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Five-Year Summary

Daikin Industries, Ltd. and Consolidated Subsidiaries
Years Ended March 31

Millions of yen

	2003	2002	2001	2000	1999
Net sales	¥572,413	¥538,790	¥531,908	¥463,069	¥464,332
Air conditioning.....	453,850	422,224	401,192	344,213	345,837
Chemicals.....	83,576	81,705	96,188	81,957	79,629
Others	34,987	34,861	34,528	36,899	38,866
Operating income	44,789	41,968	39,814	25,888	23,004
Income before income taxes and minority interests	36,561	31,598	35,234	19,418	15,351
Net income	21,591	17,937	19,939	10,453	6,194
Per share of common stock (in yen):					
Net income*	¥81.48	¥67.58	¥75.60	¥39.62	¥23.48
Cash dividends applicable to the year	12.00	12.00	12.00	10.00	10.00
Total assets.....	¥475,760	¥460,549	¥453,142	¥431,009	¥434,290
Total shareholders' equity.....	205,101	191,196	173,924	159,635	149,089
Net property, plant and equipment.....	145,579	145,259	135,725	125,612	132,517
Number of employees	15,845	15,247	15,047	14,280	14,337

* Calculated on the basis of the weighted average number of common shares outstanding during each year

Financial Review

Net Sales

Consolidated net sales amounted to a record ¥572,413 million, a 6.2% increase compared with the previous term. Although the Chemicals Division was affected by continuing sluggish demand for fluorochemicals, reflecting slack demand for air-conditioning systems in Japan, overseas sales of air-conditioning systems grew strongly.

In the Air Conditioning and Refrigeration Equipment Division, overall sales rose sharply in overseas markets. The benefits of a weak yen further pushed up sales to ¥453,850 million, a rise of 7.5% compared with the previous term.

In Japan, Daikin increased its share of the market by launching distinctive and high-value-added products and targeting large-scale electronics retailers, but sales revenue declined, reflecting slack demand in the sector and falling retail prices.

Daikin greatly increased sales volumes overseas, enjoying not only greater marketing clout after its purchase of a distributor in Italy, the Company's largest market in Europe, but also the benefits of warm weather, mainly in southern Europe. Demand also remained solid in China, Australia, and other countries, supporting double-digit growth in unit sales.

In the Chemicals Division, sales rose 2.3%, to ¥83,576 million. Although demand for fluoropolymers is suffering from ongoing sluggishness in the worldwide semiconductor and IT industries and in particular the fall in demand for FEP for LAN cables in the United States, sales of other products and fluorocarbon gases increased.

Sales in the Oil Hydraulics Division rose 4.1%, to ¥15,291 million, as weak demand from machine tool manufacturers was offset by increased market share through expanded sales of distinctive and new products.

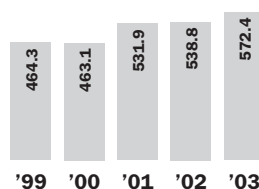
Sales in defense-related operations decreased 2.0%, to ¥19,696 million, reflecting Japan's defense budget, which remained fairly constant.

Costs, Expenses, and Earnings

During the term under review, the cost of sales amounted to ¥380,733 million, and the cost of sales ratio was 66.5%, down 0.2 percentage point from the previous term. The reduction, which offset the impact of lower sales prices, was achieved by increasing unit sales, expanding sales of high-value-added products, and cutting production costs. A particular effort was made to reduce production costs, both in factories in Japan and overseas.

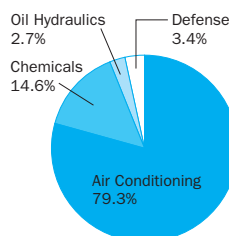
Net Sales

(¥ billion)



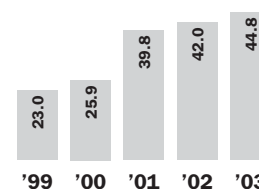
Sales Breakdown

(For fiscal 2003)



Operating Income

(¥ billion)



Years Ended March 31,	2003	2002	2001	2000	1999
Gross profit (net sales less cost of sales) as a % of net sales	33.5%	33.3%	33.0%	32.3%	31.2%
Operating income as a % of net sales	7.8	7.8	7.5	5.6	5.0
Interest coverage (operating income plus interest and dividend income divided by interest expense) (times)	11.1	9.2	7.8	5.6	3.6
Net income as a % of net sales	3.8	3.3	3.7	2.3	1.3

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses increased ¥9,374 million from the previous term, to ¥146,891 million, reflecting a rise in personnel costs following an increase of staff at overseas subsidiaries to prepare for global expansion and expanded R&D expenditure for strengthening technological competitiveness.

Operating Income

Operating income amounted to a record ¥44,789 million, a 6.7% rise compared with the previous fiscal year and the ninth consecutive term of increase, due to major growth in sales of air-conditioning systems in overseas markets and a drive to cut costs across the board.

Financial Position

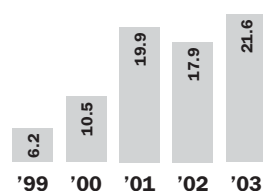
As a result of Groupwide efforts to reduce notes and accounts receivable and inventories, the retaining period for receivables was 67 days, the same as in the previous term, and the retaining period for inventories was kept at last fiscal year's level of 64 days.

