



Daikin Industries, Ltd.

Q1 Financial Results Briefing for the Fiscal Year Ending March 2024

August 8, 2023

Event Summary

[Company Name]	Daikin Industries, Ltd.	
[Company ID]	6367-QCODE	
[Event Language]	JPN	
[Event Type]	Earnings Announcement	
[Event Name]	Q1 Financial Results Briefing for the Fiscal Year Ending March 2024	
[Fiscal Period]	FY2024 Q1	
[Date]	August 8, 2023	
[Number of Pages]	26	
[Time]	16:00 – 16:55 (Total: 55 minutes, Presentation: 13 minutes, Q&A: 42 minutes)	
[Venue]	Webcast	
[Number of Speakers]	2	
	Kota Miyazumi	Executive Officer, Responsible for Corporate Communication
	Kazuhiro Matoba	Head of Investor Relations Management Group, Corporate Communication Office
[Analyst Names]*	Tsubasa Sasaki	Mitsubishi UFJ Morgan Stanley Securities
	Yuichiro Isayama	Goldman Sachs
	Yoshinao Ibara	Morgan Stanley MUFG Securities
	Graeme McDonald	Citigroup Global Markets
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*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A or whose questions were read by moderator/company representatives.

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Presentation

Sakamoto: We will now begin the presentation of Daikin Industries, Ltd.'s financial results for Q1 of the fiscal year ending March 31, 2024. Thank you for taking time out of your busy schedule to join us today.

The explanatory material is available on the Company's website under investor relations.

Today's two speakers are Kota Miyazumi, Executive Officer, Responsible for Corporate Communication, and Kazuhiro Matoba, Head of Investor Relations Management Group, Corporate Communication Office.

I, Sakamoto, of the Investor Relations Management Group, will be the facilitator. Thank you for your cooperation.

Mr. Miyazumi will begin today's session with overview of the financial results, followed by a question-and-answer session. The end time is scheduled for 17:00.

Now, Executive Officer Miyazumi, please.

Miyazumi: My name is Miyazumi. Thank you for taking time out of your busy schedule to attend today's financial results briefing.

I will explain the Q1 financial results in accordance with the document.

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Summary of Financial Results

Both Net sales and operating profit rose year over year. Even after excluding the effects of the foreign exchange rates, revenue and profits increased on a real basis, and Daikin established new record highs in financial results.

While stagnant demand in all regions made the business environment challenging, we worked to increase profitability by strengthening proposals for products and services related to carbon neutrality and energy savings, expanding the Solutions business, implementing strategic selling price measures, and reducing variable and fixed costs.

- ✓ Air Conditioning business: Sales expanded in China and Asia. Even in Japan, the Americas, and Europe, we worked to identify dynamic markets and expand sales of differentiated products and services. This led to higher revenue and profits.
- ✓ Chemicals business: Despite the significant impact of demand slowdown, efforts were made to expand sales in the semiconductor market, and this enabled us to maintain strong growth in profits.

Although an even more severe business environment is expected from the second quarter onwards, we will accelerate initiatives for key themes while also reinforcing and expanding measures in response to changes as we aim to achieve the annual plan (Net sales of 4.1 trillion yen and operating profit of 400 billion yen).

(billion yen)	Q1 Results		
	FY2022	FY2023	Y/Y
Net Sales	967.8	1,094.7	113%
Operating Profit <small>(Percentage of profit to net sales)</small>	107.9 (11.1%)	117.9 (10.8%)	109%
Ordinary Profit <small>(Percentage of profit to net sales)</small>	109.5 (11.3%)	114.8 (10.5%)	105%
Profit Attributable to Owners of Parent <small>(Percentage of profit to net sales)</small>	70.6 (7.3%)	80.3 (7.3%)	114%
USD/JPY	¥130	¥137	
EUR/JPY	¥138	¥149	
RMB/JPY	¥19.6	¥19.6	

FX Effect (Y/Y)

Net Sales	+36.0 billion yen
Operating Profit	+3.0 billion yen

Y/Y Results Excluding FX Effect

Net Sales	109%
Operating Profit	106%

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See page two. This is a summary of the Q1 financial results.

Both net sales and operating profit exceeded those of the previous year on a real basis, excluding the effect of foreign exchange rates, and the Daikin achieved its highest-ever performance.

The business environment in Q1 was very challenging, with sluggish demand in various regions, including the residential market in the Americas and the heat pump heating market in Europe. However, we were able to achieve our internal plan for the Q1 results by strengthening our profitability by strengthening proposals for products and services that contribute to carbon neutrality and energy conservation, expanding our solutions business, thoroughly implementing strategic selling price measures, and reducing cost of sales and fixed costs.

Foreign exchange rates were JPY 137 against the US dollar, JPY 149 against the euro, and JPY 19.6 against the Chinese yuan. Foreign exchange effects versus the previous year had a positive impact of JPY 36 billion on net sales and JPY 3 billion on operating profit.

We expect demand recovery to be delayed in Q2 and beyond, and the severe business environment is expected to continue. However, Daikin will aim to achieve its annual plan by accelerating efforts on priority themes and strengthening and expanding measures in response to changes in the environment.

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Financial Results by Segments

(billion yen)		Q1 Results		
		FY2022	FY2023	Y/Y
Total	Net Sales	967.8	1,094.7	113%
	Operating Profit <small>(Percentage of profit to net sales)</small>	107.9 (11.1%)	117.9 (10.8%)	109%
Air Conditioning	Net Sales	889.3	1,011.8	114%
	Operating Profit <small>(Percentage of profit to net sales)</small>	94.5 (10.6%)	103.7 (10.2%)	110%
Chemicals	Net Sales	63.9	60.9	95%
	Operating Profit <small>(Percentage of profit to net sales)</small>	12.5 (19.6%)	12.8 (21.0%)	102%
Others	Net Sales	14.6	22.0	151%
	Operating Profit <small>(Percentage of profit to net sales)</small>	0.9 (5.9%)	1.4 (6.4%)	165%

*Air-Conditioning business includes filter, refrigerator and freezer businesses.

