



# Annual Report 2010

Fiscal Year Ended March 31, 2010





# 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"**



## Forward-Looking Statements

This annual review contains statements regarding the 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.

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Going forward, plans call for the Group to dynamically create and capture demand on a global scale.

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### Implementing a Business Strategy Centered on Environmental Technologies

As a pioneer in the field of inverter air conditioners, Daikin is expanding its presence in global markets by offering a full lineup of products ranging from residential room air conditioners to applied (large-scale commercial) air-conditioning equipment.

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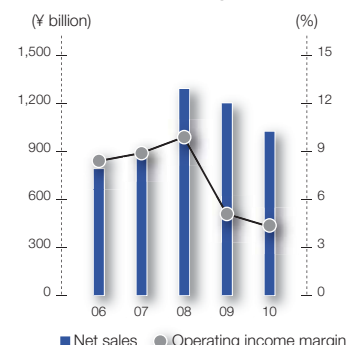
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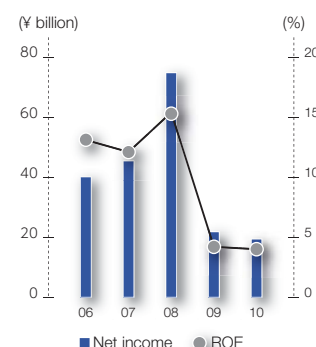
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## Financial Highlights

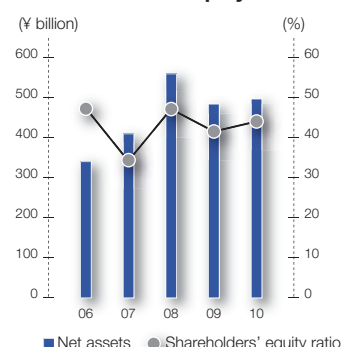
### Net Sales and Operating Income Margin



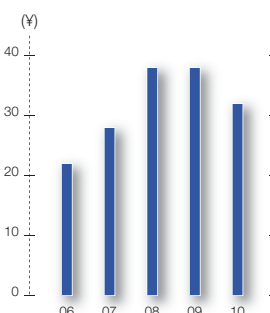
### Net Income and ROE



### Net Assets and Shareholders' Equity Ratio



### Cash Dividends per Share



## To Our Shareholders

# Pioneering the Future with “Environmental Technologies”

**The Daikin Group is now facing huge business opportunities—opportunities associated with a worldwide economic/industrial paradigm shift based on the trend toward giving greater consideration to the preservation of the global environment. The distinctive “environmental technologies” that are a special strength of Daikin provide the Company with a solid business development base. We are aiming to leverage that base to realize a V-shaped recovery in our performance and quickly attain new record high levels of profitability.**

Global warming prevention has been recognized to be an important issue throughout the world for quite some time, and each country and region has begun actively striving to reduce the volume of its greenhouse gas emissions. Compared with the period of time up to the financial crisis that triggered the current worldwide recession, it is clear that the rising consciousness of environmental issues has changed consumers' value concepts in ways that are having tangible effects on demand and market trends. This situation is what is forcing people to recognize and respond to the ongoing economic/industrial paradigm shift.

This shift is presenting the Daikin Group with opportunities. As a manufacturer of air conditioners—a product with an intrinsically deep relationship to global warming—we have long undertaken the leading-edge R&D programs needed to pioneer numerous kinds of outstanding environmental technologies, such as those related to inverters, heat pumps, desiccant air conditioners, and new refrigerants. We have used these technologies to maintain a lead over other companies regarding the development of sophisticated environment-friendly products, and this lead has been among the factors that have dynamically propelled our business expansion. Besides helping us effectively differentiate our air-conditioning products, our advanced technologies are enabling us to achieve advances in HVAC solution business—which includes peripheral equipment, heating, and ventilation products—and to augment our profit-earning capabilities.

At the same time, we are continuing to make relentless efforts to reduce costs, shrink inventories, eliminate product

defects, and take other measures designed to strengthen Daikin's fundamental management constitution.

Currently, at a time when we are seeing rapid expansion of the emerging countries' air-conditioning markets, it is particularly important to do whatever can be done to prevent the increasingly widespread use of air conditioners from promoting a further acceleration of global warming. Daikin is commercializing reasonably priced inverter air conditioners that are highly energy efficient, and we are confident that these products are well designed to meet the air-conditioning needs of emerging countries.

Going forward, the Daikin Group will sustain concurrent contributions to protecting the natural environment and increasing the comfort of human living environments. In this way, and by dynamically responding to new needs and new markets, we will be doing our utmost to further increase our own corporate value.

Currently, we are giving top emphasis to realizing a V-shaped performance recovery and, as mentioned above, are intent on reaching new record high profit levels as quickly as possible. We are determined to do what it takes to live up to our shareholders' expectations.

June 2010

Noriyuki Inoue

Chairman of the Board and CEO



*Noriyuki Inoue*

Noriyuki Inoue  
Chairman of the Board and CEO

## Interview with the President



Yuki Yoshi Okano  
President and COO

# Moving Ahead from a Focus on Generating Profit in Individual Fiscal Years to an Emphasis on Getting on Track for Sustained Growth

In fiscal 2010, ended March 31, 2010, the Daikin Group's performance was directly impacted by the global recession and the appreciation of the yen, but the Group resolutely and dynamically implemented various strategic measures—including efforts to strengthen its management constitution, augment the market shares of its existing products, promote greater sales of environment-friendly products, and comprehensively reduce costs—and was consequently able to generate more operating income than originally forecast. While the operating environment in fiscal 2011 continues to be challenging, Daikin is redoubling its efforts to bolster its management constitution in line with its objective of quickly attaining new record high levels of profitability.

From fiscal 2011, the Daikin Group will begin implementing its next strategic management plan—FUSION 15 (tentative name)—which calls for the Group to create and capture demand on a global scale through such measures as those to develop and launch environment-friendly products, cultivate the markets of emerging countries, and progressively shift from equipment sales to service solution business.



► **How do you evaluate Daikin's performance in fiscal 2010?**

► **Despite year-on-year declines in revenue and profits, we were able to make steady progress in preparing a solid foundation for our corporate development and growth over the medium term.**

Although the global economy did show some positive trends during the latter half of fiscal 2010, the overall state of economic conditions continued to be harsh to an almost unprecedented degree. While we have seen some signs of recovery in certain sectors of the Japanese economy, the severe employment environment, a deflationary tendency, and other factors continue to be grounds for concern regarding the Japanese economy's capability to muster an autonomous recovery.

Amid this operating environment, at the beginning of 2009, the Daikin Group selected the phrase "Now is the time for full focus on the three Cs—Creative Challenge and Change" to serve as its central strategic theme. In addition, the Group gave top priority to generating short-term profits by making concerted Groupwide efforts to implement measures in accordance with 49 emphasized strategic themes, including those that call for expanding the market share of existing products and promoting greater sales of environment-friendly products. We have powerfully moved forward with fixed-cost reductions based on a contingency plan that calls for rapid and decisive responses to changes in the operating environment.

However, reflecting the impact of such factors as slumping demand and yen appreciation, our consolidated net sales amounted to ¥1,023,964 million, while operating income and net income were ¥44,038 million and ¥19,391 million, respectively.

At the same time as we have implemented cost cuts, however, we have actually accelerated and increased our proactiveness in making farsighted

investments that are designed to promote a future surge in our performance. These include investments for developing highly energy efficient applied (large-scale commercial) equipment at the Daikin McQuay Applied Development Center, for the market launch of inverter air conditioners developed in cooperation with China-based Gree Electric Appliances, Inc., of Zhuhai, for bolstering the lineup of Daikin Altherma heat-pump room- and water-heating equipment, for inaugurating operations at our new factory in India, and for conducting research on the Brazil market. These investments are enabling us to make steady progress in preparing the foundation for the Group's growth and development over the medium term.

► **Could you explain your plans for a performance recovery during fiscal 2011?**

► **We are seeking to attain a new record high level of sales volume while promoting a V-shaped recovery in our performance.**

In fiscal 2011, we intend to leverage the management constitution base that we have been strengthening to date and make the most of opportunities presented by a gradual recovery in the global economy supported by rapid growth in the emerging countries. As sales volume is not affected by exchange rates, we have set ourselves the goal of reaching a new record high level of sales volume while promoting a V-shaped recovery in our performance as a whole.

