Annual Report 2003

Fiscal Year Ended March 31, 2003

Profile

Since its establishment in 1934, Daikin Industries, Ltd., has grown into a leading producer of air-conditioning systems and fluorochemical products. Faced with major competition due to the advent of a single global market, we are making every effort to expand our operations on a global basis.

Combining different specialist technologies with our strength in R&D, we are also expanding our business in the oil hydraulics and electronics industries to generate revolutionary products with industrial and lifestyle applications.

Currently, Daikin is striving to meet the targets set forth in its strategic management plan, "Fusion 05." Daikin aims to freely and rapidly implement various policies to build a management framework emphasizing total corporate value and establish a more refined management under our unique "fast & flat" management framework that can be applied globally. Daikin is aiming to develop into a "global top-tier company" by fiscal 2006.

In fiscal 2003, both consolidated net sales and operating income reached record highs and operating income rose for the ninth consecutive year. These are major achievements.

To ensure still greater progress, we will raise the quality of our management framework by honing our technological strengths through radical reform, refining our speed of management and developing a unique corporate governance system, and strengthening and enhancing consolidated management.

In August 2002, we compiled "Our Group Philosophy," with the aim of honing and spreading our concept of "people-oriented management," developed over many years, to Group companies around the world. By maximizing the ability of every employee in the Group, we believe we can achieve the Group goal of making a quantum leap forward.

Daikin is challenging itself to develop leading-edge technologies and will continue to provide dependable products and systems, so that it becomes an organization that enjoys the highest level of trust of all its stakeholders.

Contents

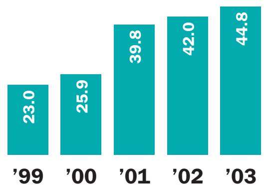
Forward-Looking Statements

This annual report contains statements regarding future plans and strategies of Daikin Industries, Ltd. (the Company), as well as the Company's future performance. These statements are not statements of past facts but are based on judgments made by the Company on the basis of information known at the time. Therefore, readers should refrain from drawing conclusions based only on these statements regarding the future performance of the Company. The actual future performance of the Company may be influenced by economic trends, strong competition in the industrial sectors where it conducts its operations, foreign currency exchange rates, and changes in taxation and other systems. For these reasons, these forward-looking statements are subject to latent risk and uncertainty.

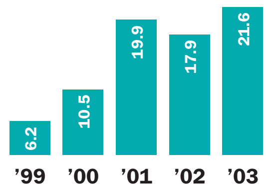
Financial Highlights

Net Sales
(¥ billion)

Operating Income
(¥ billion)



Net Income
(¥ billion)



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

	Millions of yen		
	2003	2002	2001
Net sales	**¥572,413**	¥538,790	¥531,908
Operating income	**44,789**	41,968	39,814
Net income	**21,591**	17,937	19,939
Total assets	**475,760**	460,549	453,142
Total shareholders' equity	**205,101**	191,196	173,924
	Yen		
Per share of common stock:			
Net income*	**¥81.48**	¥67.58	¥75.60
Cash dividends applicable to the year	**12.00**	12.00	12.00

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

Management Perspective

Noriyuki Inoue
Chairman and CEO

Hiroyuki Kitai
President and COO

OVERVIEW OF FISCAL 2003 RESULTS

In fiscal 2003, ended March 31, 2003, the global economy moved in the direction of staging a moderate recovery, with the U.S. economy beginning to firm up, the European economy bottoming out overall despite certain regional unevenness, and the Chinese and other Asian economies continuing to show strong growth. While external demand was healthy, domestic demand in the Japanese economy remained lackluster and was characterized by sluggish consumer spending, reduced capital investment, and other factors that contributed to a challenging operating environment.

In response, we wholly rededicated ourselves to achieving the management objectives set by Daikin Industries, Ltd.'s president in 2002, namely, to "accelerate our fast & flat policy and follow each successful transformation with the next."

In fiscal 2003, Daikin achieved record-high sales and profitability levels Companywide based on its initiatives both in Japan and overseas to expand sales and market share via the launch of high-value-added and distinctive products; to transform the structure of its business operations into one focused on innovation; to accelerate creation of new market opportunities; and to reduce costs throughout the Group.

Compared to the prior fiscal year, in fiscal 2003, consolidated net sales for the Group increased 6.2%, to ¥572.413 billion; operating income rose 6.7%, to ¥44.789 billion; and net income climbed 20.4%, to ¥21.591 billion. As a result of this performance, Daikin posted a new record in consolidated net sales for the third straight year, and operating income hit a new high and was up for the ninth year in a row.

With the objective of maximizing corporate value, Daikin focused management attention on its total market capitalization. In addition to expanding sales and operating income, we are actively developing our business operations and strengthening the quality of management by focusing on such Ratio Management measures as free cash flow (FCF), Daikin economic value added (DVA), return on assets (ROA), return on investment (ROI), and return on equity (ROE).

In particular, as the underpinning of corporate value, we have chosen to focus on FCF because it serves as the driver of all key management indicators. In fiscal 2003, FCF amounted to ¥8.8 billion, which was lower than fiscal 2002 due to the fact that we gave priority to the implementation of certain strategic investments.

At the shareholders' meeting held on June 27, 2003, a cash dividend applicable to the year of ¥12.00 per share was approved.

Overview of Operations

Sales in the Air Conditioning and Refrigeration Equipment Division rose 7.5% compared with the previous term, to ¥453.850 billion, and operating income increased 6.8%, to ¥34.409 billion.

Turning to the Japanese market for residential air-conditioning systems, demand for room air conditioners contracted due to unseasonable weather in the first half of the season and slack consumer spending. However, we significantly boosted market share by introducing distinctive high-value-added air-conditioning systems, such as the URURU & SALALA, which offers year-round humidity control and generates negative ions to improve health. In addition, efforts to substantially expand sales through large-scale electronics retailers also helped increase market share. Net sales in fiscal 2003 stayed at the same level as the prior fiscal year due to the impact of reduced selling prices.

As one of our so-called "innovation businesses," we substantially increased sales of air purifiers, which mimic the natural atmosphere via healing ultrasonic waves and relaxing modulated airflow.

With regard to commercial air-conditioning systems in Japan, despite lackluster demand conditions associated with a contraction in private-sector investment spending, Daikin won its highest ever market share position by expanding sales of high-value-added products. This includes such products as the SUPER INVERTER ZEAS II, which features the highest energy-saving efficiency in the industry and a new refrigerant with an ozone-depletion coefficient of zero. Commercial air-conditioning systems sales declined in fiscal 2003 due to slack demand conditions as well as the substantial adverse impact of weakened selling prices.

Daikin has been quick to identify growing markets for air-conditioning systems, and aggressively strengthened marketing organizations in Europe, China, and Australia. Our overseas business now accounts for 37.0% of total sales, an increase of four percentage points above the previous fiscal term. In particular, in fiscal 2002, we strengthened our marketing capabilities in Europe, the largest of our air-conditioning markets overseas, by purchasing a sales distributor in Italy, which is Europe's largest single market for this product. Our decision to acquire two sales distributors in 2003 in the United Kingdom, which is one of the biggest markets of any European country, will drive further sales expansion under a more comprehensive sales policy.