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See page three. These are the results by business segment.

In the air conditioning business, net sales and operating profit increased due to expanded sales in China and Asia, as well as efforts to expand sales of differentiated products and services in Japan, the Americas, and Europe by identifying relatively strong markets.

The chemicals business maintained its profit growth trend by striving for sales to the semiconductor market, despite being severely affected by the slowdown in demand.

Foreign exchange rates had a positive impact of JPY 34.1 billion on net sales and JPY 1.9 billion on operating profit in the air conditioning business, and a positive impact of JPY 1.9 billion on net sales and JPY 1.1 billion on operating profit in the chemicals business.

The status of each business and the regional status of the air conditioning business will be explained later.

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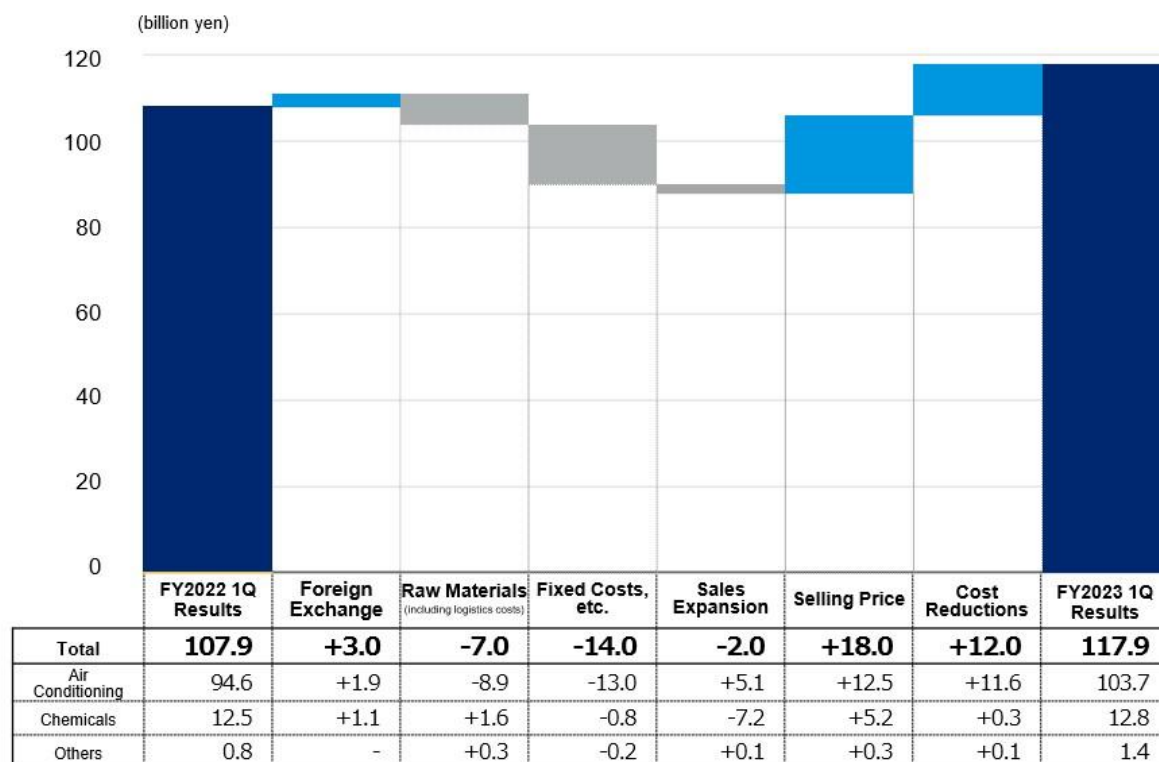
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Breakdown of Changes in Operating Profit - Year-on-Year Results



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See page four. This is an analysis of YoY changes in operating profit.

Although Daikin was significantly affected by sluggish demand, it compensated for the negative impact by implementing selling price measures, thorough cost reductions, and striving for efficient management of fixed costs by curbing hiring and reducing expenses.

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Net Sales by Region – Air Conditioning Business

* Includes refrigerator, freezer and filter businesses

*Percentage expresses year on year comparison

(billion yen)	FY2019 Q1		FY2020 Q1		FY2021 Q1		FY2022 Q1		FY2023 Q1	
Japan	112%	127.4	91%	116.3	117%	136.4	97%	132.3	106%	139.8
Europe	107%	93.8	93%	87.4	157%	137.0	112%	153.8	114%	174.9
China	96%	112.4	79%	89.1	146%	130.0	95%	123.3	118%	146.0
Americas	107%	180.7	92%	166.1	133%	221.6	147%	325.1	116%	378.1
Asia	107%	82.8	64%	53.2	138%	73.5	143%	105.0	112%	117.4
Oceania	92%	16.9	97%	16.3	138%	22.5	129%	29.1	100%	29.0
Middle East	91%	9.7	75%	7.2	186%	13.4	136%	18.2	130%	23.6
Africa	82%	1.6	71%	1.1	115%	1.3	194%	2.5	117%	2.9
Total	105%	625.3	86%	536.7	137%	735.6	121%	889.3	114%	1,011.8
Overseas Sales ratio	80%		78%		81%		85%		86%	
USD/JPY	¥110		¥108		¥110		¥130		¥137	
EUR/JPY	¥123		¥118		¥132		¥138		¥149	
RMB/JPY	¥16.1		¥15.2		¥17.0		¥19.6		¥19.6	

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See page five.