Interest-bearing debt decreased ¥11,265 million compared with the previous year-end, to ¥142,279 million. This was due not only to increased sales and income but also to our efforts to reduce such debt from FCF generated by enhanced working capital efficiency. The interest-bearing debt ratio decreased 3.4 percentage points to 29.9%.

Total shareholders' equity increased ¥13,905 million compared with the previous year-end, to ¥205,101 million, chiefly reflecting an increase in internal reserves accompanying increased sales revenue. The shareholders' equity ratio rose 1.6 percentage points, to 43.1%.

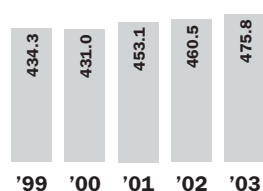
Net Income

(¥ billion)



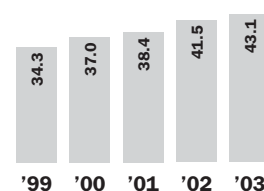
Total Assets

(¥ billion)



Shareholders' Equity Ratio

(%)



Years Ended March 31,	2003	2002	2001	2000	1999
Notes and accounts receivable (¥ billion).....	103.1	98.0	104.2	106.3	103.6
Inventories (¥ billion).....	101.1	93.8	92.2	84.2	95.4
Interest-bearing debt (not including trade notes discounted) (¥ billion)	142.3	153.5	143.7	159.1	171.9

Cash Flows

During the term under review, net cash provided by operating activities was ¥48,502 million, chiefly reflecting an increase in income.

However, net cash used in investing activities amounted to ¥36,892 million, chiefly a result of purchases of property, plant and equipment.

Net cash used in financing activities was ¥16,712 million, due mainly to a decrease in interest-bearing debt.

As a result, cash and cash equivalents, end of year, totaled ¥40,305 million. This figure is equivalent to approximately 0.8 times the Company's average monthly net sales of ¥47,701 million. Liquidity in hand, including a Commitment Line with banks of approximately ¥25,000 million, amounted to ¥65,305 million, or 1.4 times average net sales per month.

Dividends

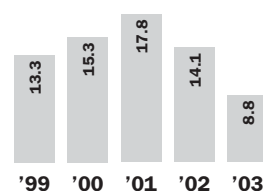
To maximize corporate value, Daikin is vigorously expanding its business domains and bolstering its operating structure. As part of this effort, the Company is establishing virtual companies and introducing managerial indicators for items such as FCF, DVA, ROA, and ROI. At the same time, as we are committed to returning profits to shareholders, we aim to raise the ratio of cash dividends to shareholders' equity (on a non-consolidated basis) to at least 2.0%.

Dividend payments were the same as in the previous term, at ¥12.00 per share (1.8% of the non-consolidated cash dividend shareholders' equity ratio).

Free Cash Flow (FCF)

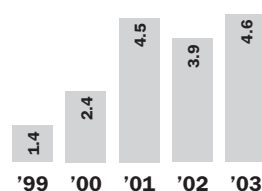
(¥ billion)

FCF = Income before income taxes +
Depreciation and amortization –
Investments ± Net working capital



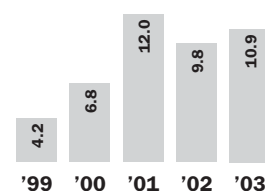
Return on Assets (ROA)

(%)



Return on Equity (ROE)

(%)



Consolidated Balance Sheets

Daikin Industries, Ltd. and Consolidated Subsidiaries
March 31, 2003 and 2002

ASSETS	Millions of yen	
	2003	2002
Current assets:		
Cash and cash equivalents	¥ 40,305	¥ 46,257
Short-term investments (Note 7).....	1,499	320
Trade receivables (Note 6):		
Notes	10,112	12,039
Accounts	94,547	86,867
Allowance for doubtful receivables.....	(1,582)	(913)
Inventories (Note 3).....	101,118	93,840
Deferred tax assets (Note 11).....	9,413	9,212
Prepaid expenses and other current assets.....	16,545	12,513
Total current assets	271,957	260,135
Property, plant and equipment (Note 7):		
Land.....	23,685	24,302
Buildings and structures	118,120	118,745
Machinery and equipment	224,023	218,375
Furniture and fixtures.....	71,612	70,115
Construction in progress	11,833	5,482
Total	449,273	437,019
Accumulated depreciation	(303,694)	(291,760)
Net property, plant and equipment	145,579	145,259
Investments and other assets:		
Investment securities (Note 4)	29,233	31,635
Investments in and advances to unconsolidated subsidiaries and associated companies.....	3,261	3,146
Goodwill (Note 5).....	5,555	3,293
Deferred tax assets (Note 11).....	5,386	3,350
Other assets (Note 7).....	14,789	13,731
Total investments and other assets	58,224	55,155
Total	¥475,760	¥460,549

See notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen	
	2003	2002
Current liabilities:		
Short-term borrowings (Note 7).....	¥ 65,640	¥ 72,288
Current portion of long-term debt (Note 7).....	13,858	27,799
Trade payables (Note 6):		
Notes.....	11,051	19,343
Accounts.....	51,241	35,769
Construction payable.....	8,492	7,832
Income taxes payable.....	4,986	5,476
Deferred tax liabilities (Note 11).....	4	7
Accrued expenses.....	22,300	20,630
Other current liabilities.....	20,049	17,706
Total current liabilities.....	197,621	206,850
Long-term liabilities:		
Long-term debt (Note 7).....	62,781	53,457
Liabilities for retirement benefits (Note 8).....	4,294	2,722
Deferred tax liabilities (Note 11).....	216	290
Total long-term liabilities.....	67,291	56,469
Minority interests.....	5,747	6,034
Commitments and contingent liabilities (Note 15)		
Shareholders' equity (Notes 9, 10 and 16):		
Common stock, no par value—authorized, 500,000,000 shares; issued 263,813,973 shares in 2003 and 2002.....	28,023	28,023
Capital surplus.....	25,968	25,968
Retained earnings.....	155,654	137,347
Net unrealized gain (loss) on available-for-sale securities.....	(784)	2,331
Foreign currency translation adjustments.....	(2,938)	(2,007)
Total.....	205,923	191,662
Treasury stock, at cost: 363,535 shares in 2003 and 192,571 shares in 2002.....	(822)	(466)
Total shareholders' equity.....	205,101	191,196
Total.....	¥475,760	¥460,549

Consolidated Statements of Income

Daikin Industries, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2003 and 2002

	Millions of yen	
	2003	2002
Net sales	¥572,413	¥538,790
Cost of sales	380,733	359,305
Gross profit	191,680	179,485
Selling, general and administrative expenses	146,891	137,517
Operating income	44,789	41,968
Other income (expenses):		
Interest and dividends income.....	894	1,157
Interest expense	(4,104)	(4,699)
Royalty income.....	400	287
Exchange losses	(404)	(363)
Loss on disposals of property, plant and equipment	(844)	(680)
Gain on sales of investment securities	425	
Write-down of investment securities.....	(3,962)	(7,696)
Write-down of other assets.....	(43)	(357)
Equity in earnings of unconsolidated subsidiaries and associated companies	142	176
Insurance proceeds received.....		1,660
Other—net.....	(732)	145
Other expenses—net	(8,228)	(10,370)
Income before income taxes and minority interests	36,561	31,598
Income taxes (Note 11):		
Current	13,482	15,236
Deferred	50	(2,899)
Total	13,532	12,337
Minority interests	(1,438)	(1,324)
Net income	¥ 21,591	¥ 17,937
	Yen	
Amounts per common share:		
Net income	¥81.48	¥67.58
Cash dividends applicable to the year	12.00	12.00

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Daikin Industries, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2003 and 2002

	Number of common shares issued	Millions of yen					
		Common stock	Capital surplus	Retained earnings	Unrealized gain on available-for- sale securities	Foreign currency translation adjustments	Treasury stock, at cost
Balance, April 1, 2001	263,813,973	¥28,023	¥25,968	¥122,694	¥4,802	¥(7,327)	¥(236)
Treasury stock acquisition—net (99,539 shares).....							(230)
Net income				17,937			
Appropriations:							
Cash dividends, ¥12 per share ...				(3,164)			
Bonuses to directors and corporate auditors				(120)			
Net unrealized loss on available-for-sale securities					(2,471)		
Foreign currency translation adjustments.....						5,320	
Balance, March 31, 2002	263,813,973	28,023	25,968	137,347	2,331	(2,007)	(466)
Treasury stock acquisition—net (170,964 shares).....							(356)
Net income				21,591			
Appropriations:							
Cash dividends, ¥12 per share ...				(3,163)			
Bonuses to directors and corporate auditors				(121)			
Net unrealized loss on available-for-sale securities					(3,115)		
Foreign currency translation adjustments.....						(931)	
Balance, March 31, 2003	263,813,973	¥28,023	¥25,968	¥155,654	¥ (784)	¥(2,938)	¥(822)

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Daikin Industries, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2003 and 2002

	Millions of yen	
	2003	2002
Operating activities:		
Income before income taxes and minority interests	¥36,561	¥31,598
Adjustment for:		
Income taxes—paid	(13,989)	(21,402)
Depreciation and amortization	21,694	20,956
Gain on sales of investment securities	(425)	
Write-down of investment securities	3,962	7,696
Write-down of other assets	43	357
Loss on disposals of property, plant and equipment	844	680
Equity in earnings of unconsolidated subsidiaries and associated companies	(142)	(176)
Changes in assets and liabilities, net of effects of the purchase of a subsidiary:		
Trade notes and accounts receivable	(2,165)	8,340
Inventories	(5,345)	884
Other current assets	(2,632)	1,892
Trade notes and accounts payable	6,607	(11,372)
Accrued expenses	1,179	(340)
Other—net	2,310	1,070
Total adjustments	11,941	8,585
Net cash provided by operating activities	48,502	40,183
Investing activities:		
Purchases of property, plant and equipment	(23,741)	(31,023)
Increase in investments in unconsolidated subsidiaries and associated companies		(155)
Payment for purchase of a subsidiary, net of cash acquired	(2,851)	
Payment for purchase of minority interest	(710)	
Net increase in short-term investments	(1,068)	
Payments to acquire investment securities	(7,617)	(2,314)
Proceeds from sales of investment securities	1,034	4
Other—net	(1,939)	(202)
Net cash used in investing activities	(36,892)	(33,690)
Financing activities:		
Net increase (decrease) in short-term borrowings	(8,693)	6,400
Increase in long-term debt	3,418	14,405
Repayments of long-term debt	(7,919)	(13,260)
Payments of cash dividends	(3,163)	(3,164)
Other—net	(355)	(804)
Net cash provided by (used in) financing activities	(16,712)	3,577
Effect of exchange rate changes on cash and cash equivalents	(850)	705
Net increase (decrease) in cash and cash equivalents	(5,952)	10,775
Cash and cash equivalents, beginning of year	46,257	35,482
Cash and cash equivalents, end of year	¥40,305	¥46,257