Daikin is also vigorously expanding its container refrigeration and heating unit business beyond mainstay Japanese customers, winning a large volume for marine container refrigeration systems from a major European container fleet operator.

In the Chemicals Division, sales advanced to ¥83.576 billion, a 2.3% gain compared to the previous fiscal term, and operating income improved 3.4%, to ¥9.616 billion. Fluoropolymer sales contracted as a result of delayed semiconductor market demand recovery and narrowing market demand for LAN cable due to slack IT investment in the United States. Sales of chemical products increased overall, reflecting a significant increase in sales of oil- and water-repellents in Asia and the United States and robust performance of semiconductor-etching agents in Asia. We also boosted sales of fluorocarbon gases principally in Japan and the rest of Asia, thanks to the shift to such new alternative refrigerants as R-410A and R-407C and our intensified sales initiatives.

"Fusion 05" Strategy: Efforts toward Achieving the Goals Outlined in the Medium-Term Implementation Plan

Daikin is focused on "Becoming an appealing company that pulls together human resources, capital, and information," and, as a part of this, in April 2001, we formulated our "Fusion 05" strategic management plan set to run through fiscal 2006. We are committed to making Daikin a "global top-tier company" through our focus on market capitalization and global implementation of our unique "fast & flat" management style.

"Fusion 05" specifies both the Medium-Term Implementation Plan through fiscal 2004 and a core strategy to be realized in fiscal 2006. Our Medium-Term Implementation Plan sets concrete quantitative targets that we will thoroughly focus on via our Ratio Management approach. When the Medium-Term Implementation Plan culminates in fiscal 2004, Daikin aims both to boost operating income for the tenth straight year and to make steady progress toward our fiscal 2006 strategic target of attaining the number one or number two position in the air-conditioning and fluorochemical markets. We are committed to making steady progress by taking however many concrete acts of creative destruction are needed and by seizing opportunities in growing markets.

While targeting record-high sales and an improvement in profitability, on a consolidated basis our specific quantitative targets for fiscal 2004 are a 9% increase in net sales, to ¥625.0 billion, and an 8.3% rise in operating income, to ¥48.5 billion.

PRIORITY MANAGEMENT MEASURES FOR FISCAL 2004

1. Accelerating Business Strategies for China

We have achieved sustained progress in China, which we consider one of the most important areas of our global strategy and where we have established a solid foothold. By following strategies to stay ahead of the growth and changes taking place, we aim to achieve net sales of ¥100.0 billion in China in fiscal 2006.

As regards the air-conditioning systems business in particular, we will strengthen the capabilities of the regional headquarters company set up in September 2001, make it the core entity of Group strategy in China, and concentrate all air-conditioning systems businesses under it for coordinated production, sales, and services.

2. Further Expansion of Global Air-Conditioning Operations

In addition to carrying out our strategy in China, we are accelerating the development of a global business focused on key markets.

This is why we are expanding production and sales operations at a rapid pace. As regards production strategy, we are building a flexible production and procurement framework based on the principle of being as close as possible to the target area or market.

In fiscal 2004, we plan to establish two new manufacturing companies in Shanghai, China, one for commercial air conditioning and variable refrigerant volume systems for office use and one for central air-conditioning systems. Turning to Europe, we also intend to set up an air-conditioning systems production facility in Plzen in the Czech Republic.

Based on production facilities located in strategic market areas, Daikin aims to set up a system where international manufacturing costs are identical no matter where production takes place. Daikin will establish a global-scale supply chain management (SCM) system by transferring overseas its advanced production methodologies first developed in Japan. Such high-cycle methodologies feature globally optimized procurement of parts and materials and lead times that are reduced to absolute minimums.

3. Transforming the Fluorochemicals Business

To progress to a higher level and compete as a major global player, Daikin is setting up new business models to develop fresh market opportunities, particularly in China and the United States.

In China, we are focused on building a rapid-growth integrated operational structure, launching full-scale demand-creation initiatives together with the start of operations at our Changshu Plant in Jiangsu Province in fall 2003.

With demand for fluorocarbons still in its infancy in China, we believe there is a sizable opportunity as both the market and applications are developed. In the future, the business model will be to have our own fluorochemical business in China, potentially supported by collaborative or M&A activities with Japanese, North American, or European companies as well as by our own plastics processing businesses. Further, we will strengthen the marketing of repellents and fluoroelastomers in the United States, which accounts for about 45% of global demand for fluorochemical products, and actively target applications development there. We are also developing and implementing a plan for overhauling the chemicals business, to give it a stronger, more flexible operating structure.

Our plan has 11 main elements, including intensive development of new applications, strengthening basic technologies and continually developing new products, overhauling process technologies and enhancing engineering capabilities, and undertaking far-reaching cost-cutting measures. We will make the organization and framework flatter to facilitate the rigorous implementation of each measure across the business.

4. Speeding Up the Creation of "Innovation Businesses"

With demand for air-conditioning products reaching maturity in Japan, Daikin is working to build up "innovation businesses" to assure future growth and profitability and transform operating structures, while expanding sales of existing products as well as current market share positions.

Daikin continues to focus on operations in some 21 areas, including retail store systems and service, total-management systems for buildings, factory engineering, air-conditioning systems, water-heating systems, and low-temperature logistics. For many of these new developments, we have reached the point where future success is now discernable.

For example, the "Convenience Pack" for convenience stores combines air conditioning, refrigeration, and freezing functions in a single system, reducing energy consumption by 50% and occupying 60% less space. It has won praise in convenience store field tests.

In fall 2002, we began redeploying sales people in line with our new system of management priorities. In fiscal 2004, we are including in the management plan a target of increasing sales to ¥60.0 billion compared with fiscal 2001.

5. Expanding Benefits of Synergy from Tie-ups and Alliances

In fiscal 2004, we expect our balance sheet to begin to reflect the benefits of synergies from our tie-ups, notably with the Trane Company of the United States. We plan to launch full-fledged cross-sourcing of products, especially in Europe, North America, China, and Japan.

In addition, our tie-up with Matsushita Electric Industrial Co., Ltd., has steadily borne fruit, for example, in such areas as the joint development of residential air-conditioning systems, provision of commercial air-conditioning systems to Matsushita Electric Industrial, joint procurement of parts, and participation in recycling projects. In fall 2003, Matsushita Electric Industrial will begin full-fledged supply of residential air-conditioning systems to Daikin.

Our tie-up with Sauer-Danfoss Inc. (U.S.A.) in the oil hydraulics field, now into its third year, is proceeding according to plan. We aspire to expand sales in the Chinese market based on its remarkable growth rate to obtain still greater benefits from the collaboration.

6. Adding Value to Products and Cutting Costs Across the Board

With sales prices in the domestic air-conditioning business set to continue to decrease in fiscal 2004, Daikin recognizes the need to improve its ability to generate revenues. Developing products that anticipate each new customer demand, we will assure revenues by launching multifunctional, high-value-added products. Moreover, while reducing manufacturing costs, we will work to cut costs across the board, not only reducing manufacturing expenses but also improving the efficiency of peripheral operations and reducing expenses for plant, property, and equipment.