Sales in the air conditioning business increased YoY in all major regions. Excluding the effect of foreign exchange rates, YoY sales in real terms were 105% in Europe, 119% in China, 110% in the Americas, and 109% in Asia.

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Net Sales by Region – Chemicals Business

*Percentage expresses year on year comparison

	FY2019 Q1		FY2020 Q1		FY2021 Q1		FY2022 Q1		FY2023 Q1	
(billion yen)										
Japan	103%	12.6	71%	9.0	147%	13.2	128%	17.0	94%	15.9
Americas	95%	10.8	71%	7.7	135%	10.3	131%	13.6	78%	10.7
China	90%	8.8	105%	9.3	133%	12.3	123%	15.1	86%	13.0
Asia	87%	5.3	88%	4.7	127%	6.0	132%	7.8	99%	7.7
Europe	63%	6.4	76%	4.8	173%	8.4	121%	10.1	132%	13.4
Others	81%	0.3	40%	0.1	179%	0.2	139%	0.3	55%	0.2
Total	88%	44.3	80%	35.6	142%	50.4	127%	63.9	95%	60.9
Overseas Net Sales ratio		71%		75%		74%		73%		74%
USD/JPY		¥110		¥108		¥110		¥130		¥137
EUR/JPY		¥123		¥118		¥132		¥138		¥149
RMB/JPY		¥16.1		¥15.2		¥17.0		¥19.6		¥19.6

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See page six. This chart shows sales by region for the chemicals business.

Excluding foreign exchange effects, real YoY sales were 74% in the Americas, 86% in China, and 122% in Europe.

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Business and Regional Overview – Air Conditioning

Japan

Both Residential and Commercial saw sluggish demand due to a delay in economic recovery and decline in consumer confidence caused by soaring prices. In addition to expanding sales of differentiated products, we incorporated the effects of selling price measures, and net sales exceeded the previous year.

- ✓ Residential: Sales improved for differentiated products such as **Urusara X**. We also capitalized on the growing need for energy savings due to higher electricity bills to increase the sales ratio of medium- to high-end products.
- ✓ Commercial: Sales expanded for **FIVE STAR ZEAS** and **machi Multi** because of their high energy savings and ease of workability. We also focused on system proposals combining such options as the **UV Stream Disinfection Unit**, which adds air cleaning and disinfection functions.

Y/Y change (Volume basis)		Q1 Results
Residential	Market	95%
	Daikin	90%
Commercial	Market	100%
	Daikin	96%
Applied	Market	114%
	Daikin	115%

*Applied is based on total net sales.

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See page seven. From here, I will provide a regional overview of the air conditioning business.

First is Japan.

Demand for both residential and commercial use was sluggish due to a decline in consumer confidence caused by soaring prices and a delayed economic recovery.

Although our market share was down in both the residential and commercial sectors, sales increased over the previous year as we expanded sales of high value-added and differentiated products, as well as implemented thorough sales price measures.

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Business and Regional Overview – Air Conditioning

Americas

Sluggish housing demand and distribution inventory adjustments led to a severe market environment. In addition to strengthening sales capabilities and expanding sales of environmentally conscious products, we also capitalized on the effect of selling price measures, and net sales exceeded the previous year.

- ✓ Ducted Unitary for Houses: Although sales volume increased significantly for our environmental premium product **FIT**, sales fell year on year from stagnant growth in industry demand due to prolonged inflation, rising interest rates for home loans, and efforts to curb distribution inventory.
- ✓ Ductless: In the Commercial market where demand is relatively strong, we utilized our enhanced sales network to increase VRV system sales. For RA/SKY, sales fell below the previous fiscal year due to efforts to curb distribution inventory.
- ✓ Applied: In addition to expanding equipment such as air handling units and chillers, net sales also increased for the After Sales Service business, leading to results that greatly exceeded the previous fiscal year.

Y/Y change (Volume basis)		Q1 Results
Ducted unitary for houses		73%
Ductless	RA/SKY	70%
	VRV	101%
Applied		154%

*Applied is based on total net sales in local currency.

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See page eight.

In the Americas' air conditioning business, net sales increased YoY due to efforts to strengthen sales capabilities and expand sales of environmentally friendly products, as well as the effect of selling prices, amid a severe business environment characterized by stagnant housing demand and distribution inventory adjustments.

In the business of ducted unitary for houses, Daikin focused on sales of the environmental premium product FIT amid stagnant demand due to prolonged inflation and rising housing interest rates, as well as the significant impact of restrained distribution inventories.

As for ductless air conditioning, we expanded sales of VRV in the commercial market, where demand is relatively strong.

Sales of Daikin North America were 102% of the previous year's level on a local currency basis. Although sales of mainstay ducted unitary for houses declined, we secured an increase in revenue, thanks to an improved sales mix through expanded sales of environmental premium products, the implementation of selling price measures, and the effect of new consolidation through acquisitions.

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Business and Regional Overview – Air Conditioning

China

Once the zero-corona policy was lifted, all manufacturing and sales activities began operating at full speed for the first time in 3 years. While the recovery of the real estate market has lagged, sales for Residential, Commercial, and Applied products have significantly expanded, and net sales exceeded the previous year. Operating profit maintained a high level due to greater sales of high value-added products and cost reduction initiatives.

