Meeting Our Social Responsibilities

Cognizant of its status as a corporate citizen, Daikin is committed to benefiting society by fulfilling its corporate economic and legal responsibilities through transparent and fair conduct of its business and through proactive environmental preservation and regional contribution activities.

Working for the Environment

Our corporate activities, centered on cooling/air-conditioning and fluorochemical products, are closely connected with global warming and other environmental issues. Daikin considers it a matter of the utmost importance to minimize such environmental impact and, to this end, incorporates energy-saving functions into its air-conditioning products and works to minimize fluorocarbon emissions. Daikin is determined to contribute proactively to a healthier global environment across the full spectrum of its business activities, from development through production and marketing, by reducing environmental load and waste products as well as product recycling.

Promoting energy-saving

Because air-conditioning systems consume a large amount of energy, models with power-saving features make a significant contribution to curbing global warming. Daikin quantifies the environmental impact of its products through a point system based on independent in-house standards. These standards—which require the adoption of energy-saving features, avoidance of harmful chemical substances in product manufacture, and "green" procurement that prioritizes environment-friendly components and materials—are stricter than official environmental laws and regulations.

We are working to protect energy resources and prevent global warming by improving the energy efficiency of each of our products and developing energy-saving systems and systems that regulate and reduce power consumption when used in conjunction with our products.

Controlling fluorocarbons

For refrigerants for our air-conditioning systems, we are shifting from fluorocarbons to new hydrofluorocarbons (HFCs), which do not damage the ozone layer. By the end of fiscal 2002 (ended March 31, 2002), all the major product series we sell in Japan and Europe had been fully converted to HFCs.

Because fluorocarbons have been implicated in global warming, we are also taking measures to prevent their emission into the atmosphere. All substances produced during our air-conditioning system manufacturing processes are recovered and disposed of in an appropriate way. In our manufacturing processes for fluorochemical products, we have set up facilities for recovering and destroying fluorocarbons generated as by-products. By fiscal 2005, we plan to have reduced the environmental impact of such emissions by 97% compared with fiscal 2001 levels.

We are also making significant contributions to the protection of the ozone layer and prevention of global warming in our Japan-based operations through integrated disposal systems for recovering refrigerants from scrapped commercial air-conditioning systems.

As a good corporate citizen, Daikin engages in a range of initiatives to promote harmonious coexistence within its regions and the wider communities it serves.

Enabling the disabled to work happily and productively

Daikin Sunrise Settsu Ltd.—set up and financed by Daikin, the Osaka prefectural government, and Settsu City—employs the disabled in the manufacture of components for oil hydraulics and air-conditioning equipment. Since the company's establishment in 1993, people with disabilities have worked there with pride, confidence, and energy, with the goal of achieving economic independence through their own efforts and mutual cooperation. Improvement measures are continuously undertaken to enhance ease of work, including briefings using sign-language every morning, the use of mobile phone email, conversions of procedural instructions into visual (non-text) formats, the upgrading of production lines, and efforts to make tools easier to handle. We also contribute to the regional community, for example by giving over 100 trainees every year the opportunity for hands-on experience at our facilities. These initiatives have drawn much praise from many quarters, including Japan's Ministry of Health, Labour and Welfare.

Contributions to arts and culture

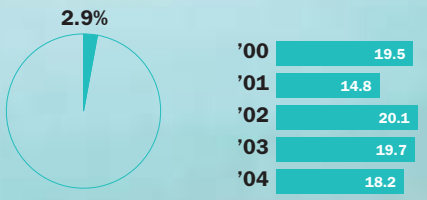
In 1996, we set up the Daikin Foundation of Contemporary Art to support the National Museum of Art, Osaka, the original "home" of modern art in Japan. Through its wide-ranging support for the exhibits, lectures, publishing ventures, surveys, and research staged or undertaken by this museum, which acts as a platform for the hottest modern art from Japan and abroad, Daikin is putting its weight behind the revitalization of culture and the arts in its home area of Osaka. The museum moved to the Nakanoshima district of Osaka in autumn 2004. Loved by Osaka people, its role in developing arts and culture can be expected to grow in importance.