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Daikin Industries, Ltd. and Consolidated Subsidiaries Years Ended March 31, 2003 and 2002

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared from the consolidated financial statements issued for domestic reporting purposes in Japan, which are different in certain respects as to application and disclosure from those prepared in accordance with International Financial Reporting Standards. Daikin Industries, Ltd. (the "Company") and its consolidated domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and in conformity with accounting principles and practices generally accepted in Japan, and its consolidated foreign subsidiaries in conformity with those of their respective countries of their domicile. The consolidated financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the Company's consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

In addition, certain reclassifications have been made for the year ended March 31, 2002 to conform to the presentations for the year ended March 31, 2003.

2. Summary of Significant Accounting Policies

Principles of Consolidation and Accounting for Investments in Unconsolidated Subsidiaries and Associated Companies

The accompanying consolidated financial statements include the accounts of the Company and its significant subsidiaries (together, the "Group").

Under the control or influence concept, those companies over whose operations the Company, directly or indirectly, is able to exercise control are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

The Group applies the equity method of accounting for investments in unconsolidated subsidiaries and associated companies except for certain insignificant companies. Investments in such insignificant companies are stated at cost except that appropriate write-downs are recorded for investments for which the value has been permanently impaired. If these subsidiaries and associated companies had been consolidated and accounted for using the equity method, respectively, the effect on the accompanying consolidated financial statements would not have been material.

The excess of the cost of an acquisition over the fair value of the net assets of the acquired subsidiary at the date of acquisition (the "Consolidation goodwill") is being amortized over a period of 5 to 10 years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

Cash Equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits and marketable debt securities issued by the Japanese Government and private companies, all of which mature or become due within three months of the date of acquisition.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is stated in amounts considered to be appropriate based on the companies' past credit loss experience and an evaluation of potential losses in the receivables outstanding.

Inventories

Inventories of the Company and its consolidated domestic subsidiaries are stated at cost, determined by the average method. Inventories of consolidated foreign subsidiaries are principally stated at the lower of cost, determined by the average-cost method, or market.

Property, Plant and Equipment

Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation of property, plant and equipment of the Company and its consolidated domestic subsidiaries is computed by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998, at rates based on the estimated useful lives of the assets. Depreciation of property, plant and equipment of consolidated foreign subsidiaries is principally computed by the straight-line method at rates based on the estimated useful lives of the assets.

The range of useful lives is 15 to 50 years for buildings and structures, 5 to 15 years for machinery and equipment and 2 to 10 years for furniture and fixtures.

Leases

All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that are deemed to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain “as if capitalized” information is disclosed in the notes to the financial statements.

Investment Securities

Under the Japanese accounting standard for financial instruments, all marketable securities held by the Group are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. The cost of securities sold is determined based on the moving-average method.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method.

For other than temporary declines in fair value, available-for-sale securities are reduced to net realizable value by charging such losses to income.

Bond Issue Costs

Bond issue costs are charged to income as incurred.

Employees' Retirement Benefits

The Company and its consolidated domestic subsidiaries have a non-contributory funded pension plan covering substantially all of its employees. Effective April 1, 2000, the Company adopted a new accounting standard for employees' retirement benefits and accounted for the liability for retirement benefits based on projected benefit obligations and plan assets at the balance sheet date. The transitional obligation of ¥25,249 million as of April 1, 2000 is being amortized over seven years and the annual amortization is presented as selling, general and administrative expenses in the consolidated statements of income.

Directors and corporate auditors are not covered by the aforementioned plans. The Company makes provision for severance indemnities to its directors and corporate auditors based upon management's estimates of amounts which will be payable, subject to approval of shareholders, for services rendered to date.

Foreign Currency Transactions

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the consolidated statement of income to the extent that they are not hedged by forward exchange contracts.

Foreign Currency Financial Statements

The balance sheet accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rates as of the balance sheet date except for shareholders' equity, which is translated at historical rates. Revenue and expense accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the average exchange rates. Differences arising from such translations were shown as “Foreign currency translation adjustments” in a separate component of shareholders' equity.

Income Taxes

The provision for current income taxes is computed based on the income before income taxes and minority interests included in the consolidated statements of income. Deferred income taxes are recorded to reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

Derivative Financial Instruments

The Group uses foreign exchange forward contracts and interest rate swaps to manage their exposures to fluctuations in foreign exchange and interest rates. The Group does not enter into derivatives for trading or speculative purposes.

Derivative financial instruments and foreign currency transactions are classified and accounted for as follows: a) all derivatives are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the statements of income and b) for derivatives used for hedging purposes, if such derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses are deferred until maturity of the hedged transactions.