- ✓ Residential market: In addition to user-direct retail sales, our unique online sales activities, such as live broadcasts using showrooms, web advertising, and SNS, contributed to sales growth. To meet customer needs, we launched the residential multi-split air conditioner series **Daikin CARE Central Air System**, which combines air conditioning, ventilation, heat pump floor heating, and Solution services that include energy-saving and air quality proposals.
- ✓ Commercial market: Deliveries resumed to projects that had been suspended because of the zero-corona policy, and sales grew. New products with high energy-saving performance were launched in response to the market growth for government projects, factories, green buildings, etc., from the promotion of carbon neutrality policies.
- ✓ Applied market: In addition to investing in growth fields related to infrastructure and semiconductors, we strengthened our maintenance and servicing business.

Y/Y change (Local currency basis)	Q1 Results
Residential	124%
Commercial	128%
Applied	107%

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See page nine.

In the Chinese air conditioning business, sales were significantly higher than in the previous year as production and sales activities were fully deployed for the first time in three years following the lifting of the zero-COVID policy. Although the recovery of the real estate market has been slow, operating profit has remained at a high level due to efforts to expand sales of high value-added products, cost reductions, and fixed costs reductions.

Sales of residential multi-split air conditioners were 125% of the previous year's level. While this is partly a reaction to last year's Shanghai lockdown, it compares favorably to Q1 of FY2021, which was a strong quarter.

In addition to promoting user-direct retail sales and online-based sales activities, we introduced a new series of products to the market that combines solution services, such as energy-saving and air quality improvement proposals, to meet customer needs.

In the commercial market, we captured growing renewal demand on the back of the promotion of carbon neutral policies.

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Business and Regional Overview – Air Conditioning

Europe, Middle East, and Africa

The economic slowdown resulting from the ongoing tight monetary policies enacted to reign in persistently high inflation made the business environment challenging. Whereas demand for heat pump heating hit a temporary lull, sales expanded in Commercial and Applied due to products having appeal from an environmental and energy-saving perspective, and overall regional net sales exceeded the previous fiscal year.

- ✓ Residential: While sales increased in countries such as France and Spain due to higher temperatures, other countries were greatly affected by a decline in consumer confidence from the economic slowdown.
- ✓ Commercial: Sales expanded by meticulous ‘spec-in’ activities addressing the energy-saving needs of offices and stores.
- ✓ Heating business: Demand for heat pump water heaters continued expanding in the background of the green deal policies of European governments. However, the first quarter was heavily impacted by lower gas prices and changes to Italy's subsidy system.
- ✓ Applied: Sales expanded due to environmentally conscious products such as R32 compact INV chillers.
- ✓ Freezer and Refrigerator business: Severe business environment continues due to weak supermarket investment.

Y/Y change (Volume basis)		Q1 Results
Residential		87%
Commercial	SKY	104%
	VRV	102%
Heat Pump Heaters		88%
Applied		119%
Refrigerator and Freezer		77%

*Residential, commercial, and heat-pump heaters are only for Europe.

*Applied, Refrigerator and Freezer are based on total net sales in local currency.

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See page 10, the Europe, Middle East, and Africa air conditioning business.

Amid a severe business environment, including an economic slowdown caused by continued monetary tightening due to high inflation and a temporary decline in demand for heat pump heating systems, overall sales in the region exceeded the previous year's level, thanks to increased sales of commercial and applied products with a focus on the environment and energy-saving.

Sales of residential products expanded in France and Spain but were affected by declining consumer confidence due to the economic slowdown.

In the commercial market, we strived to capture renewal demand in service-related markets, such as hotels and restaurants, where demand is strong.

In the Heat pump heating business, demand in Q1 was much more negative than expected, a reversal from the previous quarter, due to lower gas prices and changes in the Italian subsidy system.

Although Daikin was also affected by the decline in demand and sales volume decreased, sales increased over the previous year due to the sales expansion of high value-added products and thorough implementation of sales measures.

Daikin believes that this slowdown in demand is temporary. We believe that the trend toward carbon neutrality will remain unchanged over the medium to long term, and that demand for heat pump water heating equipment will continue to grow against the backdrop of Green Deal policies in various countries.

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Business and Regional Overview – Air Conditioning

Asia and Oceania

Despite the difficult business environment that included a slowdown in consumption from inflation and unseasonable weather in India, net sales for the region overall exceeded the previous year due to efforts to develop and support dealers.

- ✓ Residential: Focused on developing new stores, supporting dealers online, and promoting the proliferation of inverters. Rising temperatures acted as a tailwind in expanding sales in Indonesia, Thailand, and other countries. While an unseasonably cool summer resulted in sluggish demand in India, sales increase by utilizing the sales network that has been expanded.
- ✓ Commercial: Through meticulous dealer support, we ensured that recovery demand led to confirmed orders, and sales expanded mainly in India and Thailand.
- ✓ Applied: In addition to expanding equipment sales, we concentrated on the After Sales Service business, such as maintenance and servicing.

■ Year-on-year net sales of main countries (local currency basis)
 Australia: 102% India: 120% Vietnam: 107%
 Malaysia: 103% Indonesia: 123% Thailand: 130%

Y/Y change (Volume basis)		Q1 Results
Residential		104%
Commercial	SKY	108%
	VRV	119%
Applied		151%

*Applied is based on total net sales in local currency.

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See page 11.

For the Asia and Oceania air conditioning business, overall sales in the region exceeded the previous year's level due to efforts to develop and support dealers amid a severe business environment, including sluggish consumption due to unfavorable weather in India and inflation.

For residential use, sales expanded in Indonesia, Thailand, and other countries where weather conditions were favorable, as we focused on developing new outlets, supporting dealers by utilizing online channels, and promoting the spread of inverter machines.

In India, we were affected by the cool summer, but we were able to increase sales by taking advantage of the sales capabilities we have built up over the years, including a network of sales outlets that we have expanded to regional cities.