Prioritizing contact with local communities at the factory level

As a corporation, Daikin can exist only if it operates in harmony with local communities. To assist in the development of regional society, Group companies in Japan and abroad are involved in a wide range of activities. In Japan, we hold large *O-Bon* (mid-summer) festivals on Company premises in various locations for local residents, with attendance exceeding 20,000. Similarly, Daikin America, Inc., regularly opens its gates to the public, staging a festival featuring elements of Japanese culture and customs such as *O-Bon* dancing and *wadaiko* drumming. It has also helped with the financing of Japanese gardens in two parks in its neighborhood. Daikin Industries (Thailand), Ltd. makes annual contributions to educational facilities at local schools. It also hosts factory visits by students of many kinds, seeing these visits as opportunities to help the next generation of engineers acquire new technologies and expertise.

Review of Operations

At a Glance

Segment	Major Products & Services	Sales
Air Conditioning	• Room air-conditioning systems • Air cleaners • Dehumidifiers • Packaged air-conditioning systems • Medium- and low-temperature air-conditioning systems • Marine-type container refrigeration • Water-chilling units • Absorption refrigerators • Air-handling units	Sales (% of net sales, ¥ billion) 
Chemicals	• Fluorocarbons • Fluoroplastics • Fluoroelastomers • Fluorinated oils • Oil- and water-repellent products • Mold release agents • Pharmaceuticals and intermediates • Semiconductor-etching products • Dry air suppliers	Sales (% of net sales, ¥ billion) 
Oil Hydraulics	• Pumps and motors • Control valves • Stack valves • Positioning motors • Oil-cooling units • Power packages • Hydrostatic transmissions • Centralized lubrication units and systems • Multilevel car-parking systems	Sales (% of net sales, ¥ billion) 
Defense	• Ammunition • Aircraft parts • Safety and arming devices • Warheads • Home-use oxygen therapy equipment	Sales (% of net sales, ¥ billion) 
Electronics	• Network management systems • Computer graphics systems • DVD-authoring systems • CAD/CAM/CAE systems	

Air Conditioning

In fiscal 2004, ended March 31, 2004, sales in the Air Conditioning and Refrigeration Equipment Division rose 10.4% compared with the previous term, to ¥501.2 billion. The division's sales accounted for approximately 80% of consolidated net sales. Operating income increased 11.9% compared with the previous term, to ¥38.5 billion. The ratio of operating income to segment sales was 7.7%.

The Japanese Market

Market share grew for both residential and commercial air-conditioning systems

In residential air-conditioning systems, we endeavored to further increase sales of distinctive products such as the URURU & SALALA systems, which offer year-round optimized humidity control and ventilation functions, through large-scale electronics retailers and electrical equipment wholesale channels. Although overall air-conditioning demand was dampened by the cool summer of 2003, we recorded a rise in sales volume from the previous fiscal year, substantially increasing our share of the market, and expanded sales.

Demand for commercial air-conditioning systems also grew despite some adverse impact from a cool summer, on the back of increased private-sector capital investment and replacement demand for systems delivered during the bubble economy period of the 1980s. We focused marketing efforts on distinctive, high-value-added products, such as the SUPER INVERTER ZEAS II system, which features superior energy efficiency, quieter and more comfortable operation, and greater environment friendliness. However, although we increased market share, sales declined, partly reflecting a fall in selling prices.

• Marketing proposals tailored closely to user needs

In fiscal 2005, we expect demand for commercial air-conditioning systems to increase. Although we do not foresee significant growth from construction starts, demand is likely to be supported by recovery in capital investment and building refurbishment, particularly in the manufacturing sector. We are beginning to feel the effects of a new round of heavy bulk demand as systems delivered during the bubble economy period reach replacement age. Further demand and business chances are being created by increased environmental and energy-conservation awareness as well as Japan's low birthrate and rapidly aging population.

Our newly developed products include the Round Flow ZEAS cassette-type, ceiling-embedded system, which eliminates temperature variation and draft sensations and offers 360-degree operation, an industry first; and the multiple-room air-conditioner Ve-up Q for office use, which enables replacement of individual units without changing existing refrigerant piping. These products, with features that no competitor can rival, are spearheading our aggressive drive to offer solutions.

• The UX: A slim and stylish air-conditioning system

We forecast demand for residential air-conditioning systems to grow in fiscal 2005, fueled by an extension of a tax reduction on housing loans, the televisation of the Athens Olympics, and other positive factors.

Residential air-conditioning systems are now required to have a high coefficient of performance (COP) point under the revised Law Concerning the Rational Use of Energy that went into effect in October 2003. To further increase our share of the market, we are developing products with superior energy-saving properties and proprietary special features. We are aggressively expanding sales with a focus on two unique products: URURU & SALALA, a driver of increased market share due to its ability to draw moisture from the air outside

to humidify air inside without a water supply, and the UX series of design-led residential room air conditioners with the slimmest profile—15cm—in the industry.