The interest rate swaps that qualify for hedge accounting and meet specific matching criteria are not remeasured at market value but the differential paid or received under the swap agreements is recognized and included in interest expense or income.

Appropriations of Retained Earnings

Appropriations of retained earnings at each year end are reflected in the financial statements for the following year upon shareholders' approval.

Amounts per Common Share

Effective April 1, 2002, the Company adopted a new accounting standard for earnings per share of common stock issued by the Accounting Standards Board of Japan. Under the new standard, basic net income per share is computed by dividing net income available to common shareholders, which is more precisely computed than under previous practices, by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share is not disclosed because potentially dilutive securities are not issued and stock options issued by the Company had no dilutive effect.

Basic net income per share for the years ended March 31, 2003 and 2002 is computed in accordance with the new standard.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

3. Inventories

Inventories at March 31, 2003 and 2002 consisted of the following:

	Millions of yen	
	2003	2002
Finished products and merchandise.....	¥ 60,420	¥54,388
Semi-finished products and work-in-process	31,165	29,309
Raw materials and supplies	9,533	10,143
Total	¥101,118	¥93,840

4. Investment Securities

The acquisition costs and aggregate fair values of marketable available-for-sale securities included in investment securities at March 31, 2003 and 2002 were as follows:

	Millions of yen			
	2003			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥24,985	¥4,452	¥(5,709)	¥23,728
Debt securities	2,030	1		2,031
Other	614		(69)	545
Total	¥27,629	¥4,453	¥(5,778)	¥26,304

	Millions of yen			
	2002			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥22,821	¥6,370	¥(1,993)	¥27,198
Debt securities	2,140		(11)	2,129
Other	764		(357)	407
Total	¥25,725	¥6,370	¥(2,361)	¥29,734

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2003 and 2002 were as follows:

	Millions of yen	
	Carrying amount	
	2003	2002
Available-for-sale:		
Equity securities	¥1,926	¥1,897
Other	1,003	4
Total	¥2,929	¥1,901

Proceeds from sales of available-for-sale securities for the years ended March 31, 2003 and 2002 were ¥1,034 million and ¥4 million, respectively. Gross realized gains and losses on these sales computed on the moving average cost basis were ¥425 million of gains for the year ended March 31, 2003 and ¥1 million of losses for the year ended March 31, 2002.

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale at March 31, 2003 were as follows:

	Millions of yen	
	2003	2002
Available-for-sale:		
Due after one year through five years	¥ 30	
Due after five years through ten years	2,001	
Total	¥2,031	

5. Goodwill

Goodwill at March 31, 2003 and 2002 consisted of the following:

	Millions of yen	
	2003	2002
Consolidation goodwill	¥4,442	¥1,869
Others	1,113	1,424
Total	¥5,555	¥3,293

6. Related Party Transactions

Receivables and payables, with respect to transactions with unconsolidated subsidiaries and associated companies, at March 31, 2003 and 2002 were as follows:

	Millions of yen	
	2003	2002
Trade notes and accounts receivable	¥3,575	¥3,738
Trade notes and accounts payable.....	685	533

Sales to and purchases from unconsolidated subsidiaries and associated companies for the years ended March 31, 2003 and 2002 were as follows:

	Millions of yen	
	2003	2002
Sales.....	¥14,666	¥13,238
Purchases.....	6,642	7,284

7. Short-Term Borrowings and Long-Term Debt

Short-term borrowings of the Group at March 31, 2003 and 2002 consisted of the following:

	Millions of yen	
	2003	2002
Bank overdrafts and notes to banks	¥48,640	¥54,288
Commercial paper	17,000	18,000
Total	¥65,640	¥72,288

Unused short-term bank credit lines were ¥25,000 million at March 31, 2003. Weighted average interest rates of bank overdrafts and notes to banks at March 31, 2003 and 2002 were 1.67% and 2.01%, respectively.

Weighted average interest rates of commercial paper at March 31, 2003 and 2002 were 0.05% and 0.03%, respectively.

Long-term debt at March 31, 2003 and 2002 consisted of the following:

	Millions of yen	
	2003	2002
1.60% unsecured bonds, due 2002.....	¥	¥20,000
1.925% unsecured bonds, due 2004.....	10,000	10,000
2.70% unsecured bonds, due 2006.....	10,000	10,000
0.82% unsecured bonds, due 2009.....	20,000	
Collateralized loans from government sponsored banks, with interest 1.75%, due through 2012.....	1,200	1,200
Unsecured loans from government sponsored banks, with interest ranging from 1.40% to 6.53%, due through 2012	4,585	4,864
Collateralized loans from banks with: Fixed interest 5.49%, due through 2005	303	
Floating interest ranging from 0.44% to 0.58% (2003), and from 0.48% to 0.68% (2002), due through 2010.....	18,779	21,939
Unsecured loans from banks, payable in foreign currencies, with interest ranging from 2.75% to 5.99% (2003) and from 2.75% to 6.00% (2002), due through 2006.....	9,148	10,645
Unsecured loans from banks with interest ranging from 0.49% to 7.30% (2003), and from 0.53% to 7.30% (2002), due through 2027	2,624	2,608
Total	76,639	81,256
Less current portion	(13,858)	(27,799)
Long-term debt, less current portion	¥62,781	¥53,457

Annual maturities of long-term debt outstanding at March 31, 2003 were as follows:

Years ending March 31,	Millions of yen
2004	¥13,858
2005	17,396
2006	11,888
2007	511
2008	2,350
2009 and thereafter.....	30,636
Total	<u>¥76,639</u>

At March 31, 2003, property, plant and equipment with a net book value of ¥50,270 million and other assets with a value of ¥129 million were pledged as collateral for short-term borrowings and long-term debt, and short-term investments with a value of ¥1,068 million were pledged as collateral for a supplier's borrowings with a value of ¥1,068 million.