As for commercial use, we steadily linked the recovering demand to orders and expanded sales mainly in India and Thailand.

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Business and Regional Overview – Chemicals

Net sales decreased year on year as a result of lower demand for semiconductor process materials, automobiles, and fine chemical products.

- ✓ Fluorocarbon Gas
In addition to relatively strong demand, we also incorporated the effect of selling price measures, leading to sales that significantly exceeded the previous year.
- ✓ Polymers and Fluoroelastomers
 - Fluoropolymers: Despite strong sales for semiconductor manufacturing equipment, sales decreased in the information and communication field, including LAN cable, resulting in sales remaining on par with the previous year.
 - Fluoroelastomers: Sales fell below the previous year from stagnant demand in the automotive field.
- ✓ Fine Chemicals, Etc.
Demand for etching agents, anti-smudge surface coating agents, and water and oil repellents declined, leading to sales that fell below the previous fiscal year.

Y/Y change (Net sales basis)	Q1 Results
For all fluorochemical products	95%
Fluorocarbon Gas	151%
Fluoropolymers & Fluoroelastomers	100%
Fine Chemicals, etc.	72%

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See page 12.

In the chemicals business, sales were lower than the previous year due to decreased demand for semiconductor process materials, automobiles, and fine chemicals.

As for fluoropolymers, sales of high-performance materials used in semiconductor manufacturing equipment remained strong, but sales of LAN cables and other products for the information and telecommunications sector declined, resulting in sales at the same level as the previous year.

Fluoroelastomers were significantly affected by the slowdown in the automobile market.

As for fine chemicals, sales of etching gases, anti-smudge surface coating agents, and water and oil repellants declined.

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Business and Regional Overview – Filters

Net sales declined from the impact of withdrawing from low-profit businesses in the United States, and sales declined year on year.

- ✓ Air Filter: Sales of high-performance filters for hospitals, pharmaceuticals, and data centers grew amid steady demand in the United States, Europe, and Asia. In Japan, we expanded sales to the semiconductor market since demand for infectious disease control products has run its course.
- ✓ P&I (※): Efforts were made to improve the business structure, which included shifting resources to the After Sales Service business.

*P&I: commercial-use dust collection systems such as for gas turbines and large-scale plants

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See page 13.

In the filter business, sales of high-performance filters increased in each region, but sales fell below the previous year's level due to the impact of lower sales resulting from the withdrawal from low-profit businesses in the United States.

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Capex, Depreciation and R&D Cost

(billion yen)	FY2022		FY2023	
	Q1 Results	Full-year Results	Q1 Results	Full-year Forecast
Capex	43.9	250.3	79.0	315.0
Depreciation	33.1	142.7	39.2	170.0
R&D Cost	23.2	102.2	30.2	115.0

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See page 14.

The Q1 results for capital expenditures, depreciation, and R&D expenses are as stated.

None of the annual plans have been changed, as investments to increase production capacity for future growth and development, upfront investments in product development and other areas, and investments to strengthen IT and other areas are being executed as planned.

That is all for the explanation. Thank you very much.

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Question & Answer

Sakamoto [M]: We will now have time for questions and answers.

Mr. Sasaki of Mitsubishi UFJ Morgan Stanley Securities, please.

Sasaki [Q]: My name is Sasaki from Mitsubishi UFJ. Thank you.

First, I would like to ask about the breakdown of changes in operating profit. There are some points that I do not understand. As Mr. Miyazumi explained, I believe that in many of the regions, sales of air conditioning have increased YoY on a local currency basis.

However, looking at the sales expansion on page four, the increase in profit in air conditioning is JPY 5.1 billion. Even taking into account the fact that sales expanded in each region, especially in high-margin China, the volume effect of air conditioning was not so great in Q1.

Could you please tell me how to understand that, despite the solid sales growth in each region, the volume effect to operating profit was not so great in Q1? Is there an unrealized profit impact because the inventory has accumulated quite a bit? As Mr. Miyazumi explained, the situation differs from product to product, and some products are not growing, so the volume effect was not large overall?

I would appreciate it if you could explain to us how we can understand the fact that you are not seeing much volume effect for the sales growth.

Miyazumi [A]: Thank you.

You are correct that the volume has not increased. What is common to some extent worldwide is that the so-called stay-home demand has run its course. One of the first things to mention is that demand for housing, durable consumer goods, home appliances including air conditioners, etc., is declining. We are seeing a trend of a reactionary decline from the stay-home demand.

At the same time, on the demand side, the structure of consumption is changing a little, as service consumption is growing due to the lifting of behavioral restrictions after the COVID-19 pandemic. We understand that this is the first major background.

Supply constraints having been resolved to some extent worldwide, but on the other hand, the consumption structure has shifted toward the services side from goods demand. Due to the lack of real demand, goods are not selling, and inventories are accumulating. This also applies to air conditioners.

I think those things have caused the volume to drop a little bit.

Sasaki [Q]: Can I understand that Daikin as a whole did not see much volume effect in Q1 due to the lack of growth in ducted unitary for houses in the US and the lack of growth in heat pump heating?

Miyazumi [A]: Yes.

Let me talk a little bit about quantity and the price effects in the US. In the case of the US, the Q1 sales of ducted unitary for houses were down considerably at 73% of the previous year's level. However, DNA as a whole secured an increase in revenue of 102% on a local currency basis.

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I would like to tell you the breakdown of factors I would like to tell you the breakdown of factors that DNA secured an increase in revenue even though the volume of its mainstay unitary remained at the level of 73%. First of all, volume is approximately 25 percentage points below the previous year's level. This was offset by 3 percentage points in selling price, 20 percentage points in product mix, and 4 percentage points in the effect of new consolidation through M&A, resulting in total sales of 102% YoY.