Through the timely monitoring of such factors as demand trends in each country and region, currency exchange rates, and the effects of our strategic measures, we plan to quickly devise and implement rapid successions of sales promotion measures and otherwise make our utmost efforts to attain our performance targets.

► **What are the fiscal 2011 management policies you have established for the sake of the V-shaped performance recovery?**

► **We have determined the management problems we need to overcome, and we are resolutely and boldly taking the measures needed to directly address those problems.**

In brief, we are shifting from defensive to offensive strategies. Having made concerted Companywide efforts in line with our 49 emphasized strategic themes of a defensive nature during fiscal 2010, we have drafted a list of nine clear-cut strategic themes that we must emphasize during fiscal 2011 through Companywide efforts to generate positive results. Having defined these nine Companywide task themes, Daikin's top management is participating in efforts to ensure the tasks are thoroughly addressed in a way that prepares a broad path for our sustained growth going forward.

- (1) Fundamentally strengthen commercial package air-conditioner business and build a global No. 1 position in that field

- (2) Promote comprehensive cost reductions at factories in Japan and strengthen our global cost-competitiveness
- (3) Promote a sharp surge of sales (air conditioners, chemicals, and hydraulic products) in China, which is the world's largest growth market
- (4) Rapidly expand heat-pump room- and water-heating systems business in Europe, China, and the United States
- (5) Accelerate the global development of applied air-conditioning business
- (6) Accelerate the results of global sales promotion measures for household room air conditioners by increasing competitive capabilities with respect to relatively low-priced models
- (7) Take proactive measures to expand the Group's positions in the markets of India and Brazil (Latin America)
- (8) Use Flash Streamer technology to develop commercial business and then expand such business globally
- (9) Comprehensively raise the level of customer satisfaction regarding product quality, services, etc.

► **Daikin Group Growth (2006-2010)**





► **Could you describe the strategies the Daikin Group will be using to realize growth over the medium- to long-term future?**

► **We have drafted and begun implementing medium- to long-term strategies that fall into three general categories.**

The first category of medium- to long-term strategies focuses on responses to environmental issues. Amid manufacturing industries' full-scale paradigm shift toward sustainable growth concepts, Daikin believes it can play an important role as a leader in the air-conditioning industry, which is well positioned to make a major contribution to helping prevent global warming. As a result, we recognize that promoting the paradigm shift is part of our mission. We take particularly great pride in our heat-pump and inverter technologies, and we intend to further raise the level of those technologies.

We are also taking steps to augment our environment-friendly product lineups in our chemicals business and other business fields.

The second category includes offensive strategies for expanding our presences in the emerging countries'

markets. Even though the speed of growth in those markets could slacken, those markets are still projected to sustain their growth over the medium-to-long term. We are giving special attention to India and Brazil (Latin America), which are featured in one of the nine Companywide task themes for fiscal 2011. Based on thorough market research, we will be implementing our own unique business expansion strategies in those markets.

The third category involves the creation of new air-conditioner business models. For example, we have already developed such models as the *Netsu Marugoto* (Comprehensive Heat) business for comprehensively reducing the energy consumption of buildings, which encompasses Airnet services for enabling optimal energy-conserving air-conditioning equipment operations, the use of thermal-insulation coatings to reduce air-conditioner loads, and provisions for making good use of waste heat. It is also important to take full advantage of the rise in demand for air-conditioner maintenance and repair services that occurs when customers delay their purchases of replacement equipment during recessions and therefore seek to prolong the useable lives of their old equipment. In this field, the Daikin Group is leveraging its outstanding strengths



regarding the submission of detailed proposals to customers. Going forward, we intend to continue flexibly applying this approach to create additional demand for our services.

► **What is your approach to developing business in the Chinese market, which may be the key to your ability to become the global No. 1 company in the air-conditioning field?**

► **To sustain rapid business growth in China, we are taking measures including those to expand our business in such new markets as those for economically priced air conditioners and for heating equipment.**

We positioned fiscal 2010 as a key initial year for establishing strong air-conditioning business operations in China. Having initially targeted cities in coastal regions and the premium equipment market, we made a major strategic transition in fiscal 2010 that involved expanding our operational scope to include outlying regions, inland areas, and economically priced equipment. We will be sustaining this strategy in fiscal 2011 while taking proactive marketing promotion measures. While our business in China previously centered on multiple air-conditioning systems for office buildings, we are broadening the business scope to include room air conditioners and applied air-conditioning equipment, and we are concurrently establishing a full-scale presence in the heating equipment market. In addition, we are moving forward with a business model transition involving a shift away from equipment marketing-centered business and an increase in the provision of customer solutions. By implementing all these strategies at the same time, we are aiming to expand our operations in China quite quickly.

Regarding room air conditioners, China's increasingly strict environmental regulations have helped promote a rapid advance in the introduction of inverter air conditioners to replace equipment that is less energy efficient. In fiscal 2010, we initially forecast that our sales of inverter air conditioners would grow to

account for 7%-8% of our total unit sales volume in China, but that sales share actually ended up surging to about 15%. We are currently forecasting that the share will rise to about 30% in fiscal 2011 and 50% in fiscal 2012.

Having been quick to note this interesting trend, we worked with our local ally, Gree Electric Appliances, to cooperatively develop inverter air-conditioner products that are suitable for high-volume market segments and feature a high level of price-competitiveness. We were able to launch those products on the market during fiscal 2010, before other Japan-affiliated companies could launch similar models. In fiscal 2011, we are aiming to sell more than 500,000 air conditioners in China, including the premium models that we had introduced previously. To attain this level of sales volume, we are planning to build a network of approximately 4,000 agencies centered on leading mass merchandisers, specialty stores, and shops catering to professional builders and tradespeople.

► **As we approach the final year of Daikin's FUSION 10 strategic management plan, could you give us your appraisal of the overall results of that plan and the gist of your conception of the upcoming FUSION 15 (tentative name) plan?**

► **Going forward, we will be placing strategic emphasis on promoting a transition toward environmentally responsive business and business involving the provision of services and solutions.**

Reflecting the impact of the recession triggered by the Lehman Shock, we are not likely to attain the numerical volume targets of the three-year version of FUSION 10 updated in May 2008, but I believe we have made considerable progress toward our goal of being the global No. 1 air-conditioning company. We are now only a few small steps away from reaching that goal. We have built a corporate constitution that has demonstrated its strength by not collapsing in the face of an extremely

severe operating environment. The foundation of that solid corporate constitution puts us in a strong position to further accelerate our shift toward business that leverages the environmental-protection technologies that are needed to respond to society's increasingly rigorous requirements.

Regarding the FUSION 15 (tentative name) plan we will begin implementing from fiscal 2012, the content of that plan will reflect our in-depth discussions of how to respond to the global changes in the structure of manufacturing industries that are expected to come in the wake of the current global recession. The plan will place strong emphasis on environment responsiveness and a paradigm shift from equipment toward services and solutions as key concepts for promoting our growth. We see a need to stimulate global demand by further increasing the sophistication of our environmental technologies and developing environment-friendly products.

To put it more concisely, in our air-conditioning business, we will be shifting from equipment sales to the provision of services and solutions. In chemicals business, we will strive to develop additional applications. In the environmental business field, we will be seeking to create products that anticipate demand for such next-generation materials as thermal insulation coatings, lithium batteries, and solar cells. The main aspect of all these strategies will be included in our FUSION 15 plan. We intend to draft that plan based on thorough consideration of how to survive and realize sustained corporate growth and development during an era of great changes in the industrial structure.

► **Please explain the levels of dividends applicable to fiscal 2010 and your policy regarding dividends going forward.**

► **We unfortunately felt constrained to reduce the level of our dividends for fiscal 2010, but we are doing our utmost to position ourselves to boost dividends for fiscal 2011.**

Regarding returns to shareholders, Daikin has a fundamental policy of maintaining the ratio of cash dividends

to net assets (consolidated basis) at 2.0% or higher and seeking to set stable levels of dividends based on a comprehensive consideration of such factors as the Company's consolidated performance, financial position, and funding requirements.