A CLOSER FOCUS ON CORPORATE ETHICS

Based on a philosophy that can be summarized as "Absolute Credibility," "Enterprising Management," and "Harmonious Personal Relations," Daikin has always viewed "maintenance and strictest possible observance of corporate ethics" as a management priority for the entire Group. Recently, we strengthened and extended our ethical framework to ensure "establishment and maintenance of the strictest possible adherence to corporate ethics" throughout each of the Group's offices around the world, including overseas subsidiaries and affiliates.

We have established the Corporate Ethics Committee, responsible for assurance of a high level of corporate ethics across the Group, with Daikin's president and COO as chairman. By setting up the Corporate Ethics Department with a specialist staff under the Officer in Charge of Corporate Ethics, Daikin will be able to keep track of internal and external developments at all times, identify the issues that the Group needs to address more rigorously, and resolve them.

At a special desk in the Corporate Ethics Department, suggestions and advice can be offered by Group employees in all matters of legal compliance and other aspects of corporate ethical conduct. In the future, we plan various initiatives to promote corporate ethics and further enhance our record of accomplishment in this area, including the compilation of the *Handbook for Group Corporate Ethics,* implementation of various educational programs, enhancement and fine-tuning of self-appraisal mechanisms, and creation of mechanisms for double-checking audits of corporate ethics compliance.

TO OUR SHAREHOLDERS

For the beginning of the year 2003, Daikin adopted a policy of "using the present as an excellent opportunity to boldly strive for a quantum leap." While Japan's economy continues to face unprecedented challenges, the Group has managed to increase operating income on a consolidated basis for nine straight terms, and we have developed a strong business foundation. Even as a feeling of uncertainty about the future has spread due to deflationary and lackluster conditions in the Japanese economy, and, despite the defensive mentality created, pressure on stock prices, the SARS epidemic, and other factors, Daikin is keen to take on world markets and hasten its transformation into a multinational corporate group. The tasks ahead are many and varied, but the course of action is clear; there is no sense of uncertainty at Daikin. We believe the time is ripe for a significant move forward.

In fiscal 2002, Daikin decided on a coordinated policy essential for this substantial step forward. It rests on three principles: "Daikin's Technology Statement" specifying strategies and initiatives for taking our technological capabilities to the next level; strengthening of corporate governance to further hone our management capabilities; and "Our Group Philosophy," which spells out the thinking and beliefs shared by the Group as a whole.

In fiscal 2003, all employees across the Daikin Group will work together in a concerted way to boost the value of the Daikin brand.

Daikin will reinforce the level of corporate ethics in every section of the Group, conducting its business fairly and according to high ethical standards. In addition to addressing the previously raised issues, we will meet the challenge of ensuring that every office in the Group is led by "customer first" management, aim for a tenth consecutive term of increased operating income, and meet the targets of the "Fusion 05" strategic management plan.

We would like to express our appreciation to all of our shareholders for their understanding and unwavering support over the years.

June 27, 2003

Noriyuki Inoue

Noriyuki Inoue, Chairman and CEO

Hiroyuki Kitai

Hiroyuki Kitai, President and COO

Our Group Philosophy: Maximizing Corporate Value through Groupwide Pooling of Corporate DNA

In August 2002, Daikin formulated "Our Group Philosophy." We devoted a year to developing the ten themes of Our Group Philosophy. In this special feature, we will address the aims of this plan and the way their strict application will shape the evolution of the Daikin Group.

Goals of Our Group Philosophy

Between fiscal 1996 and fiscal 2001, Daikin implemented the "Fusion 21" strategic management plan, laying down a firm basis for development into the early 21st century. Now we have formulated a new strategic management plan, "Fusion 05," with a strategy for realizing our vision of Daikin in fiscal 2006. Under this plan, we intend to become a "global top-tier company," boldly taking on the challenge of meeting new, more ambitious targets.

Daikin is not daunted by the siege mentality and sense of powerlessness that prevail throughout the world economy due to uncertainty about future prospects. Instead, there are many issues we want and need to boldly address. Our conviction has strengthened that the time is ripe for a quantum leap forward, instantly taking us far ahead of our rivals.

To make the most of this opportunity, and to rapidly reach our goals, the Group, rooted in a single vector, needs to act in unison in solving the problems we face. For this to happen, the thinking and philosophy underpinning our business must be wholly shared Groupwide. Looking at Daikin's former management philosophy, it is clear that elements comprehensible and achievable for the personnel of the whole global Group, and not just the parent company, should have been incorporated. This is the main reason why Daikin has formulated Our Group Philosophy.

Furthermore, any revised philosophy should tailor its priorities to changing times, and be able to address new ideas whenever they arise. The issues of corporate ethics and the global environment were not dealt with thoroughly enough in the former management philosophy, but we recognize now that these are issues that directly affect the continued existence of the Company. This is one of the most important items of Our Group Philosophy.

Another reason for the revision is that we decided it would be best to add three objectives to go along with "Daikin's Technology Statement" of March 2002, which laid down policies and measures for raising our technological capabilities in the Air-Conditioning and Refrigeration Equipment Division to industry-leading levels. These three objectives are: (1) "reform of the corporate governance system" to strengthen our management capabilities, (2) "introduction of a new management system" to forcefully implement our corporate governance systems, and (3) "formulation of Our Group Philosophy." We believe the most effective way to increase the speed of reform is to align the aims and goals of everyone in Daikin and maximize the "power of the people," at the same time as we develop Our Group Philosophy.

Harnessing Human Ability, the Company's Greatest Asset

One of the most distinctive features of our corporate philosophy is that it clearly articulates a plan tailored to the needs of all Daikin personnel. By harnessing to the maximum possible extent the ability of every employee of the Group, we are acting in line with our creed of "people-oriented management" as drivers of growth and development.

The 10 items of Our Group Philosophy contain numerous references to the relationship between society, the Company, and Daikin employees, under slogans such as "An Atmosphere of Freedom, Boldness, and Best Practice, Our Way," "The Pride and Enthusiasm of Each Employee Are the Driving Forces of Our Company," and "Be Recognized Worldwide by Optimally Managing the Organization and Its Human Resources under Our Fast & Flat Policy."

Attitudes toward human resources are generally the same the world over. The corporate atmosphere that Daikin has created, one in which individual employees can address challenges and all levels of personnel can work in harmony, should be extended to Group companies throughout the world.

Daikin Chairman Noriyuki Inoue and President Hiroyuki Kitai have made trips to explain Our Group Philosophy to overseas centers in Europe, the United States, China, Southeast Asia, Australia, and elsewhere to explain in direct dialogues and discussions with staff as to why a Groupwide philosophy is necessary and ensure that this thinking is thoroughly instilled at every level of the Daikin Group. By promoting understanding of Our Group Philosophy, we can refine the concept of the individual as Daikin's pivotal element and hasten Group growth and development still further.