Also, the high value-added FIT has been growing to some extent in the unitary category. The product mix is improving as the ratio of high value-added products is increasing. In addition, of course, sales channels are expanding a bit. Through these efforts, we managed to secure an increase in revenue.

Sasaki [Q]: Thank you very much.

The second question is related to what you just said. Let me ask about the inventory. Compared to the end of March, inventory levels have expanded considerably.

As you mentioned, the mix is improving, but what do you think about the current situation of inventory buildup in ducted unitary for houses, heat pump heating, and other areas where global demand for air conditioning is sluggish?

Of course, this is a risk, but on the other hand, it is also securing the product. Should the expansion of inventory levels be viewed as a challenge, or can it be sold in Q2 of the demand period? Could you please explain your view on the high inventory levels?

Miyazumi [A]: Regarding inventory, we have basically had a policy of holding a thick inventory since the beginning of the pandemic and the Ukraine issue.

However, with the pandemic ending and the Ukraine issue in a bit of a lull, supply constraints have been removed, and inventories have accumulated considerably. We have some inventory accumulated in the past and some backlogged inventory, so we are beginning to examine the contents of our inventory. However, since the sales volume did not increase, we were unable to eliminate our distribution inventory, and the situation was very difficult during Q1.

As the future recovery of actual demand, we recognize that uncertainty about real demand is increasing worldwide. At the same time, air conditioners are strongly linked to housing as a durable consumer good, which is affected by high mortgage rates due to high interest rates. So, we will now carefully assess whether we can sell enough to clear our inventory.

In this context, the first step is to carefully check and adjust the contents of the inventory on hand.

Sasaki [M]: I understand very well. Thank you very much.

Sakamoto [M]: Thank you very much.

Next, Mr. Isayama of Goldman Sachs, please.

Isayama [Q]: Thank you very much for all your help. This is Isayama of Goldman Sachs.

First, I would also like to ask about the Americas. I think the 20% increase of the product mix is a pretty big impact. How much does this include the impact of FIT? Could you please tell us a little more about the breakdown of the 20% positive impact?

At the same time, the 27% drop in volume seems a bit weak compared to other companies. I would appreciate any additional information on what is going on, e.g., about market share.

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Does Daikin carry more inventory than other companies? I thought that Daikin had been able to handle its inventory due in part to the M&A effect. I wasn't expecting the extent of this steep decline. I would appreciate it if you could explain a little more about each of these.

Matoba [A]: My name is Matoba.

Regarding the volume of unitary in the US, shipments did not proceed as expected due to a slightly high level of distribution inventories, and actual sales were also very weak during the period.

The situation in Q1 of last year was the opposite of the current situation and very good, which resulted in a large YoY decline.

Regarding your first question about the product mix of approximately 20 points, there are three major factors.

The first is a factor in the product sales mix, and the second is the sales channel. In our case, the selling price level of our own wholesale route is relatively high, and sales here were relatively good even with the drop in volume as a whole.

The third is the market. The renewal business for existing homes, where we are relatively strong, is doing relatively well, while the new construction market seems to be experiencing price competition, and our market share has dropped considerably. This resulted in an improved mix.

We believe that the 20-point figure includes about the same amount of each of the three factors I just mentioned.

Isayama [Q]: Thank you very much.

Since it is getting hot again in both the US and Europe, I expect the demand to be sustainable, but Mr. Miyazumi commented that the demand is quite severe. Will Daikin be able to maintain an increase in revenue?

Matoba [A]: Yes. We originally assumed that demand for unitary would be toughest during the period from January to June of this year. In fact, it was as expected or a little tougher than we expected, but we believe the trend is basically as we expected it to be.

Now that housing transactions are recovering a bit, we believe we have managed to get through the toughest months, April through June.

Isayama [Q]: Thank you very much.

Second question. As for Europe, you have also been excited so far about heat pump heaters, so I feel that the decrease has finally happened. Can you break down the sales figures for this as well as for the US business?

I think it is great that you are able to secure 105% in LC growth year-on-year in the entire European business, even if the heat pump heaters and residential are negative. I would appreciate it if you could tell us more about this factor and about the fact that you think the slowdown in demand for heat pump heating is temporary.

Miyazumi [A]: Regarding heat pump heaters in Europe, we saw a very large drop in demand in Q1. This is due to several factors.

As I mentioned earlier, the first is the significant drop in natural gas prices. Due to the Russian problem, natural gas prices peaked last August and are now at about 1/10 of last year's level.

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Also, as I mentioned a little bit, there is a movement in some countries to cut subsidies. This is especially true in Italy and, to a lesser extent in France.

In addition, there is a rush demand for combustion heating boilers. There is a move to accelerate the timing of combustion heating and combustion boiler purchases.

Those factors have led to a slight decline in demand for heat pump water heaters.

Basically, we see this as transitory. An environmental policy called REPowerEU has been promoted throughout Europe. Although cyclical factors, such as the Russian issue, have emerged, we believe that the carbon neutral structure will not change. We intend to strengthen our heat pump heating business, which we have been continuing to do, including the expansion of our plant in Poland.

Heat pump heating volume in Q1 was 88% year-on-year. From this 88% on a volume basis, sales improved by 10 points on a selling price basis, by 8 points due to sales expansion in the high-end zone, and by 6 points due to an increase in the composition ratio in Germany, where the average unit price is higher, to 112% on a sales basis.

Isayama [Q]: Do you think you will be able to maintain revenue growth in Europe?

Miyazumi [A]: Yes, basically, we would like to maintain an increase in revenue during the year.

Isayama [M]: I understand very well. Thank you very much.

Sakamoto [M]: Thank you very much.

