

Briefing on Financial Results of the 2nd Quarter Ending March 31, 2019
“Management Situation and Policy for the Future”
President & CEO Masanori Togawa

○Opening Remarks

I am Masanori Togawa, and I would like to express my deep appreciation to you for taking time out today to attend this briefing and respectfully ask for your kind consideration and understanding for the operations and management of Daikin.

○Second Quarter Financial Results for Fiscal Year 2018

With regard to the second quarter financial results, uncertainty has grown for the macro economy in light of additional U.S. custom duties, an economic slowdown in the China market, yuan depreciation, and currency depreciation in emerging markets, and the severity of the surrounding market environment has increased further. Nevertheless, in addition to expanding sales in each region and business, Daikin achieved a record high in sales for the second consecutive term and in profit for the sixth consecutive term by implementing selling price measures and promoting total cost reductions.

○Recognition of Surrounding Market Environment

From the second half to the next fiscal year, the surrounding market environment is expected to be extremely severe with demand for the global economy said to reach a peak next year.

That type of challenging environment will require us to not only promote key strategies for achieving Fusion 20 but also to anticipate market changes, take the initiative in each region, and respond as rapidly and flexibly as possible. Today I would like to talk about the following: 1) Maintaining high profitability

in the China air conditioning business; 2) Improving profitability for the Americas; 3) Enacting measures to absorb increased costs such as the price hike for raw materials, additional customs duties, and foreign exchange; 4) Developing the energy solutions business as an important theme added to the Fusion 20 Latter-Half Three-Year Plan; and 5) Increasing revenue in the Chemicals business.

○ Approach to Concerns for the Second Half

1) Maintaining high profitability in the China AC business

First, in regard to China, the real growth rate has continued to decline since the start of this year (Jan-March 6.8%, April-June 6.7%, July-Sept 6.5%), and an economic slowdown has become apparent. The market environment of the air conditioning business has undergone a rapid change, marked by a decline in demand for residential-use multi-split air conditioners in urban areas due to government restrictions on new home construction and promotion of low-cost housing. Severity is expected to increase for the business environment, including less willingness among Chinese companies to make capital investments for equipment due to the China-U.S. trade friction. However, Daikin will work to expand sales by focusing on the relatively brisk personal spending.

Specifically, concerning our mainstay product of residential-use multi-split air conditioners, new demand has fallen in large cities as I mentioned earlier, but demand accompanying replacement demand and renovation of existing houses has increased. Here Daikin is making efforts to utilize its overwhelming market stock. For example, we are obtaining inquiry information for replacement projects from collaborations with interior design contractors and accelerating development and launch of indoor units that can be installed even to rooms without suspended ceilings, something that is unique to renewal properties. On the other hand, construction of new housing is

increasing for second and third tier cities (including Nanking, Wuhan, Chongqing, and Chengdu) in inland and midwestern regional cities, and there is an increase in buyers of residential multi-split air conditioners due to rising incomes. In these regions we will be developing PROSHOPs at a rapid pace.

For commercial use, we have launched intelligent VRV systems that link to customers via Internet connection ahead of our competitors and have begun to provide after sales services such as centralized control, remote monitoring and failure detection. In the future, we will be providing new services that utilize data from these.

Increasing air quality is also an important social issue in China. In addition to conventional temperature and humidity control and air ventilation, we are accelerating system development that interlocks a PM2.5 detection sensor with air conditioners. Since entering the China market, Daikin has constantly been at the forefront of air conditioning history in China by creating new air-conditioning markets, such as deploying VRV system to mobile base stations and launching ceiling-mounted cassette type indoor units and residential-use multi-split air conditioners. In addition to its rapid adoption of the Internet, many air-related issues exist in China, and it continues to be region where there are many opportunities for our company to produce differentiated products. We intend to expand our differentiated products as air solutions and continue to maintain high profitability in the future.

2) Improving profitability for the Americas

Next is the Americas. In order to increase revenue, it is essential that we strengthen sales and marketing capabilities, accelerate product development, and improve manufacture.

As for strengthening the sales network for residential unitary, we are enlarging company-owned distributors having excellent dealers for volume zone. Concerning high-end, we are strategically promoting exclusive

dealerships with technological and proposal-making capabilities for Daikin Comfort Professional Dealers, which handle products that have high environmental performance such as VRV systems and inverter unitary. Our plan is to increase the number of shops in 2020 to 1,500, which is double the current number.