Meeting Stakeholder Expectations

Having fused the concepts of "people-oriented management" and "management-based in the logic of capital," the Company will position human resources as our corporate pivot and, at the optimum time, boldly proceed by selecting the most suitable policy in terms of in-house corporate governance, management methodology, and management strategy. By increasing corporate value, we are determined to become a group that is highly rated by all stakeholders outside and inside the Company.

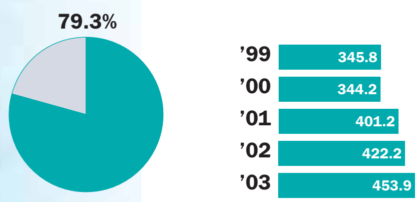
Focused on these goals, we believe that Our Group Philosophy will help to maximize the power of the Daikin Group, so that it reverberates as the universal conviction of the Group, making our quantum leap forward even more certain.

Overview of Our Group Philosophy

1. **Create New Value by Anticipating the Future Needs of Customers**
2. **Contribute to Society with World-Leading Technologies**
3. **Realize Future Dreams by Maximizing Corporate Value**
4. **Think and Act Globally**
5. **Be a Flexible and Dynamic Group**
   1) Flexible Group Harmony
   2) Build Friendly yet Competitive Relations with Our Business Partners to Achieve Mutual Benefit
6. **Be a Company that Leads in Applying Environmentally Friendly Practices**
7. **With Our Relationship with Society in Mind, Take Action and Earn Society's Trust**
   1) Be Open, Fair, and Known to Society
   2) Make Contributions that Are Unique to Daikin to Local Communities
8. **The Pride and Enthusiasm of Each Employee Are the Driving Forces of Our Group**
   1) The Cumulative Growth of All Group Members Serves as the Foundation for the Group's Development
   2) Pride and Loyalty
   3) Passion and Perseverance
9. **Be Recognized Worldwide by Optimally Managing the Organization and its Human Resources, under Our Fast & Flat Management System**
   1) Participate, Understand, and Act
   2) Offer Increased Opportunities to Those who Take on Challenges
   3) Demonstrate Our Strength as a Team Composed of Diverse Professionals
10. **An Atmosphere of Freedom, Boldness, and Best Practice, Our Way**

Air Conditioning

Sales (% of net sales, ¥ billion)



In fiscal 2003, ended March 31, 2003, sales in the Air Conditioning and Refrigeration Equipment Division amounted to ¥453.9 billion, a 7.5% increase compared with the previous term. The division's sales accounted for 79.3% of consolidated net sales. Operating income increased 6.8% compared with the previous term, to ¥34.4 billion. The ratio of operating income to segment sales was 7.6%, as in the previous term.

The Japanese Market

Overview

Although demand for air-conditioning systems was boosted in the late part of the summer, which was very hot, poor prospects for recovery in the economy held down new office and housing starts, causing sales of both commercial and residential air-conditioning systems to decline compared with the previous fiscal year.

However, in unit terms, Daikin sales outperformed average growth rates in the industry, reflecting an overall prowess based on a creative specialized retailer-centered marketing strategy, launches of distinctive products tailored to consumer requirements, and the excellence of our service, distribution, and supply networks. These strengths earned us the approval of both customers and partners in the retail industry.

In commercial air-conditioning systems, Daikin outperformed the industry in unit sales terms but was unable to increase sales revenues compared with the previous fiscal year due largely to a slackening of demand. At the same time, our high-value-added store- and office-use SUPER INVERTER ZEAS II and RAKU PITA ZEAS systems were well received and maintained robust sales. Working through retail channels, we focused marketing efforts on raising end-user awareness of the capabilities of our products.

In residential air-conditioning systems, demand for room air conditioning was down year on year across the industry, but Daikin outperformed the industry in terms of unit sales growth. However, a fall in retail prices meant, overall, that Daikin's revenue in this segment was comparable with the previous term.

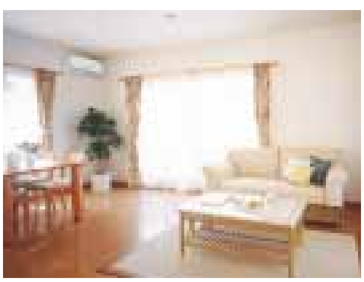
The popularity of URURU & SALALA air-conditioning systems helped drive an increase in unit sales of residential air-conditioning systems. The URURU & SALALA, launched four years ago, is capable of drawing moisture from the air outside to humidify air inside without a water supply. With demand rising across the sector in the second half compared with the previous fiscal year, its humidification function proved particularly popular during winter. Daikin increased market share both in terms of sales through large-scale electronics retailers and systems sold through the housing construction industry as pre-installed units, which is a strength and a priority area.

Outlook

In fiscal 2004, the air-conditioning industry is expected to continue to face an extremely harsh operating environment due chiefly to ongoing deflation in the Japanese economy, a delay in recovery in housing starts, and reduced capital investment.

Although there is little prospect of an increase in demand for commercial air-conditioning systems, we are confident that business opportunities remain. New demand is being created as enormous volumes of systems delivered during the bubble economy period of the 1980s reach replacement age, environmental and energy-saving awareness grows, and factors such as the falling birthrate and rising numbers of aged people take effect. To respond to these trends, Daikin will adopt a total solutions approach of offering products tailored even more closely to individual customers. For example, in April 2003, we launched the SUPER INVERTER ZEAS for stores and offices, a product concept developed to satisfy a range of market demands for lower energy consumption, compactness, convenience, and environmental friendliness. In addition to energy-saving features, we will continue to provide individually tailored solutions to customers in a way that other companies cannot match.

Little increase in demand can be expected for residential air-conditioning systems, reflecting the uncertainty regarding a recovery in housing starts for detached units and the sales boom caused by the very hot summer of 2002. A change in the operating environment came in October 2003 with the enactment of the revised Law Concerning the Rational Use of Energy. Because a high Coefficient of Performance point is required, air-conditioning system manufacturers will have to reorient their business to energy-saving models as their mainstay products. Daikin will continue to focus marketing efforts on URURU & SALALA systems, which have excellent energy-saving properties. Also, Daikin is focusing marketing efforts on ventilation systems and hot water supply systems that mainly use CO_2 refrigerants in response to an increase in demand for ventilation equipment. This follows a July 2003 revision of construction legislation and a rise in demand for ventilation equipment and hot water systems for housing that uses only electricity, a growing trend which is changing the operating environment for the construction industry.



Global Market

Overview

In fiscal 2003, world economies were deeply affected by the clear signs of slowdown in the United States, the driving force of the global economy, due to the broadening recession in the IT industry and dampened consumer sentiment. Particularly impacted were Japan and Europe, which are mired in deflationary recessions, and the economies of Asia, which have been unable to escape stagnation. Reflecting these worldwide trends, growth in global demand for air-conditioning systems in fiscal 2003 was slightly lower than the high levels of recent years.

Turning to global trends in the air-conditioning market, with the increasing pace of expansion of manufacturers in South Korea and China, there are signs of further intensification of price competition, particularly in the market for small residential units.

