set forth in “Fusion 05.”

At the beginning of 2002, Daikin challenged itself to flatten its organization, enhance management performance, and generate a continual stream of new innovations. Daikin will maintain the same dedicated focus that has been successful in the past while aiming to be a “global top-tier company.” A continuous series of innovations will support our ongoing efforts to achieve the high targets we have set.

We hope that our shareholders will continue to understand and support Daikin’s management efforts.

June 27, 2002

Noriyuki Inoue, Chairman and CEO

Hiroyuki Kitai, President and COO