Furthermore, we are developing products unmatched by other companies and corresponding to the market needs in the Americas. One example would be the launch in October of inverter-equipped SEER16 products, an industry first in residential unitary, as part of the synergy between Daikin and Goodman. Currently, residential unitary for volume zone is SEER14. While inverter-equipped products are developed for SEER18 and higher, they are expensive for users, and this hinders widespread adoption. Ahead of competing companies, Daikin will create a new market for inverter-equipped SEER16 products ahead of other companies, accelerate conversion to inverters, and strengthen the Daikin brand.

From the aspect of manufacture, the Goodman new factory starts the final transfer from the Fayetteville Factory with completion scheduled for the end of February. Currently, there are 17 production lines that have been established, and a total of 22 lines are planned when transfer is complete. This year we anticipate a \$50 million increase in profitability from improved productivity and cost reductions.

In Applied Systems, we are accelerating a change to a direct sales system so that we can remain connected with customers. We also continue acquisition of contractors and service companies as well as capital participation in dealerships. Last year we acquired three companies, and this fiscal year we have already entered into several acquisition negotiations. Furthermore, centered on the Technology and Innovation Center, we will accelerate development of solutions products in addition to equipment sales while also working in cooperation with the Applied Development Center and

Daikin Open Innovation Lab.

3) Enacting measures to absorb increased costs such as the price hike for raw materials, additional customs duties, and foreign exchange

Next, I would like to speak a little concerning cost reduction measures. To absorb the factors of cost increases, we fortified the business structure and undertook drastic cost reductions, in addition to further strengthening the sales and marketing capabilities and developing differentiated products in each global region, in order to further enhance profitability.

Currently, we are striving to maximize cost reductions by focusing on the four themes of “material replacement,” “standardization of key components,” “greater in-house production,” and “integration with suppliers.” For example, in “material replacement,” because copper is highly susceptible to market conditions, we have been promoting a conversion to aluminum and stainless steel, which have fewer price fluctuations. For “standardization of key components,” we are unifying specifications such as compressors, which occupy a higher percentage of production costs, and printed circuit boards for electrical equipment while also working to streamline models. For “integration with suppliers,” we aim for reciprocal cost benefits by having members of the Daikin procurement and production departments visit suppliers, passing on *monozukuri* know-how, and working together to reduce costs for manufacturing parts. Through these efforts, we hope to obtain further reductions in total cost on a global scale.

Furthermore, the impact to the Daikin Group for strengthening of U.S. custom duties is calculated to be approximately 7 billion yen in operating profit and includes the List 3 tariffs that were invoked on September 24. Goodman, in particular, has many imports from China such as compressors, motors, and electronic components, in addition to raw materials, and has been significantly affected by cost increases. Daikin has already taken measures to absorb the

total amount of these increases through cost control measures and pass-through pricing. For example, regarding Daikin compressors that are imported from China and Suzhou Factory, we are taking measures early by examining transfer to production bases in Asia (Thailand/Japan).

4) Developing the energy solutions business

For the Fusion 20 priority strategic theme of developing an energy solutions business, we aim to provide services to the air conditioning value chain overall as well as solutions to customers throughout the life cycle of the air conditioning equipment.

For example, architectural firms calculate air conditioning load for the entire building at the request of the building owner at the time of introducing equipment, and the optimum air conditioning equipment is selected. Daikin has always responded to customer needs by providing high-efficiency equipment that leads the industry, but we are now aiming to further improve work efficiency for architectural firms and building owners by providing tools that make equipment designs, such as automated quotations and BIM (Building Information Modeling), more efficient.

After air conditioning equipment is selected, instrument system engineering and installation and trial operation adjustments for air conditioning and peripheral equipment are performed to ensure products operate as designed. Work in the past required significant manpower, labor, and time since details differed for each project. Utilizing our strengths as a comprehensive air conditioner manufacturer having a wide variety of air conditioning equipment, we will strive for quality improvements in installation and trial operation by providing solutions that package air conditioner equipment and instrument systems.

5) Increasing revenue in the Chemicals business

Finally, concerning the Chemicals business, we see the semiconductor market leveling off temporarily, but we anticipate the vigor in IoT/AI related demand to continue in the mid-to-long term. For further business expansion, we decided to double the current production ability in fiscal year 2021 by investing 10 billion yen to increase domestic production capacity for fluorochemical products to the semiconductor industry. We also decided in April 2019 to establish an R&D base for fluoropolymers in the suburbs of Dusseldorf, Germany, which is a concentrated area for the automobile industry in Europe. By taking measures in this way, we are accelerating application development.

This concludes my remarks. Because the officers from each division have come, I would now like to ask for your questions.