Despite these challenges, Daikin continues to steadily expand revenue. Daikin strengthened its European marketing capacity through measures such as the purchase of an Italian distributor in fiscal 2002 and its subsequent conversion into a wholly owned subsidiary. Sales in Europe grew notably in Spain, France, and Italy. In Australia, where demand is relatively robust, sales of residential air-conditioning systems grew solidly. In China, where demand has risen steeply, Daikin promoted strong sales of Variable Refrigerant Volume and commercial air-conditioning systems.

As a result, Daikin posted higher revenue and income in both residential and commercial air-conditioning systems and also expanded its share of the global market. However, in recent years, price competition has grown increasingly severe. In meeting the need to respond to faster and more flexible production methods amid changing markets and to create measures to reduce exchange-rate risk, Daikin is striving to reform its sales routes. Output from our production operations in Thailand used to be bought up entirely by Daikin, but now we have shifted to a new framework in which this production base directly supplies overseas marketing bases to maximize cost-competitiveness.

In fiscal 2002, Daikin began to see the concrete benefits of synergies from its tie-ups with Matsushita Electric Industrial and Trane, which have enabled the Company to expand its lineup of air-conditioning products and enhance customer convenience. Simultaneously, Daikin has expanded sales by marketing products through Matsushita Electric Industrial and Trane.

Outlook

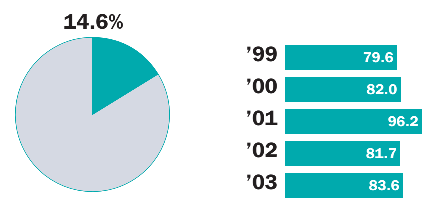
Robust growth in demand for air-conditioning systems is expected to continue in overseas markets, which are anticipated to grow steadily despite the uncertainties generated by factors such as terrorism and the SARS outbreak. Looking ahead to fiscal 2004, Daikin is confident of steady expansion of sales in the now huge European and Chinese markets, and in Australia, which is expected to show steady growth. But competition is also likely to intensify in these markets, as it did in fiscal 2003, not only with leading companies in Japan and the United States but also entrants from South Korea, China, and elsewhere, which are advancing rapidly in the sector.

To meet these challenges, Daikin will strengthen its competitiveness across the board, chiefly by further expanding production bases in Thailand and China and honing their cost-competitiveness, putting in place a production system capable of responding flexibly to market change and exchange rate fluctuation and launching new products for all overseas markets by using high-quality common parts and instruments under a single concept. Daikin also plans to meet service demand at a regional level by getting closer to its markets and is considering setting up production bases in Eastern Europe, South America, and other emerging regions.

In marketing strategy, the focus is on Europe, China, and Australia, where we plan to further strengthen marketing networks and business frameworks. We are also aggressively launching new products to stimulate new demand. In addition to supplying hardware, Daikin also plans to expand revenue by developing peripheral business fields such as solutions businesses and maintenance services finely tuned to customer wishes. We also aim to pursue a strategy of closer collaboration with other companies to achieve greater synergies.

Chemicals

Sales (% of net sales, ¥ billion)



In fiscal 2003, sales in the Chemicals Division amounted to ¥83.6 billion, a 2.3% increase compared with the previous term. The division accounted for 14.6% of consolidated net sales. Operating income increased 3.4% compared with the previous term, to ¥9.6 billion. The ratio of operating income to sales was 11.5%.

Overview

The operating environment in the fluorochemical business remained harsh in fiscal 2003. Since its peak in fiscal 2000, this market has contracted sharply. There was little recovery in fiscal 2003, and Daikin estimates sales to have been flat from that year.

Sales of fluoropolymers and fluoroelastomers declined partly as a result of falling demand for plenum LAN cable due to stagnation in IT investment in the United States and the slow pace of recovery in demand for semiconductor products. Sales of fluorocarbons increased again, as Japanese air-conditioning manufacturers switched to R-410A and R-407C and other alternative refrigerants. This, in combination with a marketing drive, resulted in a 1.6-fold increase in sales.

In chemical products, sales of all oil- and water-repellent products rose sharply, reflecting increased production capacity in Japan and the United States and advances into global markets. Sales also increased for semiconductor-etching products thanks to buoyant exports to other Asian countries.

Outlook

The operating environment for fiscal 2004 is likely to remain uncertain. However, Daikin expects stable long-term growth from fluorine-based materials, which have a wide range of applications in fields from semiconductors and IT to automobiles, consumer electronics, and textiles.

Under the "Fusion 05" strategic management plan, Daikin is developing new applications for its products, accelerating its global expansion, and creating new fluorochemical application businesses. As we enter fiscal 2004, the final year of our medium-term plan, we are committed to business management with a strict emphasis on attaining numerical targets. In tandem with our policy of growing by expanding sales of, and creating new markets for, priority products such as oil- and water-repellent products, fluoroelastomers, and PTFE resins, we are reducing fixed costs and taking other measures to overhaul our business structure and strengthen its operating base.

In order to accelerate global development, we are increasing capacity at each production base and establishing new production bases to enhance supply systems. Simultaneously, we are strengthening our operating base by upgrading our marketing frameworks. Daikin Fluorochemicals (China) Co., Ltd., currently under construction in Changshu, Jiangsu Province, China, will start manufacturing operations in fall 2003, supplying China and the rest of the Asian region with high-quality, price-competitive fine fluorochemicals. By combining these operations with the expansion of operations of Daikin Chemical International Trading (Shanghai) Co., Ltd., which is nurturing the fluorine materials processing industry in China, Daikin Fluoro Coatings

(Shanghai) Co., Ltd., and Daikin Chemical (Hong Kong) Ltd., Daikin is building an overwhelming lead in both the Chinese and other Asian markets.

In Europe, Daikin Chemical France S.A.S. will begin production of fluoroelastomers in early 2004. By combining this operation with the pre-compound fluoroelastomer production of Daikin Chemical Netherlands B.V. and fluorochemical production and marketing activities of Daikin Chemical Europe GmbH, Daikin is creating a unified network for fluoroelastomer operations in Europe from production to marketing.

Under its growth strategy, Daikin America, Inc., is increasing production capacity for oil- and water-repellent agents as well as strengthening technological services and developing new product applications. It aims to further consolidate its market position by expanding business areas through resource investment in areas selected on the basis of examination of the latest technological trends in the semiconductor industry and environmental regulations affecting the automobile industry.

In the U.S. market, the world's largest and one of the most advanced in terms of the development of new product applications, Daikin is developing products in close partnership with the customer through its technological services. In addition, R&D company Daikin Institute of Advanced Chemistry and Technology, Inc., considers ways of commercializing promising innovations and is building up a network of personal contacts and a global R&D network.

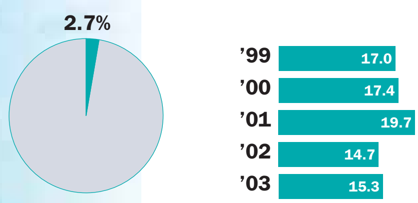
In Japan, Daikin uses tie-ups and collaborative arrangements—over joint development and similar projects—with leading companies in all fields and universities as well as other

institutes to speed up its development of cutting-edge technologies and make more efficient use of its management resources. Achievements in R&D include commercialization of a string of products including PCTFE film, the first use of such material in Japan was for pharmaceutical blister films, the fluorine cleaner HFE-S7, and the world's first adhesive fluoropolymer Neoflon EFEP.