The Company employs internal reserves for strategic investments designed to further strengthen its management structure as well as to accelerate its global business development, accelerate its development of products that contribute to the global environment with the objective of increasing the scale of its business operations, and raising the level of its competitiveness.

Dividends applicable to fiscal 2010 amounted to ¥32 per share, down ¥6 per share from the fiscal 2009 level. Although we worked hard to realize a short-term rise in profitability, we recorded considerable year-on-year declines in sales and profits and believe that those declines make it imperative to adjust our dividend level.

As I previously mentioned, we are committed and determined to realize a V-shaped performance recovery during fiscal 2011. We are aiming to make a proposal on fiscal 2011 dividend levels at the time we announce our second quarter business results.

I am hoping for shareholders' continued understanding and support going forward.

June 26, 2010

*Yukiyoshi Okano*

Yukiyoshi Okano  
President and COO,  
Member of the Board

## Fighting for Success in Global Markets

# Implementing a Business Strategy Centered on Environmental Technologies

### Promoting the Use of Inverter Air Conditioners Worldwide

In such countries as China and India that have achieved stunningly high rates of economic growth, in European countries that have seen fatalities associated with hot summer weather, and in other countries and regions throughout the world, demand for air conditioning is on the rise. Reflecting this situation, global sales of air-conditioning equipment products are growing at a strikingly rapid rate, and it is undeniable that this growth has brought increases in electric power consumption and associated CO<sub>2</sub> emissions. The application of inverter technology to air conditioners offers a crucial means of helping alleviate these problems.

Inverter technology is an energy-conservation technology field in which Japan has a considerable lead over the rest of the world. When applied to air conditioners, this technology optimizes the compressor speed and makes other fine adjustments to the operation of the air conditioner. Inverter technology and certain other technologies have made it possible to reduce the average power consumption of Japanese room air conditioners by approximately 40% during the past decade. Looking at the global market, however, it is clear that most air conditioners sold are still not equipped with inverters.

Going forward, demands for the comfort offered by air conditioning are expected to grow globally, with particularly strong growth in the emerging countries. As a leading global manufacturer of air conditioners, the Daikin Group is confident that it has the capabilities required to meet that demand while using inverter technology to minimize environmental impact, and it has begun working to promote the use of its energy-saving air-conditioning equipment and related services throughout the world.

In Japan, Daikin already provides such air conditioner-related services as Airnet II, which integrates inverter air conditioners with IT remote monitoring and control technologies to optimize air-conditioner operations and reduce electric power consumption by 10% or more.

In response to the fiscal 2011 revision of Japan's Energy Conservation Act, Daikin began offering its ENE-FOCUS service to companies with numerous business facilities. When data on the electric power, gas, and other utility services consumed by each facility is input via the Internet, this service enables such companies to get a clear and concrete understanding of their overall energy consumption. Offered together with diverse optional features, the ENE-FOCUS service makes it much easier for companies to maintain rigorous compliance with the Energy Conservation Act.



## Developing New Products that Leverage Inverter Technologies

The Daikin Group has been a leading pioneer in introducing inverter air conditioners into global markets, and it now offers a full line of inverter air-conditioner products ranging from home room air conditioners through applied (large-scale commercial) air-conditioning equipment. We are attentively catering to the air-conditioner needs of customers in all kinds of markets while concurrently working to help realize a brighter future for the global environment.

In the United States, the Daikin Group is making steady progress in its efforts to strengthen its marketing network and service systems. The Group is also giving priority to measures to build up its marketing networks in Europe, China, other Asian countries, and Oceania, and plans are moving forward for the launch of products designed to promote the diffusion of inverter air conditioners in India, Brazil, and other emerging countries with rapidly growing economies.

In June 2009, the Group expanded its applied air-conditioning lineup in North America by commencing the marketing of air-cooled screw chiller units. As the energy-conservation and noise-reduction advantages of these units have given them an overwhelming advantage over competing products, their sales are steadily rising.

To measure the energy efficiency of air-conditioning products, we employ a coefficient of performance (COP) calculated by dividing cooling power (kW) by power consumption (kW). The higher the COP of a product, the higher that product's efficiency and energy-conservation benefits. The Daikin Group's chillers have attained a COP level of 4.5, which is among the highest levels found worldwide. This represents a 59% rise in energy efficiency compared with Daikin's own products marketed about 15 years ago.

The turbo refrigerators with DC inverters that Daikin launched in North American markets in September 2009 have earned kudos from numerous leading specialists, including the chairman of the American Society of Heating, Refrigerating and Air-Conditioning Engineers (ASHRAE). Offering overwhelming levels of energy-conservation performance, those turbo refrigerators are important strategic products for the Daikin Group.

Aiming to meet needs in Chinese markets, Daikin has produced customized versions of its large-volume turbo refrigerators and is seeking to increase the number of its orders for such products.

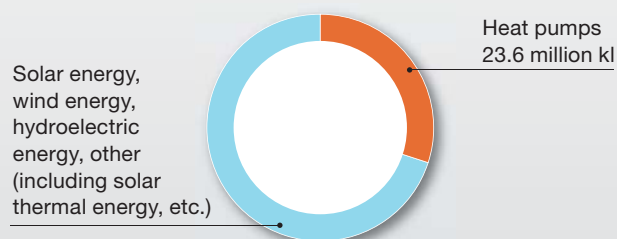
## Heat Pumps that Reduce CO<sub>2</sub> Emissions from Room- and Water-Heating Equipment

An important component of the Daikin Group's outstanding environmental technologies, heat-pump technologies are extremely effective means of reducing CO<sub>2</sub> emissions.

Currently, most room- and water-heating systems throughout the world are fuel-burning systems that employ such fuels as coal, oil, or natural gas. The huge amount of CO<sub>2</sub> emissions from those fuel-burning systems is said to account for about 30% of total global emissions. Moreover, 70% or more of the total amount of energy used by European households is used for heating rooms and water. On the other hand, heat-pump room- and water-heating systems do not burn fuel and, because they simply pump up heat from the air and use it to heat rooms, they are able to heat rooms efficiently. It is estimated that the CO<sub>2</sub> emissions from heat-pump systems (emissions associated with the generation of electric power to drive the systems' compressors and other components) are only about half the level of emissions from fuel-burning systems. The International Energy Agency (IEA) has reported that the global spread of heat-pump use for room and water heating could reduce global CO<sub>2</sub> emissions by 8% or more—or about 1.8 times Japan's current CO<sub>2</sub> emissions. Going forward, as clean new energy sources grow to account for a growing share of electric power generation, it is clear that the environmental benefits from heat pumps will grow still more. Many countries throughout the world are promoting the broader use of heat-pump technologies as a key means of reducing their CO<sub>2</sub> emissions.

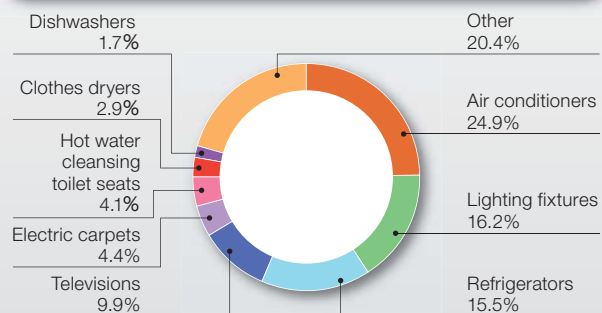
The Altherma heat-pump room- and water-heating systems (also useable for room cooling in the summer) the Daikin Group is currently marketing in Europe have earned a high evaluation for their friendliness to the global environment, and they have been a large commercial success. In Japan, Daikin has been marketing a diverse range of EcoCute natural refrigerant heat-pump water heaters—including such models as those for cold regions that can operate when outside temperatures go as low as -20°C and models for urban locations that have installation footprints comparable to the size of a newspaper—and the products have been chosen by a growing number of households.