• **Expanding sales of chillers**

Demand for central air-conditioning systems remains anemic, but we outperformed the industry in sales volume growth for chillers. We recorded buoyant sales for our industrial-use Inverter Chiller, designed for factory use, which earned plaudits for its high-precision water-supply temperature control and energy-saving properties attributable to the inverter.

We plan to increase sales of chillers for factory use, as capital investment is now showing recovery momentum. Our carefully tailored solutions for energy-saving and other applications are based on a product mix that matches diversified customer needs. Our systems similar to the Inverter Chiller and heat-recovery-capable systems include a system that slashes energy costs through a process of extracting low-temperature water during heat recovery as well as the High-Efficiency Air-Cooled Chiller system, which boasts the highest efficiency level in the industry.

The Global Air-Conditioning Market

Expanding business in Europe and China

In fiscal 2004, sustained stable growth trends in the global economy fueled a steady increase in demand for air-conditioning equipment. Demand growth was notable in China, which continues to grow strongly, and Europe, where 2003 summer temperatures reached record high levels. We forecast air-conditioning demand to keep expanding worldwide.

In such an environment, we were able to expand our share of the global air-conditioning market, increasing revenues and income in every field of the household and commercial-use sectors, and sustaining growth momentum in earnings, particularly in Europe and China.

We purchased two sales agencies in the United Kingdom in 2003—following similar acquisitions in Italy in 2002—and aim to further strengthen our marketing capability in Europe by converting these companies into wholly owned subsidiaries. In addition, we took advantage of the opportunities presented by ramped-up air-conditioning demand in Europe along with the June 2003 heat wave and continued to enjoy robust sales into the low season beginning in autumn. In China, we were able to increase sales of multiple air-conditioning systems for office buildings and commercial air-conditioning systems. In Australia, very hot weather in the latter part of the summer helped us greatly expand sales despite the negative impact of the termination of a tax reduction for housing construction.

New production bases in the Czech Republic and China

To further expand our overseas air-conditioner business, we are rapidly setting up distribution networks. In addition to building a second air-conditioning equipment production base in Europe, in the Czech Republic, and thereby expanding our European presence, we built new manufacturing facilities in China for room and commercial air conditioners, large air-conditioning systems, and compressors.

Recent global expansion by South Korea– and China–based air-conditioning manufacturers, particularly in the market for small residential units, has resulted in a further intensification of price competition. This, together with the striking upward trend in global raw material prices since the previous fiscal year, has made it imperative for us to respond effectively to price competition. By establishing production networks in all our major air-conditioning markets, we aim to better position ourselves to deal quickly and flexibly with changes in demand while reducing exchange-rate fluctuation risk.

We are taking every measure to strengthen competitiveness by continuously launching new products while promoting the existing main products sold in all our markets.

Further strengthening marketing capability

In Europe and China, our priority regions, as well as Australia, we are enhancing marketing frameworks by further strengthening sales networks and staff effectiveness. We are also positioning our marketing operations to respond more accurately to demand growth in the ASEAN region, which has shown striking economic recovery momentum.

In addition, we are increasing earnings through an integrated approach to our air-conditioning operations, with solutions businesses tailored to customer needs and followed up by maintenance and other services.

We are expanding sales through tie-ups with other companies (Matsushita Electric Industrial Co., Ltd., and the Trane Company, for example) and deepening synergies through closer relationships.

Chemicals

In fiscal 2004, sales in the Chemicals Division amounted to ¥88.5 billion, a 5.9% increase compared with the previous term. The division accounted for approximately 14% of consolidated net sales. Operating income decreased 14.9% compared with the previous term, to ¥8.2 billion, and the ratio of operating income to segment sales was 9.2%.

Sales of fluoropolymers did not exceed previous-year levels. Although demand showed signs of recovering momentum with regard to semiconductor manufacturers and expanded in Europe and China, a pickup in demand from LAN cable manufacturers in the United States was delayed.

In contrast, chemical products enjoyed increased sales on the back of another year of robust demand in the United States and Asia for oil- and water-repellent products as well as sharp growth in demand for high-performance fluorine materials in the IT sector.

Sales of fluorocarbon gas expanded in Japan and elsewhere in Asia amid continued robust demand following the switch from environmentally suspect refrigerants to R-410A and other alternative substances.