While continuing to assure the safe operation of its business with due consideration of the environment, Daikin will contribute to society by strengthening its global supply and service systems to assure a stable supply of high-quality products.

Oil Hydraulics

Sales (% of net sales, ¥ billion)



In fiscal 2003, sales in the Oil Hydraulics Division amounted to ¥15.3 billion, a 4.1% increase compared with the previous term. Segment sales accounted for approximately 2.7% of consolidated net sales.

Overview

• Oil Hydraulics Equipment

Demand in Japan again declined in tandem with the protracted deflationary economy in fiscal 2003 but recovered in the rest of Asia, largely due to the expansion of demand in China. Overall shipments in the oil hydraulics equipment industry increased 2.9%, to ¥200.0 billion.

In oil hydraulics products for industrial machinery, Daikin continued to develop a distinctive line of products with energy-saving features and leveraged its technological strength in high-performance motors for air conditioning to develop the new high-pressure super unit and other lines of coolant pumps and inverter-regulated oil cooling units. Efforts to raise awareness of these distinctive new products were focused on research of the end-user market and on creation of new markets in terms of clients and requirements.

In oil hydraulics products for construction machinery, Daikin embarked on a global collaborative strategy, establishing joint ventures in fiscal 2001 with Sauer-Danfoss to target a substantial market share in the promising Asian region and expand applications of hydrostatic transmissions.

• Parking Systems

Demand for multilevel car-parking systems for condominiums, the main source of demand in this segment, is diversifying. Daikin aims to create distinctive hydraulic multilevel car-parking systems that can take more vehicles in a limited space using proprietary technologies for lower noise, less vibration, higher operating speeds, and greater energy saving. In fiscal 2003, sales were approximately 20.0% higher than in the previous term, reflecting strong market approval.

• Lubrication

Lubricant sales declined compared with the previous fiscal year amid a slackening of demand in the iron and steel industry, which is a major customer.

Outlook

• Oil Hydraulics Equipment

The operating environment in Japan for oil hydraulics equipment is expected to remain harsh. Shipments in fiscal 2004 are likely to rise 5.4% compared with the previous fiscal year, to ¥210.8 billion, reflecting the positive impact of accelerated global growth of companies making the products in which Daikin oil hydraulics equipment is installed, with account taken of the negative impact of the spread of electrically driven and other competing systems. To ensure our success in this industry, Daikin is adopting the following strategies.

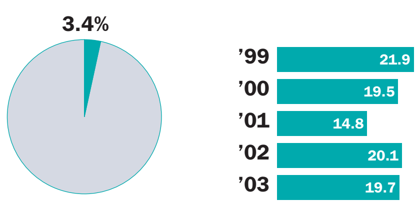
1. We will produce new hybrid products through the fusion of our conventional hydraulics technologies with those using electrical and pneumatic platforms, shifting the center of our operations from power control devices to power motion control devices that regulate power and location.
2. Daikin will extend operations to promising Asian markets, possibly in alliances or tie-ups with other companies. As part of this strategy, we have strengthened our relationship with Sauer-Danfoss and, drawing on both companies' strengths, established two joint ventures. Our aim is to become the market leader by fiscal 2005 in the Japanese and other Asian oil hydraulics equipment markets.

• **Parking Systems**

At the moment, Daikin is among the top producers of parking systems. To further strengthen our position, we intend to expand sales through alliances and tie-ups with manufacturers of electrically driven multi-level car-parking systems. By developing service businesses drawing on our industry-leading service structures, we will nurture this business into a pillar of profitability for the division.

Defense

Sales (% of net sales, ¥ billion)



In fiscal 2003, sales in Daikin's defense-related operations amounted to ¥19.7 billion, a 2.0% decrease compared with the previous term. The division's sales accounted for approximately 3.4% of consolidated net sales.

Overview

Sales declined in defense-related operations. In fiscal 2003, Japan's defense budget remained fairly constant, and there were no significant changes in the operating environment. The private-sector business is currently undergoing structural reform. In home-use oxygen therapy equipment, Daikin increased sales by supplementing its range of conventional fiber-reinforced plastic composite vessels and oxygen conservers with a newly launched two-liter oxygen concentration system.

Outlook

The operating environment for defense-related business is likely to remain harsh, with the fiscal 2004 defense budget related to combat equipment being set at ¥763.0 billion, down ¥3.0 billion from the previous term. In home-use oxygen therapy equipment, competition is likely to intensify as the number of hospital patients is expected to decline partly because of an increase in personal medical expenditure mandated by reforms of the health insurance system in Japan.

Defense-Related Business: Daikin expects continued robust orders for tank practice ammunition, for which mass production began in fiscal 2002, as it has proved capable of raising the efficiency of exercises for many sections of the armed forces. Daikin is developing new technologies for armor-piercing ammunition and a new rifle grenade and expects to further increase orders.

Private-Sector Business: In home-use oxygen therapy equipment, blunted growth of conventional products such as oxygen vessels due to intensified competition has prompted Daikin to greatly expand sales of a new two-liter oxygen concentration system launched in the term under review. Daikin also expects to expand sales of its intensive care unit device for small animals, the DEAR M10, which has earned industrywide acclaim since its launch in fiscal 2002.

Electronics

In fiscal 2003, Daikin was able to bring this operation to profitability by shifting from sales-agency-based operations to a solutions-provider paradigm, despite the harsh operating environment caused by a worsening of the malaise in the IT sector.

The mainstay product of this division, software for computer graphics animation production, was hit by slowed demand growth and increased use of compact computers and PCs over the last few years. This business sector has been undergoing structural change, therefore, Daikin is accelerating the transformation of the division into a solutions-provider business driven by the development of new products and services, under the key concepts of professionalism, speed, and technological strength.

In network solutions, Daikin developed the proprietary SpaceFinder system for display of data analysis for R&D knowledge management systems.

In the field of digital content production systems, Daikin speeded up deliveries of the Vi[z] Virtual Studio, a low-cost, highly functional virtual studio service for broadcasters launched in 2001.

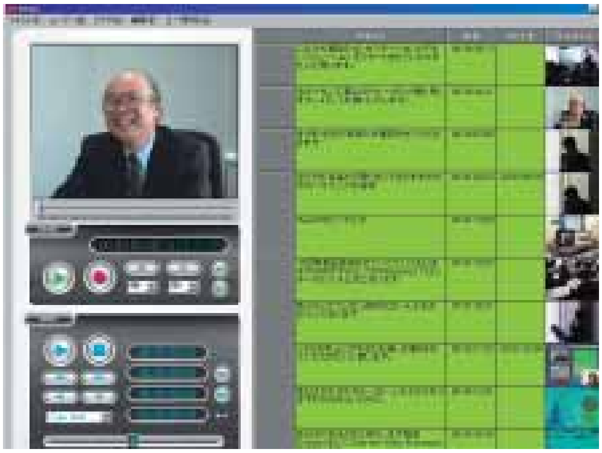
Daikin's FILDER software retains its No. 1 share of the market for CAD design software. Now we are moving beyond this field to create a new business offering a full range of services from estimates to process management.