### ► Heat Pumps' Share of Renewable Energy in 2020 (Estimate)



Source: Heat Pump & Thermal Storage Technology Center of Japan (HPTCJ)

### ► Household Electric Power Consumption by Type of Appliance



Source: Overview of Supply and Demand for Electric Power, Public Utilities, Department of the Agency of Natural Resources and Energy, Ministry of Economy (Fiscal 2005)

## Great Worldwide Expectations for Renewable Energy

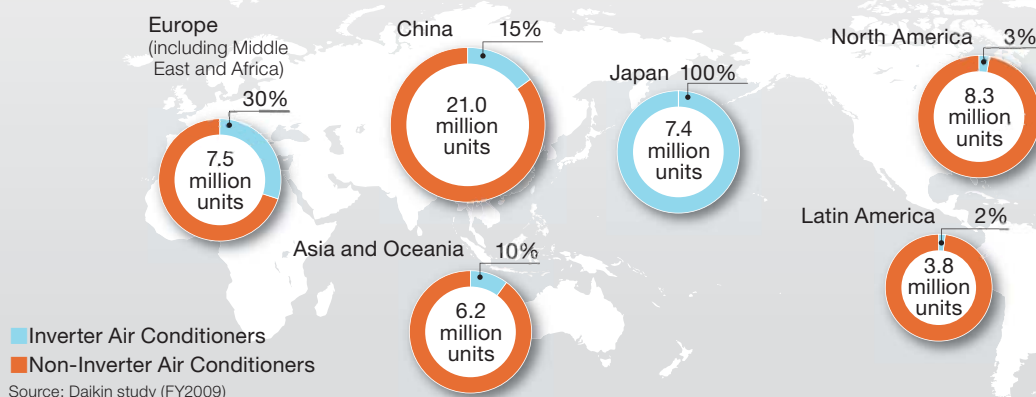
In April 2009, the EU formally adopted its 'climate and energy package' law. Prior to that, in December 2008, the EU formally recognized that heat pumps are a type of "renewable energy source (RES)" technology.

Together with the EU's determination that heat pumps are an RES technology, France, Germany, and the United Kingdom began subsidizing a portion of the cost of purchasing heat-pump room- and water-heating systems. In France, which is currently the largest market for Daikin's Altherma heat-pump system products, a demand decline due to the global recession slowed the pace of growth in Altherma product sales during fiscal 2010, but the increase in those sales has been sustained. The policies of France and the rest of the EU are continuing to create supportive conditions for business in Altherma products. Over the medium-to-long term, it is projected that EU demand for heat-pump systems will remain on a path of stable growth, particularly in France, and Daikin is preparing to meet that demand by broadening its product lineup. In fiscal 2011, plans call for launching new heat-pump room- and water-heating systems for condominiums and apartment buildings.

In fiscal 2010, Daikin began marketing its Altherma heat-pump system products in North America, particularly in the northeast and northwest portions of the United States and in Canada, and sales so far have been greater than originally projected. During fiscal 2011, plans call for promoting a rise in sales volume by expanding the geographic marketing region.

Countries throughout the world are devoting particular attention to setting CO<sub>2</sub> emissions volume reduction targets for the milestone year of 2020, at which time longer-term targets for attainment by 2050 are to be worked out. Against this backdrop, the role played by heat-pump technologies is expected to grow steadily. The use of these technologies will dependably bring about large-scale reductions in energy consumption and CO<sub>2</sub> emissions. Aiming to effectively promote the use of heat-pump room- and water-heating equipment, the Daikin Group will be continuing to develop diverse products tailored to the special conditions of individual countries and regions.

### ▶ Inverter Air Conditioners' Share of Annual Sales Volume of Home Air Conditioners



## Speedy Development of Applied Products Suitable for Markets throughout the World

In May 2009, Daikin completed a sophisticated new development and testing facility within the Daikin McQuay Applied Development Center near Minneapolis, in the U.S. state of Minnesota. Constructed at a total cost of \$52.0 million (approximately ¥5.0 billion), the world-class facility can replicate the climatic conditions (in a temperature range from -20°C through 60°C) and the electric power supplies (cyclic frequencies and voltages) of any country on earth. This new facility enables the development of screw chillers, turbo freezers, and other large-scale air-conditioning equipment products for large office buildings and factories that offer still-higher levels of energy efficiency and reliability.

The mission of the Applied Development Center is to fuse McQuay's applied air-conditioning technologies with the Daikin Group's technological strengths—particularly those related to heat pumps, inverters, and systems engineering—to enable the speedy development of global base models of outstanding new products. Then, the base models can be quickly customized in each region of the world to suit local conditions, making it possible to place high-performance, highly dependable new products on regional markets within a short period of time.

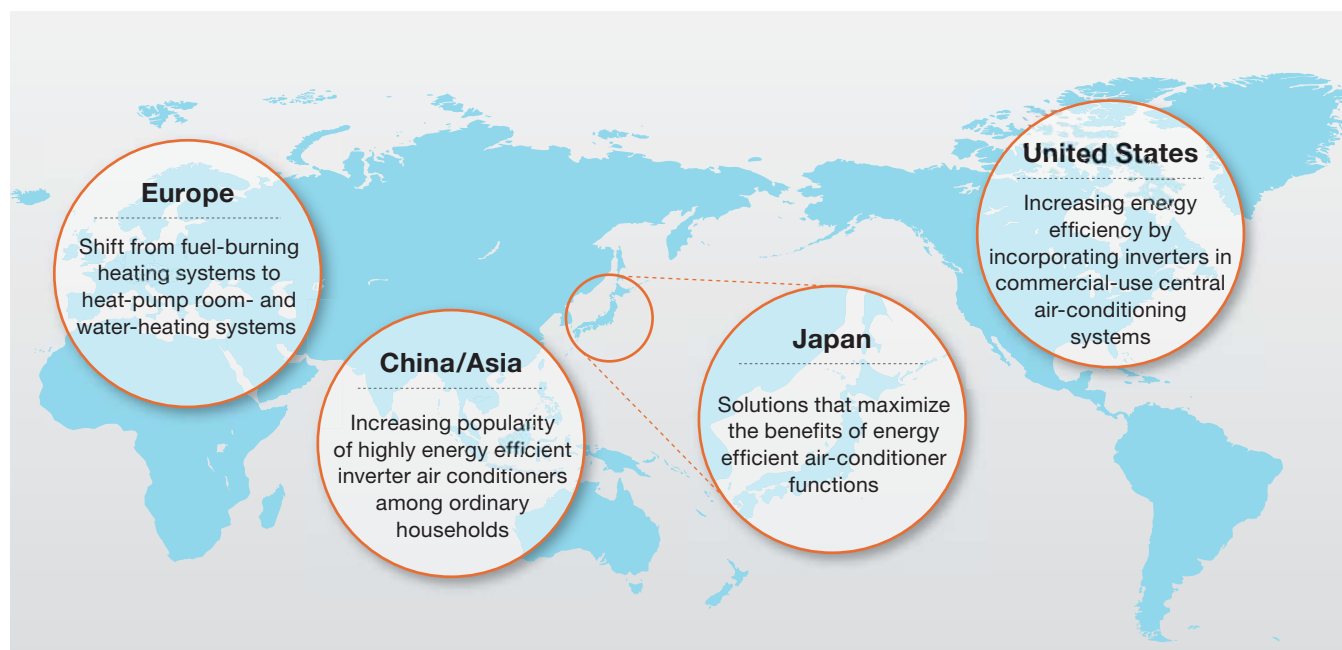
The Daikin Group has previously been applying its energy-conservation technologies and other environmental technologies primarily in the fields of household air conditioners and small- and medium-scale commercial air conditioners, and it has earned a strong position as a global leader in those fields. Aiming to become the global No. 1 company in a comprehensive range of air-conditioning fields by extending its capabilities into the applied field, Daikin moved in January 2007 to acquire the O.Y.L. Industries Bhd (OYL) Group, including McQuay, which is the fourth-largest company in the world's large-scale commercial air-conditioning market. The Daikin Group has thus been building solid capabilities for full-scale participation in all kinds of air-conditioning business in a manner even more proactive than previously.