Next, Mr. Ibara of Morgan Stanley MUFG Securities, please.

Ibara [Q]: Thank you very much.

The first point is about China. You mentioned earlier that the residential multi-split air conditioners are growing slightly more than it was two years ago. If I do the math, it probably grew by about 2%. As I recall, the April figure for China as a whole, which you presented at the time of the financial results briefing for the previous year, showed a bit more growth than two years ago. Perhaps April was good but slowed down a bit in May and June. I heard comments about the situation in China from other companies that the overall economy is more difficult than expected. I would appreciate your comments on this.

Also, the factors that contributed to the increase and decrease in operating profit a year ago included the negative impact of JPY 18 billion due to the Shanghai lockdown. I don't find the reactionary impact of the negative impact of the Shanghai lockdown this time. Could you please explain how much this has affected operating profit for this year?

Matoba [A]: I would like to give you a monthly overview of the situation in China. April and May were relatively strong, but this was due to a reaction to the Shanghai lockdown, or rather, a reaction to the zero-corona policy, or postponed demand. In June, those things ran their course, and things were back to normal. So, compared to April and May, the trend in June is down.

With respect to the analysis of changes, the impact of the Shanghai lockdown on operating profit was approximately JPY 18 billion last fiscal year. This amount is reflected as a positive impact in the current fiscal year and is included in the sales expansion effect on the item of the analysis of changes. The increase of about JPY 5 billion in the air conditioning business includes this positive JPY 18 billion. Considering this, I would say that, in real terms, the quantity effect was very severe.

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Ibara [Q]: Am I correct in understanding that the JPY 18 billion has been fully returned?

Matoba [A]: Yes, we assume that.

Ibara [Q]: Thank you very much.

The second point is about heat pump heaters. I remember that the story about the loss of Italian subsidies started in January, I believe. I feel that the business was strong until the January to March period but suddenly declined in the April to June period.

I know it is difficult to break down the three influences you just listed, but from Daikin's perspective, which ones were the most significant? Also, you may not have detailed figures, but could you give us a breakdown?

For example, in Italy, there has been a huge drop of 50%, but in Germany, where the subsidy system has not yet been changed, there has been an increase. If it has been affected by gas prices, I think that there has been a slowdown not only in Italy and France, but perhaps in Europe as a whole.

Also, the impact of the selling price is quite significant this time for heat pump heaters and other products. Earlier, Mr. Matoba mentioned a bit about price in his discussion about new construction in the US. Regarding your earlier explanation in Japan, I am also a bit concerned about the price. In some cases, selling prices may move as demand changes. The pricing has been maintained because the volume has always been strong.

Not only for heat pump heaters in Europe, but for Daikin, can you tell us if there are any markets where the situation has changed a bit and competitors have emerged to compete by lowering prices?

Matoba [A]: Overall, price increases are proceeding as planned despite the difficult demand. In general, sales prices are higher for differentiated products and high-functionality products, and sales are relatively strong in areas where products are competitive. This is the case in each region, especially in Japan, Europe, and the Americas, where sales have not dropped as much as the volume decline.

During this period, we have maintained the selling prices we raised last year, especially for heat pump heaters in Europe. In the current fiscal year, the selling price was raised between April and June, and the effect of the selling price was also achieved. Among the products, sales of high-performance zones, high value-added products, and high-efficiency types were relatively strong, and we managed to secure sales with these products.

Ibara [Q]: Are there any major differences among countries? You do not have to tell us the figure.

Matoba [A]: We have seen a large decrease in Italy, and no other countries have seen a large decrease from the previous year. In the UK, sales are slightly below the previous year's level but not significantly negative. In France, sales have remained on par with the previous year, and in Germany, we continue to maintain very high growth, more than double the previous year's level.

In Italy, the change in the subsidy system is a factor. At the end of December of last year, the programs with large reduction rates, such as super bonuses and eco-bonuses, were terminated. That doesn't mean that all subsidies have been lost. There were still some parts that remained after that, once those things were terminated.

Also, in February, those bonuses were cashed in, and trades were made, but that is no longer the case. For our clients, the impact of the regulatory changes were significant, as they had to make payments due to the system changes.

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As for France, as explained earlier, gas prices have settled down. There is also an announcement in France that the regulation banning the installation of combustion systems in new construction will be brought forward from next January. We believe sales remained at the same level as in the previous year, due in part to the rush demand for combustion-type products.

With regard to Germany, we see no significant changes in the market environment.

Ibara [Q]: Understood.

Is there currently any prospect of a change in the subsidy system outside of Italy and France? Also, is it likely that the system generally changes once a year and that we should not worry too much about the subsidy system changing again during the year?

Matoba [A]: Yes. At the moment, there are no major changes that have been announced, so we do not expect this to happen immediately.

Ibara [Q]: It will probably happen more and more in the future, but should we not worry too much about the possibility of it happening during the year?

Matoba [A]: Yes. We believe we should not.

Ibara [M]: I understand. Thank you very much.

Sakamoto [M]: Thank you very much.

Next, Mr. McDonald of Citigroup Global Markets, please.

McDonald [Q]: Thank you very much for today.

Regarding heat pumps, first of all, is the 12% decline of the actual results in terms of volume unexpected or expected? You mentioned that gas prices have peaked out since last August. It was previously mentioned that lower gas prices would reduce the need to switch from combustion boilers. I thought the impact of the plunge in gas prices on heat pump heater sales was expected and not that surprising. Could you first tell us whether the fact that the overall heat pump heater market is cooling down a bit on a volume basis is within or outside of your expectations?