In engineering, Daikin also expects to increase investment in corporate systems, supplying IT environments optimized for the business models of individual companies. Focusing on products for visual R&D solutions, IT total asset management, network security management, ASP businesses delivering software via the Internet, CALS-oriented information exchange, and sharing using networks, Daikin will work to understand the real needs of customers and develop full-fledged businesses based on these needs.

Daikin aims to enhance its position in the digital content field by developing industry-leading, high-value-added functions, such as incorporating 3-D features into the Sportcorder display system for scores from sports programs and image profiles of athletes.

In the content data management business, Daikin, in fiscal 2003, developed the MOSPY software product for simply compiling text from videotape, taking the business beyond software marketing to system integration.

In addition, Daikin is perfecting support services for its full range of products in existing businesses, such as the Softimage/DS nonlinear editing system that enables users to digitize and edit images and the SCENARIST DVD-authoring system. We are also working to anticipate customer needs by adding value and distinctive features.



Financial Section

Contents

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.

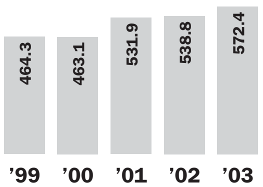
Sales in the Oil Hydraulics Division rose 4.1%, to ¥15,291 million, as weak demand from machine tool manufacturers was offset by increased market share through expanded sales of distinctive and new products.

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

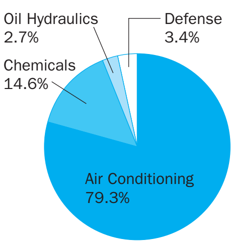
Costs, Expenses, and Earnings

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.

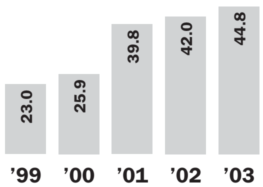
Net Sales
(¥ billion)



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.

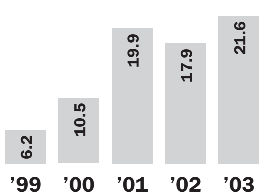
Financial Position

As a result of Groupwide efforts to reduce notes and accounts receivable and inventories, the retaining period for receiveables 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.

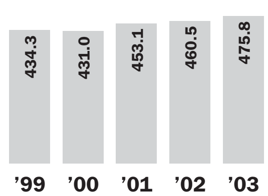
Interest-bearing debt decreased ¥11,265 million compared with the previous year-end, to ¥142,279 million. This was due not only to increased sales and income but also to our efforts to reduce such debt from FCF generated by enhanced working capital efficiency. The interest-bearing debt ratio decreased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

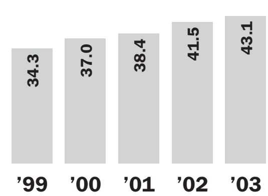
Net Income
(¥ billion)



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.

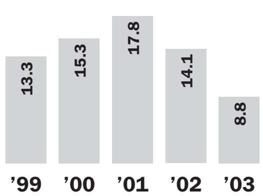
As a result, cash and cash equivalents, end of year, totaled ¥40,305 million. This figure is equivalent to approximately 0.8 times the Company's average monthly net sales of ¥47,701 million. Liquidity in hand, including a Commitment Line with banks of approximately ¥25,000 million, amounted to ¥65,305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

Dividends

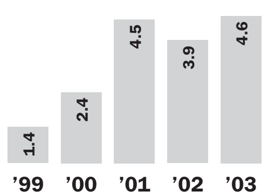
To maximize corporate value, Daikin is vigorously expanding its business domains and bolstering its operating structure. As part of this effort, the Company is establishing virtual companies and introducing managerial indicators for items such as FCF, DVA, ROA, and ROI. At the same time, as we are committed 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).

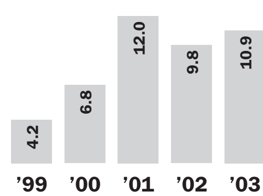
Free Cash Flow (FCF)
(¥ billion)
FCF = Income before income taxes + Depreciation and amortization – Investments ± Net working capital



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.

	Millions of yen	
LIABILITIES AND SHAREHOLDERS' EQUITY	**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

		Millions of yen					
	Number of common shares issued	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
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	¥76,639

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

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.

9. Shareholders' Equity

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		
For the year ended March 31, 2003	Furniture and Fixtures	Others	Total
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**

	Millions of yen		
For the year ended March 31, 2002	Furniture and Fixtures	Others	Total
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.

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.

17. Segment Information

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 Air Conditioning	Chemicals	Others	Eliminations	Consolidated
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 Air Conditioning	Chemicals	Others	Corporate	Consolidated
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 Air Conditioning	Chemicals	Others	Eliminations	Consolidated
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 Air Conditioning	Chemicals	Others	Corporate	Consolidated
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						
For the year ended March 31, 2003	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	Consolidated
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						
For the year ended March 31, 2002	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	Consolidated
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

Corporate Data

As of June 27, 2003

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(OVERSEAS)

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Facsimile: 86-21-6335-0700

(DOMESTIC)

Daikin Plant Co., Ltd.

Daikin Airconditioning and Technology Tokyo Co., Ltd.

Daikin Airconditioning and Technology Osaka Co., Ltd.

Daikin Airconditioning and Technology Kyushu Co., Ltd.

Daikin Airconditioning and Technology Tokai Co., Ltd.

O.K. Kizai Co., Ltd.

39 other companies

NON-CONSOLIDATED SUBSIDIARIES AND AFFILIATED COMPANIES

(OVERSEAS)

Daikin U.S. Corporation

Daikin Chemical Netherlands B.V.

6 other companies

(DOMESTIC)

Kyoei Kasei Industries, Ltd.

Daikin Sunrise Settsu, Ltd.

19 other companies

OFFICES

HEAD OFFICE
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MAIN BRANCH OFFICES
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Shanghai, Guangzhou

PLANTS AND FACTORIES
Sakai Plants (Kanaoka Factory,
Rinkai Factory), Yodogawa Plant,
Shiga Plant, Kashima Factory