Certain loan agreements provide that the lender may require the Group to submit proposals for paying dividends, issuing additional long-term debt and certain other matters, for prior approval. As is customary in Japan, security must be given if requested by a lending bank. Banks have the right to offset cash deposited with them against any debt or obligation that becomes due, or, in case of default and certain other specified events, against all other debt payable to them. To date, none of the lenders has ever exercised this right with respect to debt of the Group.

8. Severance Indemnities and Pension Plans

Under the Group's pension plans, employees terminating their employment are, in most circumstances, entitled to pension payments based on their average pay during their employment, length of service and certain other factors.

The liabilities for employees' retirement benefits at March 31, 2003 and 2002 consisted of the following:

	Millions of yen	
	2003	2002
Projected benefit obligation.....	¥70,061	¥69,816
Fair value of plan assets.....	(33,364)	(36,042)
Unrecognized prior service cost.....	122	
Unrecognized actuarial loss	(18,954)	(13,923)
Unrecognized transitional obligation.....	(14,428)	(18,035)
Net liability	¥ 3,437	¥ 1,816

The components of net periodic benefit costs for the years ended March 31, 2003 and 2002 were as follows:

	Millions of yen	
	2003	2002
Service cost.....	¥3,598	¥3,184
Interest cost	1,735	2,124
Expected return on plan assets	(901)	(1,204)
Amortization of prior service cost.....	(4)	
Amortization of transitional obligation	3,607	3,607
Recognized actuarial loss.....	1,433	410
Net periodic benefit costs	¥9,468	¥8,121

Assumptions used for the years ended March 31, 2003 and 2002 were set forth as follows:

	Millions of yen	
	2003	2002
Discount rate	2.5%	2.5%
Expected rate of return on plan assets	2.5%	3.5%
Amortization period of prior service cost.....	7 years	
Recognition period of actuarial gain/loss	10 years	10 years
Amortization period of transitional obligation	7 years	7 years

9. Shareholders' Equity

Liability for retirement benefits at March 31, 2003 and 2002 included retirement benefits for directors and corporate auditors of ¥857 million and ¥906 million, respectively. The retirement benefits for directors and corporate auditors are paid subject to the approval of the shareholders.

Japanese companies are subject to the Japanese Commercial Code (the "Code") to which certain amendments became effective from October 1, 2001.

The Code was revised whereby common stock par value was eliminated resulting in all shares being recorded with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration as a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The revised Code also provides that an amount at least equal to 10% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 25% of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The revised Code eliminates restrictions on the repurchase and use of treasury stock allowing Japanese companies to repurchase treasury stock by a resolution of the shareholders at the general shareholders' meeting and dispose of such treasury stock by resolution of the Board of Directors beginning April 1, 2002. The repurchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general shareholders' meeting.

The amount of retained earnings available for dividends under the Code was ¥111,884 million as of March 31, 2003, based on the amount recorded in the parent company's general books of account. In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

10. Stock Option Plan

On June 29, 2000, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 93 thousand shares of the Company's common stock in the period from July 1, 2002 to June 30, 2006. On July 25, 2000, the options were granted at an exercise price of ¥2,471 per share.

On June 28, 2001, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 92 thousand shares of the Company's common stock in the period from July 1, 2003 to June 30, 2007. On July 30, 2001, the options were granted at an exercise price of ¥2,541 per share.

On June 27, 2002, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 118 thousand shares of the Company's common stock in the period from July 1, 2004 to June 30, 2008. On July 30, 2002, the options were granted at an exercise price of ¥2,330 per share.

11. Income Taxes

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 42.0% for the years ended March 31, 2003 and 2002.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2003 and 2002 were as follows:

	Millions of yen	
	2003	2002
Deferred tax assets:		
Inventories.....	¥ 3,936	¥ 4,638
Retirement benefits.....	1,708	1,100
Tax loss carryforwards	1,072	678
Accrued bonus	2,190	1,576
Warranty reserve	1,386	933
Software.....	3,034	2,820
Property and equipment.....	929	788
Investment securities	115	1,787
Other.....	3,262	2,475
Less valuation allowance	(662)	(485)
Total deferred tax assets	¥16,970	¥16,310
Deferred tax liabilities:		
Deferred gains on sales of property	¥ 2,168	¥ 2,240
Unrealized gain on available-for-sale securities	10	1,690
Other.....	213	115
Total deferred tax liabilities	2,391	4,045
Net deferred tax assets	¥14,579	¥12,265

A reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2003 and 2002 is as follows:

	2003	2002
Normal statutory income tax rate	42.0%	42.0%
Permanent non-deductible expenses	2.7	2.8
Difference in foreign subsidiaries' tax rates.....	(6.8)	(5.6)
Foreign tax credit.....	(1.4)	(1.9)
Effect of tax rate reduction	0.2	
Other—net.....	0.3	1.7
Actual effective income tax rate	37.0%	39.0%

On March 31, 2003, Cabinet Order No. 9 entitled "Reform of a Portion of Local Tax Law" was issued and this reform will apply to fiscal years beginning after April 1, 2004. As a result of this reform, the statutory income tax rate to be used for the calculation of deferred income taxes concerning temporary differences, which are expected to be realized or settled after April 1, 2004, will be changed from approximately 42.0% to 40.6%. The effect of this change was to decrease net deferred tax assets by ¥95 million, increase income taxes—deferred and net unrealized loss on available-for-sale securities by ¥78 million and ¥17 million respectively, for the year ended March 31, 2003.

12. Research and Development Costs

Research and development costs were ¥23,906 million and ¥23,414 million for the years ended March 31, 2003 and 2002, respectively.

13. Leases

The Group leases certain computer equipment and other assets.

Lease payments under finance leases were ¥2,058 million and ¥2,143 million for the years ended March 31, 2003 and 2002, respectively.

Pro forma information of leased property under finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2003 and 2002, was as follows:

	Millions of yen		
	Furniture and Fixtures	Others	Total
For the year ended March 31, 2003			
Acquisition cost	¥6,348	¥2,065	¥8,413
Accumulated depreciation	3,582	1,020	4,602
Net leased property	¥2,766	¥1,045	¥3,811
For the year ended March 31, 2002			
Acquisition cost	¥6,128	¥1,954	¥8,082
Accumulated depreciation	3,030	1,012	4,042
Net leased property	¥3,098	¥ 942	¥4,040

Obligations under finance leases:

	Millions of yen	
	2003	2002
Due within one year	¥1,770	¥1,749
Due after one year	2,041	2,291
Total	¥3,811	¥4,040

The amount of acquisition cost and obligations under finance leases includes the imputed interest expense portion.

Depreciation expense under finance leases:

	Millions of yen	
	2003	2002
Depreciation expense	¥2,058	¥2,143

Depreciation expense, which is not reflected in the accompanying consolidated statements of income, was computed by the straight-line method over the respective lease periods.

14. Derivatives

The Group enters into various interest rate swap agreements covering certain portions of long-term debt as a means of managing interest rate exposure. The impact on interest expense from these agreements is recognized over the lives of the respective agreements, which are the same as the terms of the related loans.

The Group also enters into foreign exchange forward contracts to hedge foreign exchange risk associated with certain assets and liabilities denominated in foreign currencies.

All derivative transactions are entered into to hedge interest and foreign currency exposures incorporated within the Group's business. Accordingly, market risk in these derivatives is basically offset by opposite movements in the value of hedged assets or liabilities. The Group does not hold or issue derivatives for trading purposes.

Because the counterparties to these derivatives are limited to major international financial institutions, the Group does not anticipate any losses arising from credit risk.

Derivative transactions entered into by the Group have been made in accordance with internal policies which regulate the authorization and credit limit amount.

Fair Value of Derivative Financial Instruments

The fair values of the Group's derivative financial instruments at March 31, 2003 and 2002 were as follows:

	Millions of yen					
	2003			2002		
	Contract Amount	Fair Value	Unrealized Gain (Loss)	Contract Amount	Fair Value	Unrealized Gain (Loss)
Forward exchange contracts:						
Selling: GBP	¥ 4,105	¥4,099	¥ 6	¥4,057	¥4,083	¥(26)
EUR	4,070	4,087	(17)			
US\$	751	752	(1)			
HK\$	225	231	(6)			
TBH	27	28	(1)			
Currency option contracts:						
Buying: GBP	1,558	42	(14)			
Total	¥10,736	¥9,239	¥(33)	¥4,057	¥4,083	¥(26)

	Millions of yen		
	2003		
	Contract Amount	Fair Value	Unrealized Gain (Loss)
Interest rate swaps contracts:			
Pay fixed/Receive floating	¥2,597	¥(18)	¥(18)
Interest rate option contracts:			
Buying	4,544	8	(13)
Total	¥7,141	¥(10)	¥(31)

Information related to derivative contracts that qualify for hedge accounting and forward contracts that are assigned to associated assets and liabilities and recorded on the balance sheet at March 31, 2003 and 2002 are excluded from the disclosure of market value information.

The contract or notional amounts of the derivatives which are shown in the above table do not represent the amounts exchanged by the parties and do not measure the Group's exposure to credit or market risk.

15. Commitments and Contingent Liabilities

Commitments for capital expenditures outstanding at March 31, 2003 totaled approximately ¥4,011 million.

Guarantees of bank loans and items of a similar nature at March 31, 2003 were ¥2,371 million.

16. Subsequent Events

At the general shareholders' meeting held on June 27, 2003, the Company's shareholders approved the following:

Appropriations of Retained Earnings

The following appropriations of retained earnings at March 31, 2003 were approved:

	Millions of yen
Year-end cash dividends, ¥6.00 per share	¥1,581
Bonuses to directors and corporate auditors	120

Stock Option Plan

The plan provides for granting options to directors and key employees to purchase up to 118 thousand shares of the Company's common stock in the period from July 2004 to June 2008. The options will be granted at an exercise price of 105% of the fair market value of the Company's common stock at the date of option grant.