The new development and testing facility within the Daikin McQuay Applied Development Center strongly positions the Daikin Group to be a leader in developing applied air-conditioning products for markets in countries and regions throughout the world. The Group is now generating powerful momentum for the strategic expansion of its operations in large-scale, air-conditioning equipment markets.

## Proactively Approaching Emerging Country Markets

Daikin is leveraging its unique technological power to move ahead with a strategic approach to the markets of such countries as China and India, which have been sustaining rapid economic growth, as well such countries as Brazil, which are projected to commence full-scale periods of robust economic growth going forward. In preparation for this approach, the Daikin Group has been taking various measures, including those to develop air-conditioning products that are both environment friendly and carry reasonable prices that place them squarely in the middle of high-volume market segments.





In China, particularly northern regions with severely cold winters, there is an established tradition of using fossil fuel-burning boilers for heating. Against the backdrop of rising environmental consciousness in recent years, however, Chinese demand for heat-pump heating systems has increased.

Responding to this trend, the Daikin Group has employed a base of technologies incorporated in the Daikin Altherma products created for cold regions of Europe to develop and launch products tailored to local Chinese requirements. The first of these, marketed since August 2009, is a system with floor- and water-heating functions, while another product marketed since April 2010 offers floor- and water-heating functions as well as air conditioning. The Group is seeking to increase the annual sales of these products to roughly ¥10 billion in the near future.

With respect to India, in October 2009, the Daikin Group began manufacturing large-capacity commercial-use air-conditioning equipment at a new factory in the Neemrana Industrial Area of the state of Rajasthan. The Group is also proactively considering steps to fundamentally bolster its marketing systems in India through measures that include those to hire additional local staff.

Demand in Brazil is being stimulated by such prospective events as the 2014 FIFA World Cup™ and the 2016 Olympic Games (both of which it will host), and the Daikin Group has responded by posting approximately 20 professional marketing staff to that country to undertake extremely thorough marketing research. The Group is currently finalizing its plans for an early entry into the Brazilian market, and it appears likely that a full-scale local presence will be established during fiscal 2011.

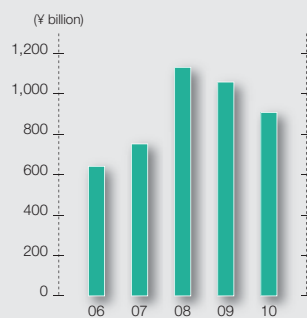
Going forward in accordance with its objective of becoming the global No. 1 company in air conditioning, the Daikin Group intends to further augment its rapid and flexible capabilities for establishing competitive positions in all kinds of markets throughout the world.

## At a Glance

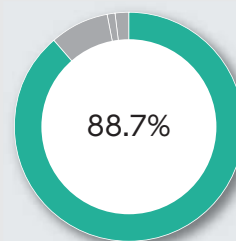
### Air-Conditioning



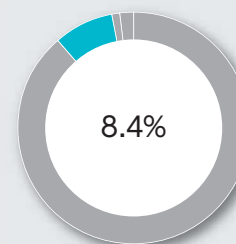
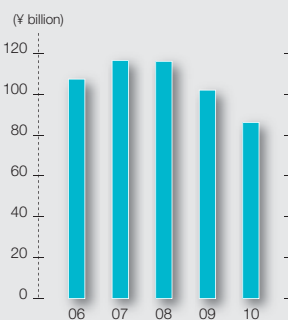
Net Sales



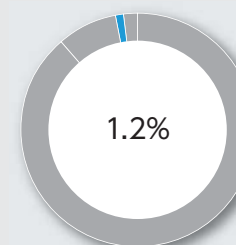
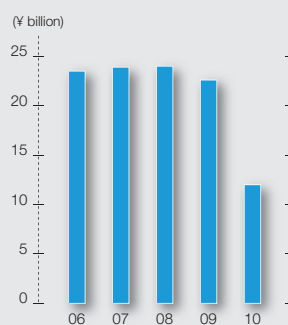
Percentage of Net Sales



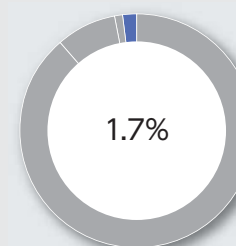
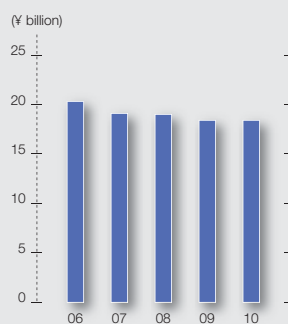
### Chemicals



### Oil Hydraulics



### Defense



## Major Products & Services

## Description

- Room air-conditioning systems
- Heat-pump hot-water-supply and room-heating systems
- Packaged air-conditioning systems
- Multiple air-conditioning systems for office buildings
- Air-conditioning systems for facilities and plants
- Medium- and low-temperature air-conditioning systems
- Absorption refrigerators
- Humidity-adjusting external air-processing units
- Air purifiers
- Water chillers
- Air-handling units
- Marine-type container refrigeration

Since becoming the first in Japan to manufacture packaged air-conditioning systems, in 1951, Daikin has supported comfortable living based on the strengths of technologies that it has itself nurtured as the world's sole manufacturer to create a full line of products from refrigerants to air conditioners.

- Fluorocarbons
- Fluoroplastics
- Fluoro coatings
- Fluoroelastomers
- Fluorinated oils
- Oil- and water-repellent products
- Mold release agents
- Pharmaceuticals and intermediates
- Semiconductor-etching products
- Dry air suppliers

In 1933, Daikin was the first in Japan to engage in research on fluorinated refrigerants. Today, our activities range from research and development to commercialization, and we offer a lineup of more than 1,800 fluorine compounds.

- Oil hydraulic pumps
- Oil hydraulic units
- Oil hydraulic valves
- Cooling equipment and systems
- Hydrostatic transmissions
- Centralized lubrication units and systems

Daikin's unique hydraulic technologies offer outstanding energy-conservation performance and are contributing to the development of industry by unleashing the potential of power control.

- Warheads
- Warheads for guided missiles
- Home-use oxygen therapy equipment

Daikin's superior machining and quality control technologies are used in the production of defense-related products and other industries where high levels of precision and performance are critical.

## Review of Operations



## Air-Conditioning The Japanese Market

In fiscal 2010, Japanese demand for both residential and commercial air-conditioning systems fell greatly owing to the low level of housing construction starts, the restraint of capital investments, and other situations attributable to the recession. The impact of these factors kept the unit volume of the Daikin Group's domestic sales of air conditioners below the fiscal 2009 level. By effectively leveraging its comprehensive range of strengths related to marketing, products, services, and other capabilities, however, the Group was able to increase its market shares for both residential and commercial systems. During fiscal 2011, the Group intends to further expand its market shares through the proactive launch of new products while also implementing diverse measures designed to enhance its profitability.

### ► Conditions in Fiscal 2010

#### Providing High Levels of Added Value in Residential and Commercial Air-Conditioning and EcoCute Fields

Despite the shrinkage of Japanese demand for residential air-conditioning systems, the Daikin Group worked to expand its sales of products with high levels of added value, particularly added value associated with energy conservation. For example, the Group introduced such new features as the exclusive URURU humidification function and the *Eraberu Kiryu* functions, which allows users to choose from among 12 kinds of airflow settings that are suitable for different seasons and activities. Through measures including the consigning of manufacturing operations to its China-based strategic partner—Gree Electric Appliances, Inc.—the Group was also able to greatly bolster its cost-competitiveness with respect to compact models in high-volume market segments.

In commercial packaged air-conditioning systems business, the Group also faced a decrease in demand, and it responded by taking measures to promote greater sales of such high-added-value products as the Clean ZEAS-Q system, which features an automatic filter-cleaning function, and the Flash Streamer ZEAS-Q system, which features a unique streamer technology to control and dispose of harmful microorganisms and pollen.

As a result, although unit sales volume fell below the fiscal 2009 level, Daikin achieved major successes in that it attained a record high market share in commercial products and was also able to expand its market share in residential product business.

In EcoCute heat-pump room- and water-heater systems business, Daikin worked to differentiate its products by giving them improved functions, more-compact configurations, and other features as well as also developed its chain of EcoPlanners Club outlets and took other steps to strengthen its marketing capabilities. These efforts supported a rise in sales volume.