Sales growth in IT/telecommunications and digital consumer electronics

Overall, we expect the business environment in fiscal 2005 to turn positive, on the back of further growth in the U.S. economy ahead of the presidential election, recovery momentum driven by the digital consumer electronics market in Japan, and Chinese demand.

In overseas markets, led by the United States, demand for chemical products is likely to grow at a rapid pace amid a bullish market for semiconductor-manufacturing equipment—a driver of fluoropolymer demand—reflecting buoyant production in that industry.

In the Japanese market, we expect to see strong production among general machinery makers and automakers, the principal customers for fluoropolymers and chemical products.

We see strong potential for stable, long-term growth in fluorine materials, used in a wide range of leading industries such as IT/telecommunications and digital consumer electronics.

Early establishment of a high-profitability operating structure

We are committed to realizing the early establishment of a high-profitability operating structure in our chemical

businesses through rigorous overseas expansion and development of new applications for our products.

Daikin America, Inc., is expanding sales of a full range of fluorochemical products, including FEP resins, general-purpose resins, oil- and water-repellent products, and fluoroestomers, and developing new applications for the U.S. fluorochemical market—the world's largest. The subsidiary has the goal of becoming No. 2 in this market. While further strengthening marketing and technical support structures, it is simultaneously accelerating its strategy of collaborative tie-ups and alliances with molded- and processed-product vendors.

In China, operations began at Daikin Fluorochemicals (China) Co., Ltd.'s plant in Changshu, Jiangsu Province, in autumn 2003. Building on the lead this plant gives us, we are nurturing and developing local markets for such products as FEP resin for LAN cable in the rapidly growing IT/telecommunications sector, fluoroestomer for autoparts (as automakers worldwide converge on China), and fluoropolymers for the high-growth field of semiconductor products, keeping pace with Japanese, U.S., and European manufacturers as they enter the Chinese market.

In Europe, Daikin Chemical France S.A. began fluoroestomer production at the beginning of 2004. This company's operations, along with the pre-compound fluoroelastomer production of Daikin Chemical Netherlands N.V. and the fluorochemical-product marketing activities of Daikin Chemical Europe GmbH, are enabling the creation of a unified network for fluoroelastomer operations in Europe from production to marketing.

Developing new applications

Based in the United States, a crucible for the development of new applications, Daikin Institute of Advanced Chemistry and Technology, Inc. (DAI-ACT), is expanding its global R&D network. In its U.S. operations, the company also pursues development related to meeting very strict local environmental regulations and is expected to commercialize new environment-friendly fluorochemical products at an early date.

In Japan, Daikin uses tie-ups and collaborative arrangements, with leading companies in all fields as well as universities and other institutes, to speed its development of new technologies. We continue to focus our research on the latest technological trends in the semiconductor industry and on environmental regulations affecting the automotive industry. In addition, we are developing applications that move away from pure fluorine to fluorine materials and compounds with other materials.

Some recent results of our R&D activities include the successful commercialization of the fluorine liquid agent ZIELEX, which enables the miniaturization needed for the development of next-generation semiconductor LSIs, and the cleaning gas COF_2, which contributes to semiconductor manufacturers' efforts to combat global warming.

Rigorous pursuit of safe operation

In January 2004, an accident occurred in the tetrafluoroethylene manufacturing process of our Kashima plant. We are making a Groupwide effort to prevent the repetition of such an incident by strengthening safety procedures at plants and through exhaustive equipment safety reviews.

We believe we can contribute to society by strengthening our frameworks for environment-friendly production and stable, high-quality global product supply and development through a renewed commitment to our basic principle that safe operation is paramount. The affected facilities at Kashima will take approximately one year to bring back onstream. Until then, supplies of fluoropolymers for tetrafluoroethylene will be handled by the Yodogawa plant, Daikin America, and our Changshu plant in China.

Oil Hydraulics

In fiscal 2004, sales in the Oil Hydraulics Division amounted to ¥17.9 billion, a 16.8% increase compared with the previous term.

Shipments of oil hydraulics equipment increased 20% compared with the previous term, to approximately ¥240 billion, due mainly to recovery in private-sector capital investment in Japan and buoyant demand in the Asian region, especially China.