BOARD OF DIRECTORS

Noriyuki Inoue
Chairman and CEO

Hiroyuki Kitai
President and COO

Satoshi Mizuno
Executive Vice President

Yukiyoshi Okano
Executive Vice President

Osamu Okumura
Senior Managing Director

Katsuhiko Takagi
Senior Managing Director

Guntaro Kawamura
Senior Managing Director

Hiroshi Tanaka
Senior Managing Director

Masahiko Amano
Managing Director

Kiyoshi Ninomiya
Managing Director

Kunikazu Torikoshi
Managing Director

Toshinari Oka
Managing Director

Takenori Miyamoto
Managing Director

Yasushi Yamada
Executive Advisor, Member of the Board

Tadasu Tachi
Director
Member of the Board
Counsellor, Kaneka Corporation

Chiyono Terada
Director
Member of the Board
President and CEO, Art Corporation

Kiyohiko Ihara
Director

Yutaka Kato
Director

Masanori Togawa
Director

Kousei Uematsu
Director

CORPORATE AUDITORS

Yoshiaki Hanaoka
Senior Corporate Auditor

Nobuyuki Shibata
Senior Corporate Auditor

Katsuyuki Mizuno
Corporate Auditor

Yoshitake Hata
Corporate Auditor

ASSOCIATE DIRECTORS

Minoru Yoshino
Associate Managing Director

Ken Tayano
Associate Managing Director

Kenji Ogura
Associate Managing Director

Junichi Sato
Associate Managing Director

Yoshibumi Katayama
Associate Managing Director

Satoshi Koyama
Associate Director

Takahiko Sakanoue
Associate Director

Hideki Tujii
Associate Director

Frans Hoorelbeke
Associate Director

Kiyoshi Nakajima
Associate Director

Susumu Okano
Associate Director

Kenji Fukunaga
Associate Director

Kenji Hara
Associate Director

PRODUCTS

AIR-CONDITIONING SYSTEMS AND INDUSTRIAL REFRIGERATION EQUIPMENT

RESIDENTIAL AIR-CONDITIONING SYSTEMS
- Room air-conditioning systems
- Air cleaners
- Dehumidifiers

COMMERCIAL AIR-CONDITIONING SYSTEMS AND INDUSTRIAL REFRIGERATORS
- Packaged air-conditioning systems
- Spot air-conditioning systems
- Medium- and low-temperature air-conditioning systems
- Air cleaners
- Total heat exchangers
- Infrared ceramic space heaters
- Marine-type container refrigeration units
- Marine vessel air-conditioning systems and refrigerators

CUSTOM AND LARGE-SCALE REFRIGERATORS AND AIR-CONDITIONING SYSTEMS
- Water-chilling units
- Screw-type refrigerators
- Turbo refrigerators
- Absorption refrigerators
- Air-handling units
- Fan-coil units

FLUOROCHEMICALS
- Fluorocarbons
- Fluoroplastics
- Fluoroelastomers
- Fluorinated oils
- Oil- and water-repellent products
- Mold release agents
- Surfactants
- *LEZANOVA* fluorinated natural leather
- Pharmaceuticals and intermediates
- Semiconductor-etching products
- *NEUROFINE* high-performance air filters
- *ZEFFLE* fluoropolymer paint base
- Organic solvent recovery and treatment equipment
- Dry air suppliers (open dry chambers, dry dehumidifiers)

OIL HYDRAULICS AND LUBRICATION EQUIPMENT
- 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

DEFENSE PRODUCTS
- Ammunition
- Aircraft parts
- Safety and arming devices
- Warheads
- Home-use oxygen therapy equipment

COMPUTER GRAPHICS
- Network management systems
- Computer graphics systems
- DVD-authoring systems
- CAD/CAM/CAE systems

SEMICONDUCTOR MANUFACTURING EQUIPMENT
- Cryo-pumps

CORPORATE INFORMATION

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Fiscal Year-end Date
March 31 on an annual basis

Date of Establishment
February 11, 1934

Paid-in Capital
¥28,023 million

Number of Shares of Common Stock Issued
263,813 thousand

Number of Shareholders
9,854

Major Shareholders
Japan Trustee Services Bank, Ltd.
Master Trust Bank of Japan, Ltd.
The Mitsui Asset Trust and Banking Company, Limited
Sumitomo Mitsui Banking Corporation
Chase Manhattan Bank, London
UFJ Trust Bank Limited
State Street Bank & Trust Company
Trust & Custody Services Bank, Ltd.
Nippon Life Insurance Company
Sumitomo Life Insurance Company

Number of Subsidiaries and Affiliated Companies
Domestic: 66
Overseas: 46

Number of Offices and Facilities
Domestic: 5
Overseas: 6

Number of Employees
15,845 (Consolidated)
6,894 (Non-consolidated)

Stock Exchange Listings
Tokyo, Osaka, Nagoya, Fukuoka, Sapporo

Newspapers for Official Notices
The Sankei Shimbun (Osaka)
Nihon Keizai Shimbun (Tokyo)

Transfer Agent and Register
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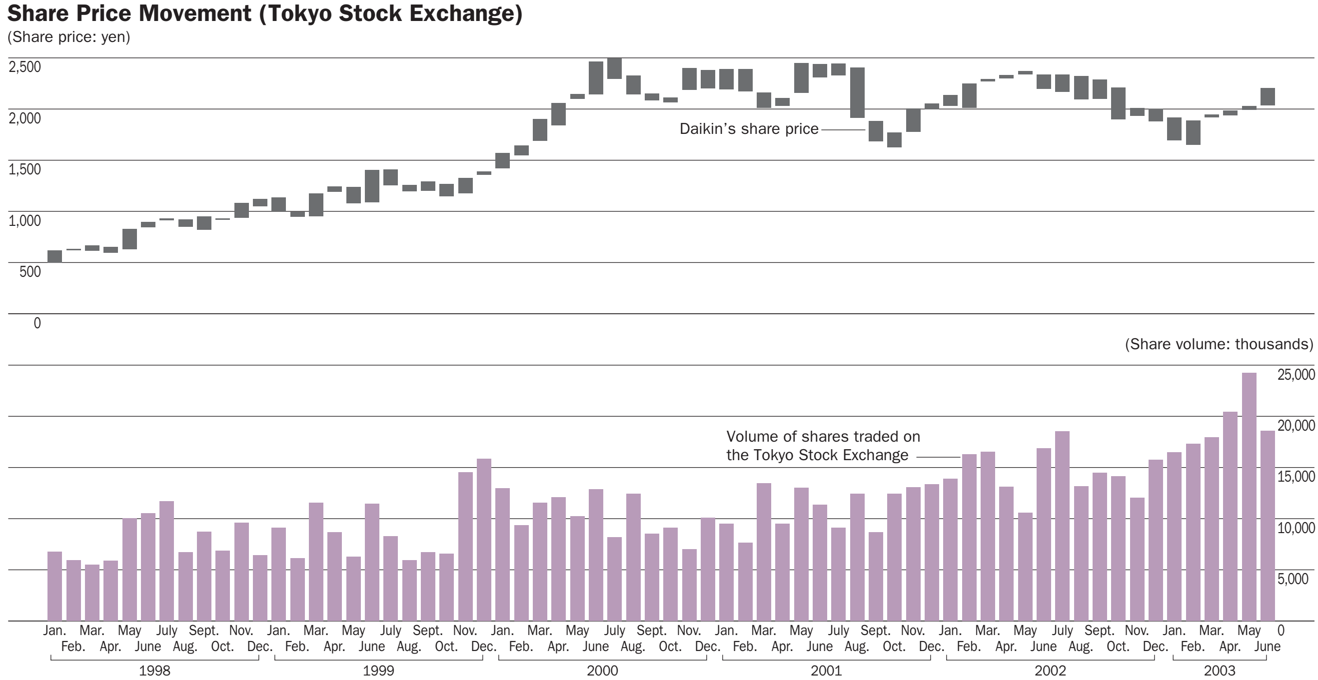
Ordinary General Meeting of Shareholders
June

Auditor
Tohmatsu & Co.

Share Price Movement (Tokyo Stock Exchange)



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