### ► Outlook for Fiscal 2011

#### Additional Emphasis on Augmenting Profitability and Helping Attain Record High Levels of Group Profitability

Among the Daikin Group's strategies for increasing the profitability of its business in residential air-conditioning products, particularly crucial are measures for realizing sufficient cost-competitiveness to generate profits from compact models. In fiscal 2011, the Group intends to realize an increase in its profitability by continuing to consign manufacturing operations to Gree Electric Appliances while launching additional



products that enable the accumulation of the Daikin Group's unique eco points.

In commercial air-conditioning product business, the Daikin Group is responding to opportunities presented by Japan's revised Energy Conservation Act by emphasizing and differentiating such offerings as the ENE-FOCUS energy management service and Environmental Solutions proposal-based marketing operations, seeking to use those services to elicit replacement demand. Moreover, besides realizing further improvements in the energy-conservation performance of equipment, the Group has newly developed ECO-ZEAS80 to enable optimal system operations in accordance with usage situations and has the objective of increasing profitability through the proactive marketing of such *No. 1/Only 1* products.

The Group is also considering the augmentation of its residential eco-point system and various other responses to the revised Energy Conservation Act, which requires that new houses built since 2008 employ energy-conservation methods to meet standards regarding air conditioning, insulation, and other features. In view of these objectives, the Group is accelerating its measures to expand the breadth of its residential facilities lineup—including EcoCute products, solar cells, and other products—as well as the marketing routes for that lineup.

Responses to the emergence of new strains of influenza and other factors are rapidly boosting demand for residential air-purification products. Daikin is seeking to expand its sales in this field by moving ahead with the seasonally coordinated launch of diverse products, including those suitable for meeting needs related to pollen and excess humidity.

## Topics

### New Environment Solutions Business Model Contributing to Energy Conservation and Global Warming Prevention

In view of a projected paradigm shift in industrial structures following the current global recession and responses to Japan's Energy Conservation Act, the Daikin Group is becoming increasingly proactive in promoting a business model centered on the provision of environmental solutions.

#### Leveraging 17 Years of Experience Providing Energy-Conservation Services

Having provided Ainet Service Systems since 1993, the Daikin Group has accumulated considerable experience with the 24-hour remote monitoring of air-conditioning systems via communications circuits and the submission to customers of proposals on the most-appropriate ways to maintain equipment and prevent breakdowns.

In 2008, the Group supplemented those basic functions with considerably expanded energy-conservation control functions, and these enhanced systems are now being marketed as Ainet II systems. Primarily designed for medium-scale and small office buildings\*, Ainet II systems enable a grasp of the real energy consumption of air-conditioning equipment, the identification of problematic issues, and the drafting of improvement proposals along with the measurement of results after the implementation of those proposals. Remote monitoring makes it possible to find operational waste and inefficiencies and the optimization of energy-conservation controls. As air conditioning accounts for roughly 40% to 50% of energy consumption within buildings, air-conditioning management is an urgent imperative. Ainet II makes a huge contribution by helping solve related problems.

#### Supporting Companies Covered by the Energy Conservation Act

In step with the April 2010 implementation of the revised Energy Conservation Act, the Daikin Group began offering the ENE-FOCUS energy management service, which is designed to facilitate companies' responses to the reformed law.

While the Energy Conservation Act previously covered individual factories and offices, the revised law focuses on individual companies, including their multiple small-scale facilities, so the scope of the regulations has become broader. Companies covered by the regulations are obliged to gather and aggregate annual energy consumption data for multiple facilities and make regular submissions of such data to the authorities. This requires companies to handle an increased volume of complicated tasks.

In response, the ENE-FOCUS service makes the volume of energy usage at multiple locations "visible" and graspable. At a reasonable cost, companies can lighten the burden of procedures they are required to undertake and enjoy automatic drafting functions for the creation of the periodic reports that must be filed.

Moreover, the grasp of operational situations obtained through ENE-FOCUS enables the identification of individual problems, and users can select an optional feature of the service that provides support for drafting the medium- to

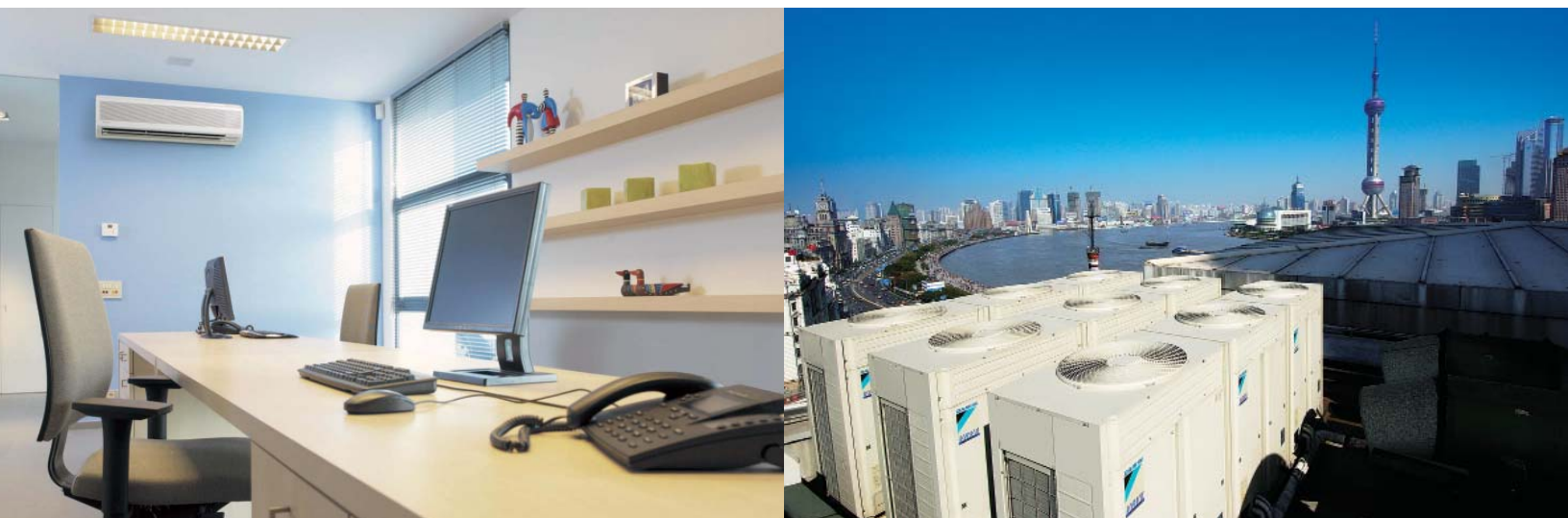
long-term energy plans that regulated companies are required to prepare. By combining several of the Daikin Group's diverse service systems, customers can obtain cogent proposals for optimal energy-conservation promotion.

#### Monitoring Operational Performance and Energy Usage Volume

In April 2010, Daikin began offering its PerformanceWatch service, which involves the remote monitoring and analysis of energy consumption associated with the operational functions of multiple air-conditioning systems for office buildings along with the provision of information customers can use to improve the operational management of those air-conditioning systems.

Previously, gaining a grasp of the operational state of multiple air-conditioning systems for office buildings required specialized measurement equipment and analysis. However, the Performance-Watch service integrates Ve-up III multiple air-conditioning systems with Ve-up Controllers to compile operating data and make data on operational functions and energy consumption "visible." Besides helping customers to improve the energy-conservation performance of individual pieces of equipment, the system provides operation-related proposals that can enable customers to realize highly environment-friendly air conditioning.

\*Office buildings equipped with the Daikin Group's Ve-up III Series multiple air-conditioning systems



## Air-Conditioning The Global Market

During fiscal 2010, the global recession caused air-conditioner demand to weaken in most countries and regions of the world, impacting the Daikin Group's performance. Although the Group strove to increase its shares of overseas air-conditioning product markets, the combined impact of demand drops and yen appreciation kept net sales below the fiscal 2009 level. In fiscal 2011, the Group plans to strategically expand its presences in the emerging country markets while placing particular emphasis on augmenting sales in China. The Group is accelerating its environmental business and plans to considerably increase its sales of heat-pump room and water heaters in Europe, North America, and China. Daikin is also stepping up its presence in the high-volume segment of the residential air-conditioner market and proactively promoting the global development of its applied air-conditioner business.