Miyazumi [A]: It is within our expectation that if gas prices go down, there will naturally be a slight downturn in demand for heat pump heaters. However, it was unexpected that gas prices themselves would drop to 1/10. It is our understanding that demand has also dropped significantly as a result.

McDonald [Q]: Once the situation of Russia and Ukraine settles down, there is a possibility that gas prices may not come back. So, in the future, I think you should change your business plan to assume that gas prices will not return.

There is a lot of talk about carbon neutrality and Green Deal policies, but I think one of the things that has boosted the market for heat pump heaters this time around is the rise in gas prices due to Russia's invasion of Ukraine. Given that gas prices have collapsed in Europe due to inflationary concerns, which has suppressed demand, I wonder if the end of the war in Ukraine will have any negative impact.

Miyazumi [A]: When gas prices spiked over August of last year, demand rose considerably as the so-called speculative funds were also deployed because of the uncertainty of what would happen in the war.

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That portion has now been stripped away, down to 1/10 of the level. It may go back a bit, but we will be looking at the heat pump heater business based on the assumption of low and stable gas prices.

In that case, I think it will depend on how serious they are about carbon neutrality. This depends on the stance of the European Commission and other European governments. Inevitably, with inflation so high, they naturally cannot resist the mindset of ordinary consumers who want to buy things as cheap as possible. We assume that, however, it will return a little.

McDonald [Q]: I would like to confirm two more points.

First, you said that there is not much change in the German market right now. According to newspapers, while there is a plan in Germany to ban the installation of gas boilers within a few years, there is a possibility that the installation restrictions will be loosened a bit. Is it concerning to you that there have been reports in the newspapers and other media that the movement to de-boiler in Germany is stalling?

Miyazumi [A]: We believe that if a party that puts the brakes on the de-boiler movement becomes the ruling party, we will naturally see such a move.

Therefore, we assume that in the short term, there will naturally be a headwind.

However, in the medium term, I think they will be heading in the direction of carbon neutrality. We believe that it is a question of the degree of growth. I think the angle of growth will slow down a bit, not as much as previously assumed, but in the medium term the direction of steadily increasing demand for heat pump heating will remain the same.

McDonald [Q]: Daikin is going to proceed with the Polish plant. Competitors are also expanding their production capacities. Whether there is a concern about oversupply and how do you see that risk?

Miyazumi [A]: We believe that there will be a slight oversupply of heat pump heaters as well, as competitors will start producing them.

The issue that needs to be cleared when this happens is the selling part. In addition to expanding sales channels, we need to quickly secure engineers and service personnel for installation. This is a story on the tactical level, but we will make sure that we are directly connected to consumers in this area.

Although the growth of the pie will slow down to some extent, we believe that our business strategy will be to stay firmly in touch with the market and take market share.

McDonald [Q]: Thank you.

Finally, sales in the chemicals business were about JPY 60 billion, a bit weaker than expected. What are your plans for the full year? How certain are you that the full year plan will be achieved?

Miyazumi [A]: The chemicals business has been severely affected by the decline in demand, and we expect that sales will probably continue to decline in Q2 and beyond. We are projecting a little more strictly at the moment. It is quite uncertain.

McDonald [M]: Okay. Thank you for today.

Miyazumi [M]: Thank you very much.

Sakamoto [M]: Thank you very much.

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Next, Mr. Maekawa of Nomura Securities, please.

Maekawa [Q]: My name is Maekawa from Nomura Securities. Thank you very much for your explanation.

First, we have repeatedly heard that demand is severe. For the current fiscal year, I believe the plan was for an 11% increase in sales in Europe and the Americas in local currency terms. Regarding the Q1 results, what measures are you planning, as sales are slightly behind the full-year plan?

For example, the situation was particularly difficult from April to June because of weather factors and other factors, but will it return in the future? Looking at the air conditioning business alone, the decreased profit in fixed costs and others is JPY 13 billion for Q1 and JPY 85.6 billion for the full-year plan. Was the increase in fixed costs controlled in Q1? Are you planning to achieve the profit plan by controlling the fixed costs?

I would like to hear about measures and approaches to be taken in the face of the downward swing in volume.

Miyazumi [A]: Basically, we are doing our best to expand selling prices and sales as a priority measure in the midst of declining demand. We will make a steady effort to pursue this thoroughly.

Naturally, we must also reduce costs and will continue to accomplish the key themes we have set forth one by one.

Maekawa [Q]: In that case, regarding the negative impact of fixed costs and others, have you done something intentionally, or did they happen to be low in Q1?

Matoba [A]: Regarding fixed costs, we made a strong effort in Q1 as a profit measure.

We have slightly reduced the scale of hiring and training personnel and reviewed unnecessary and non-essential expenses such as sales promotion expenses. We are working to drastically curb these items.

Conversely, no changes have been made to the key themes.

Maekawa [Q]: I understand. Thank you very much.

The other question is with regard to the Indian plant. I believe this will be up and running in August, or maybe very close to being up and running. I would appreciate an update on your current efforts regarding start-ups, including investments in factories, start-up status, and the impact of weather factors on the market that you mentioned earlier.

Matoba [A]: The factory in India is operating as scheduled. We started production of compressors in July, and this month we will also start production of finished room air conditioners as planned.

Regarding market conditions in India, we estimate that demand was probably negative for the industry as a whole in Q1. However, we recognize that the main factor is weather; the cool summer had a significant impact.

Despite these circumstances, we managed to secure a YoY increase in our sales, about 3 to 4 percentage points higher than the previous year.

Maekawa [M]: I understand. Thank you very much.

Matoba [M]: Thank you very much.

Sakamoto [M]: Thank you for your question.

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Since there are no other questions, we will now conclude the Q&A session.

This concludes today's financial results briefing. Thank you for your participation.

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