17. Segment Information

Purchase of Treasury Stock

The Company is authorized to repurchase up to 150 thousand shares of the Company's common stock (aggregate amount of ¥500 million) as treasury stock until the next general shareholders' meeting.

Information about operations in different industry segments, foreign operations and sales to foreign customers of the Group for the years ended March 31, 2003 and 2002 were as follows:

(1) Industry Segments

a. Sales and Operating Income

For the year ended March 31, 2003	Millions of yen				Consolidated
	Air Conditioning	Chemicals	Others	Eliminations	
Sales to customers	¥453,850	¥83,576	¥34,987		¥572,413
Intersegment sales.....	257	2,723	3	¥(2,983)	
Total sales.....	454,107	86,299	34,990	(2,983)	572,413
Operating expenses.....	419,698	76,683	34,226	(2,983)	527,624
Operating income	¥ 34,409	¥ 9,616	¥ 764	¥ 0	¥ 44,789

b. Assets, Depreciation and Capital Expenditures

For the year ended March 31, 2003	Millions of yen				Consolidated
	Air Conditioning	Chemicals	Others	Corporate	
Assets.....	¥287,965	¥109,496	¥26,708	¥51,591	¥475,760
Depreciation	11,028	9,164	1,142		21,334
Capital expenditures.....	11,548	14,153	615		26,316

a. Sales and Operating Income

For the year ended March 31, 2002	Millions of yen				Consolidated
	Air Conditioning	Chemicals	Others	Eliminations	
Sales to customers	¥422,224	¥81,705	¥34,861		¥538,790
Intersegment sales.....	400	1,217		¥(1,617)	
Total sales.....	422,624	82,922	34,861	(1,617)	538,790
Operating expenses.....	390,402	73,624	34,413	(1,617)	496,822
Operating income	¥ 32,222	¥ 9,298	¥ 448	¥ 0	¥ 41,968

b. Assets, Depreciation and Capital Expenditures

For the year ended March 31, 2002	Millions of yen				Consolidated
	Air Conditioning	Chemicals	Others	Corporate	
Assets.....	¥273,062	¥107,313	¥24,835	¥55,339	¥460,549
Depreciation	10,502	8,947	1,280		20,729
Capital expenditures.....	12,188	14,989	1,795		28,972

Corporate assets consist principally of the Company's cash, time deposits, short-term investments and investment securities.

Notes: Air Conditioning consists of Air Conditioning and Refrigeration Equipment, Electronics, Vacuums and Cryogenics and Medical Equipment.

Chemicals consists of Fluorochemicals.

Others consists of Oil Hydraulics and Defense.

(2) Geographical Segments

The geographical segments of the Group for the years ended March 31, 2003 and 2002 were summarized below:

	Millions of yen						Consolidated
	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	
For the year ended March 31, 2003							
Sales to outside customers	¥392,147	¥60,540	¥94,284	¥23,678	¥1,764		¥572,413
Interarea transfers	68,115	36,684	404	1,782		¥(106,985)	
Total sales	460,262	97,224	94,688	25,460	1,764	(106,985)	572,413
Operating expenses	436,735	86,135	88,170	23,143	1,579	(108,138)	527,624
Operating income.....	¥ 23,527	¥11,089	¥ 6,518	¥ 2,317	¥ 185	¥ 1,153	¥ 44,789
Assets	¥339,324	¥70,854	¥64,095	¥27,170	¥1,300	¥ (26,983)	¥475,760

	Millions of yen						Consolidated
	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	
For the year ended March 31, 2002							
Sales to outside customers	¥385,864	¥51,902	¥74,482	¥24,936	¥1,606		¥538,790
Interarea transfers	67,489	25,832	798	1,242		¥(95,361)	
Total sales	453,353	77,734	75,280	26,178	1,606	(95,361)	538,790
Operating expenses	424,639	71,480	68,372	25,337	1,456	(94,462)	496,822
Operating income.....	¥ 28,714	¥ 6,254	¥ 6,908	¥ 841	¥ 150	¥ (899)	¥ 41,968
Assets	¥327,623	¥63,662	¥45,994	¥32,169	¥ 918	¥ (9,817)	¥460,549

The above amounts are summarized by geographic area based on the countries where subsidiaries are located.

(3) Sales to Foreign Customers

Sales to foreign customers for the years ended March 31, 2003 and 2002 were as follows:

	Millions of yen	
	2003	2002
Asia and Oceania	¥ 82,725	¥ 70,323
Europe	97,717	74,609
Americas	27,459	28,427
Other.....	6,418	5,366
Total sales to foreign customers	¥214,319	¥178,725

Independent Auditors' Report

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**Deloitte
Touche
Tohmatsu**

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Daikin Industries, Ltd.:

We have audited the accompanying consolidated balance sheets of Daikin Industries, Ltd. and consolidated subsidiaries as of March 31, 2003 and 2002, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards, procedures and practices generally accepted and applied in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Daikin Industries, Ltd. and consolidated subsidiaries as of March 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan.

Deloitte Touche Tohmatsu

June 27, 2003