### ► Conditions in Fiscal 2010 Facing Slack Demand due to Recession but Emphasizing Increased Shares of Markets Worldwide

In fiscal 2010, Daikin strove to increase its market shares for existing products—including residential air conditioners, commercial packaged air conditioners, and multiple air conditioners for office buildings—but unit sales volume was below the level in fiscal 2009. Regarding heating system business, demand growth in the principal market of France was undercut by such situations as the shrinking of incentive payments, a drop in the number of new housing construction starts, and a decrease in oil prices. The Group responded to this by developing new marketing outlets, strengthening its service system, and launching newly developed high-temperature Daikin Altherma products designed to encourage people to replace their existing fuel-combustion-type heating equipment. These measures supported a rise in sales volume to above the fiscal 2009 level.

In China, Daikin strengthened its marketing operations in regional cities and inland regions while also proactively launching highly differentiated new products, and it was thereby able to increase its unit sales volume to above the

fiscal 2009 level. The Group also expanded its marketing of applied air-conditioning products, made a full-scale entrance into the high-volume segment of the residential air-conditioner market using inverter products developed in cooperation with Gree Electric Appliances, and worked to begin the full-scale development of local business in heat-pump room and water heaters. In these ways, the Group moved ahead with the creation of a solid foundation for a major sales expansion.

In the Asia/Oceania region, Daikin was able to proactively develop its marketing promotion measures because the impact of the deterioration of economic conditions following the recent financial crisis was weaker than in other regions. Business in Australia benefited from economic recovery, housing purchase subsidies, and extremely hot summer weather, and Daikin was able to increase its sales of residential air conditioners there. In Singapore and Thailand, demand for commercial products decreased, but the recruitment of additional marketing agencies and the stepping up of efforts to obtain relatively small orders supported a rise in sales volume to above the fiscal 2009 level.

In North America, the slack construction market depressed demand for applied air-conditioning products and

decreased Daikin's sales of such products. However, the high evaluation earned by strategic products boosted orders beginning from November 2009. The Group also strengthened its marketing network for Japanese-style ductless air-conditioning products and sustained market creation efforts for multiple air-conditioning systems for office buildings.

## ► Outlook for Fiscal 2011

### Maximizing Benefits of Environmental Technologies to Accelerate Business Expansion in China and Diverse Other Markets

In fiscal 2011, the Daikin Group intends to make the most of the gradual recovery that is projected to take place and strive to attain a new record high level of unit sales volume.

For approximately a decade, the Daikin Group has been working to build a solid foundation for its business in China by developing products that meet local needs and by preparing an extensive marketing network. It intends to quickly expand its operations throughout China by leveraging that base along with its leading-edge heat-pump and inverter technologies. Regarding residential air conditioners, also, the

Group plans to launch relatively inexpensive inverter products and build a network of several thousand marketing agencies to establish a strong presence in the high-volume segment of the market.

In Europe, Daikin intends to increase the market share of its existing products by strengthening marketing routes. In the heating equipment market, the Group will continue bolstering its marketing/service networks and product lineup, expand its sales of high-temperature Daikin Altherma products designed to elicit replacement demand, and pioneer a new market segment by launching products designed for use in multi-unit residential buildings. In applied business, the Group is advancing with measures to differentiate its products while bolstering its capabilities for solutions business.

In the Asia/Oceania region, based on expectations that demand will get back on track for growth, the Daikin Group is sustaining its marketing expansion efforts.

In North America, the Group is striving to increase its market share by expanding its array of inverter products and new applied products as well as proceeding further with measures to strengthen marketing power and service systems.

## Topics

### Developing Applied Air-Conditioning Business by Creating Facilities and Strengthening Systems

Aiming to accelerate the growth of its applied (large-scale commercial) air-conditioning business, the Daikin Group has augmented and strengthened its related systems. During fiscal 2010, the Group created a new product development and testing facility, a specialized unit that is serving as a control tower for global operations, the first showroom for applied products, and various other units.

#### Expanded and Improved Product Development-Related Testing Facilities

In May 2009, Daikin completed the construction of a research and testing facility within the Daikin McQuay Applied Development Center near Minneapolis, in the U.S. state of Minnesota.

A world-class test facility able to replicate a wide range of temperature conditions and provide diverse types of electric power used in various parts of the world, it is now staffed with about 70 development engineers from Japan, Europe, and the United States who are endeavoring to fuse the Daikin Group's applied air-conditioning technologies with the Group's heat-pump, inverter, and systems integration technologies.

One example of the work at this facility is the recent development of a base model of a large-scale heat source unit (an air-cooled chiller) that is able to reduce energy consumption to as much as 38%

below the level of energy consumed by conventional products. This base model is then customized for different countries and regions of the world. This new development system is enabling the Group to create highly reliable products with outstanding performance and dispatch them to markets throughout the world in short periods of time.

#### Control Tower for Global Business Expansion

In May 2010, Daikin established the Applied Solution Business Headquarters, which has begun serving as a virtual control tower by providing comprehensive supervision over domestic and overseas applied business with the objective of accelerating the expansion of that business. In addition to equipment sales, the headquarters is working to promote solutions business that also encompasses maintenance and other services.

#### Establishment of U.S. Showroom

In May 2010, the Daikin McQuay Solutions Plaza facility began operating as a showroom for applied business in the New York area, a region where a considerable share of the United States' design offices, major construction companies, and engineers is concentrated. It has a total of 750 square meters of floor space to exhibit the Daikin Group's most-advanced large-scale air-conditioning units.

In addition to ensuring that maintenance and repair staff are always on hand at the facility, Daikin also arranges for customers to be provided with detailed consulting services by arranging for video conferences with engineers posted at factories. As North America is the world's largest applied air-conditioning equipment market, the new showroom will play a crucial role in leading the Daikin Group onward toward its goal of becoming the global No. 1 company in all types of air-conditioning business.



# Chemicals

In fiscal 2010, the Daikin Group's chemicals operations faced a large drop in demand but moved ahead with comprehensive cost reductions of unprecedented rigor and were thereby able to advance from a large operating loss in fiscal 2009 to the restoration of operating profitability. In fiscal 2011, plans call for implementing major sales promotion programs to respond to recovery in demand related to automobiles and semiconductors while also continuing measures aimed at strengthening the fundamental business constitution of chemicals operations. The Group is seeking to determine which products are likely to be in rising demand, operate related production facilities at full capacity, and thereby increase production volume without having to make investments. While using this approach and other measures to ensure that its return to a high-profit business structure is stable, the Group is accelerating its development of applications for its environment-friendly products as a means of promoting future business growth.

## ► Conditions in Fiscal 2010

**Despite facing a harsh operating environment, the Daikin Group's efforts to strengthen the profitability of its chemicals operations bore fruit, and measures to develop new product applications also generated tangible benefits.**

Although signs emerged during fiscal 2010 of a trend toward a gradual recovery in semiconductor- and automobile-related demand for fluoropolymer resins and in demand for chemical products, conditions in the operating environment became severe overall owing to the global recession. In the fine chemicals field, a drop was seen in demand for chemical compounds used as pharmaceutical intermediates, while demand for fluorocarbon gas products decreased in Japan, China, and other Asian countries. Against this backdrop, the Daikin Group achieved an increase in its domestic sales of water and oil repellents and maintained the level of its domestic sales of semiconductor-etching products. The Group's proactive efforts to develop applications for anti-

smudge surface coating agents used in manufacturing touch panels, ordinary computer displays, and other products bore fruit and boosted sales of those agents, particularly in Japan. Although the Group's total sales of chemicals were lower than in fiscal 2009, marketing efforts to respond to a demand upturn in the latter half of the fiscal year, manufacturing cost reductions, expense streamlining, inventory rightsizing, and other business structure reform initiatives made it possible to restore the operating profitability of chemicals operations.