In oil hydraulics equipment for industrial machinery, we developed new products and applications, including high-efficiency air-conditioning motors with embedded rare earth magnets and high-precision, high-sensitivity IPM motors. Our oil hydraulics systems based on IPM motor drives outclass conventional oil hydraulics systems in terms of energy-saving and functionality, and our High-Pressure Super Unit line of hydraulic equipment, which commercializes this technology, has won plaudits from the market. In fiscal 2004, sales of these distinctive products surpassed year-earlier levels by approximately 20%, reflecting the success of a marketing offensive and recovery in demand from machine-tool manufacturers, a key customer base.

In oil hydraulics equipment for construction machinery, Daikin has embarked on a global collaborative strategy, establishing joint ventures in 2001 with Sauer-Danfoss, Inc., that target substantial market shares in the promising Asian region while working to expand applications for hydrostatic transmissions. In 2005, we aim to become No. 1 in the Japanese and other Asian markets for construction machinery oil hydraulics equipment.

Demand for our multilevel car-parking systems is being driven by the trend toward apartment towers, mainly in the Tokyo and Kansai areas. We aim to continue creating distinctive systems that can accommodate ever more vehicles in limited space using proprietary technologies that facilitate less noise and low vibration, higher operating speeds, and greater energy conservation. In fiscal 2004, sales were approximately 15% higher than in the previous term. Going forward, we will develop the multilevel car-parking systems business into a driver of profitability by expanding into the Chinese market, backed by our unparalleled servicing capability.

Lubricant sales exceeded year-earlier levels, on expanded sales to steel- and press-machinery manufacturers, both key customer segments, and recovery in private-sector capital investment.

We expect shipments of oil hydraulics equipment to rise 8%, to ¥262.0 billion, in fiscal 2005. However, we anticipate that operating conditions in the Japanese oil hydraulics equipment sector will remain severe over the medium-to-long term, due to the accelerated overseas expansion of manufacturers producing the machinery in which Daikin units are installed and competition from companies producing electrically driven, air pressure driven, and other such systems using different technologies.

With regard to future growth, we plan to develop new hybrid products through the fusion of our conventional hydraulics technologies with those using electrical and pneumatic platforms, shifting the focal point of the oil hydraulics business from power control devices to power motion control devices that regulate power and location.

Defense

Sales in defense-related operations in fiscal 2004 decreased 7.7%, to ¥18.2 billion, compared with the previous term.

In private-sector business, which we are working to make a part of this division's operations, we stepped up sales of our home-use oxygen therapy equipment. On the other hand, overall division revenues were significantly affected by reduced orders for ammunition due to defense budget cutbacks.

Despite the harsh budgetary environment in defense-related operations, we aim to increase orders for practice ammunition for tank guns, which went into mass production in 2001, as well as newly developed armor-piercing shells for tanks and rifle grenades. We also expect changes in the equipment needs of the Japanese Self-Defense Force due to a revision of the country's general defense principles, but we will continue to aggressively develop new kinds of ammunition, as the importance of medium-bore products is increasing.

In home-use oxygen therapy equipment, operating conditions have grown more difficult due to an increase in the proportion of medical expenses shouldered by the patient as a result of health insurance reforms as well as a reduction in state subsidies for medical diagnosis and treatment services. Looking ahead, we plan to bolster sales of fiber-reinforced plastic composite vessels and respiratory adjusters, in anticipation of recovery in these markets. We also aim to expand sales and market share for oxygen-concentration vessels.

Electronics

We had a second year of profit in this division, which we are transforming from a sales-agency-based operation into a solutions-provider-type business.

In the engineering field, we aim to provide optimized IT environments tailored to customer needs across the full spectrum of corporate business models by harnessing the expansion of the market through our Digital Consumer Electronics Development Department. "IT-optimized" solutions mean making more effective use of IT resources shared across divisions and projects and optimizing IT investment.

In CAD/CAM/CAE systems, Neckar drastically reduces the expense and time needed for upgrading CAD software.

Our visual R&D solutions deliver work flow and data management systems. Looking beyond analytical and design sections, we aim to expand sales to production technology, quality control, and other departments.

We are building the above-mentioned products into pillars of our solutions-type business model.

In digital content, we forecast a pickup in high-definition format and data transmission activities at local base stations in Japan in anticipation of the full-fledged launch of digital terrestrial broadcasting. We aim to fully develop proposals for broadcasters by adding 3-D features into our Sportcorder display system that will enable viewers to access scores from sports programs and image profiles of athletes, as well as through virtual broadcasting, subtitle writing, and other services.