## ► Outlook for Fiscal 2011

**The Daikin Group plans to proactively work to expand its presence in the fluorochemicals markets of China and other Asian countries while also promoting the development of environment-friendly products.**

In fiscal 2011, the Daikin Group intends to take thorough measures to increase the market shares of its established products (fluoropolymer resins for applications related to





electrical wires, LAN cables, and optical fibers; fluoroelastomers for automotive applications; water and oil repellents; etc.) in such principal markets as Japan and the United States. In light of expectations that medium- to long-term business expansion in the developed countries is unfeasible, however, the Group is taking a proactive approach to the markets of China and other Asian countries, which are believed to have a high likelihood of sustaining economic growth. Regarding China, the Group is particularly emphasizing measures to

address the abundant local demand related to government infrastructure investments and obtain related orders for fluorochemicals used in railroad, electric power, and communications applications. In addition, plans call for increasing profit in China by developing products that meet local needs and by establishing systems for effectively supplying and promoting the sales of those products. In South Korea and Taiwan, the Group is working to expand its sales to manufacturers of electrical products and semiconductors.

## Topics

### Kudos for Fluoropolymer-Based Thermal Insulation Coating that Reduces Environmental Impact

Daikin's ZEFFLE Infrared Reflective Coating Garnered the Energy Award of the 2009 *Lloyd's List* Global Awards.



*Lloyd's List*, one of the world's top shipping journals, holds an annual awards ceremony to honor organizations and individuals in 22 categories for achievements in the maritime field. Its Energy Award is given to those who have realized outstanding achievements related to maritime energy usage based on sophisticated technologies and a consciousness of important environmental issues requiring countermeasures.

The Daikin Group's ZEFFLE Infrared Reflective Coating is finding a diverse and growing array of applications related to factories, shipping vessels and containers, storage tanks, warehouses, and other structures. It is highly evaluated for its ability to help conserve energy and reduce environmental impacts.

The scope of fluorochemicals' applications is expanding into the environmental

field, and one noteworthy example of this is the use of fluoropolymer-based thermal insulation coating to reduce the energy consumption of factories and office buildings. This coating is akin to a supplementary air conditioner that can be painted onto structures. After it is painted onto roofs, the highly durable fluoropolymer coating reflects sunlight and prevents heat from entering the structure and raising interior temperatures.

The Daikin Group is doing its utmost to make the most of fluoropolymers' resistance to heat, chemicals, and weathering and other outstanding characteristics by developing applications that provide society with diverse benefits. The Group is giving particularly strong emphasis on developing and supplying products that help preserve the natural environment.



## Oil Hydraulics

**In fiscal 2010, the Daikin Group's oil hydraulics operations were impacted by moves to restrain capital investments amid the global recession, causing sales to drop considerably. In fiscal 2011, the Group intends to increase the profit-earning capabilities of these operations through fixed-cost reductions and other business constitution reform measures while concurrently seeking to strengthen its oil hydraulics environmental business by promoting greater sales of hybrid oil hydraulic package products for machine tools and forming equipment. To realize future business growth, the Group is shifting the focus of oil hydraulic operations expansion to China.**

### ► Conditions in Fiscal 2010

#### **Performance Drops in Japan, Europe, and the United States but Positive Results in Asian Markets**

Sales of industrial machinery-related oil hydraulic equipment in Japan, Europe, and the United States during fiscal 2010 were considerably lower than in fiscal 2009, reflecting the impact of decreasing demand from the machine tool manufacturers that are Daikin's principal customers in this business field as well as from the general industrial machinery sector. In contrast, exports to Asian markets were robust—particularly exports to China, South Korea, and Taiwan—and this factor supported a year-on-year increase in sales.

Conditions in markets for oil hydraulic equipment used in construction machinery and motor vehicles were depressed worldwide. Reflecting demand drops in the Japanese market—Daikin's principal market in this business field—as well as in the United States and Europe, the Daikin Group's sales did not reach their level in the previous fiscal year.

### ► Outlook for Fiscal 2011

#### **Applying a “Customer First” Strategy in China's Growing Hydraulic Equipment Market**

During fiscal 2011, the Daikin Group will be augmenting its global market research and striving to quickly build stronger

systems for developing products in response to customer requests and market needs as well as stronger cost-competitiveness and product supply capabilities.

In particular, because hybrid oil hydraulic equipment that integrates motor, inverter, and hydraulic control technologies can offer outstanding energy-conservation performance and contribute to the preservation of the world's natural environment, there is considerable latent demand and the market for the equipment is steadily growing.

In China, which is expected to sustain its economic growth, the Daikin Group is undertaking thorough market research so that it can gain an accurate grasp of actual market situations that makes it possible to build optimal business strategies going forward. In addition to reasonably priced hybrid equipment and conventional oil hydraulic equipment for industrial machinery applications, the Group is considering such cooperative ventures in China as a project to develop a compact power shovel incorporating a Daikin hybrid oil hydraulic system.

Besides implementing business expansion measures, Daikin will be sustaining its efforts to strengthen the constitution of its oil hydraulic product business. Plans call for the Group to further intensify its efforts to reduce fixed costs as well as procurement costs.



## Defense

The Daikin Group's defense business sector includes defense business as well as civil sector business. In fiscal 2010, against the backdrop of the continued downtrend in the procurement budget of Japan's Ministry of Defense, the Group undertook structural reforms centered on fixed cost reduction measures of its defense business. In civil sector business, the Group moved ahead with marketing promotion measures for new oxygen concentration units designed for home therapy and took various other initiatives. In fiscal 2011, plans call for strengthening the constitution of defense business still further and sustaining efforts to expand the scale of civil sector business.

### ► Conditions in Fiscal 2010

#### **Launching New Oxygen Concentration Products—Part of Strategy for Expanding Civil Sector Business to Compensate for the Impact of Defense Budget Shrinkage**

In fiscal 2010, facing challenges associated with Japan's shrinking defense budget, Daikin's defense business worked to thoroughly manage costs related to each individual order project and thereby promote the maintenance of a business structure that reliably generates profits.

In civil sector operations, Daikin began marketing newly developed oxygen concentration units that incorporate air compressors developed in-house. The units have been highly evaluated by patients who require in-home therapy, and their sales volume has been growing in accordance with plans.

Overall sales in the defense business segment were below the fiscal 2009 level, reflecting the impact of a decrease in demand for products of the defense business sector.

### ► Outlook for Fiscal 2011

#### **Intensifying Defense Business Sector Reforms and Creating New Business Models for Civil Sector Business**

In fiscal 2011, amid a trend of increasingly sharp cuts to government budgets, Daikin's defense business sector will undertake drastic structural reform measures considerably more ambitious than previous reform programs. Plans call for moving ahead briskly with initiatives to shrink fixed expenses, restrain capital investment, and promote internal production of procured items.

In civil sector business, the air compressors incorporated in the oxygen concentration units marketed in fiscal 2010 have attracted considerable attention from other manufacturers of gas concentration equipment. Daikin intends to begin selling those compressors as stand-alone component products during fiscal 2011 and develop such sales into a stable and growing business. Besides efforts to make good use of the Daikin Group's wide range of technology seeds and supply chain networks, plans call for stepping up global development programs and cooperation with outside suppliers as means of pioneering challenging new markets.

# Corporate Governance

## 1. Fundamental Corporate Governance Concept

The Daikin Group's corporate governance, in accord with the Group Management Philosophy, is designed to help accelerate decision making and operational execution work in response to changes in management tasks and the management environment while concurrently promoting consistently high levels of management transparency and soundness, thereby seeking to increase the Group's corporate value.

Going forward, the Group will be striving to ensure the increasing sophistication of speedy management, the strengthening of consolidated management, and still-higher levels of soundness and transparency. In addition, to realize an increase in corporate value, the Group will continually consider and reevaluate its concepts regarding the most appropriate forms of corporate governance as it pursues a diverse range of Group-level initiatives aimed at ensuring best practices throughout the Group.

## 2. Corporate Governance Systems

Rather than adopt a U.S.-style "committees system" that completely separates decision making from operational execution, the Group has adopted an "integrated management" system that calls for directors to bear responsibility for management responsibilities as well as for operational execution responsibilities. In view of the special characteristics of the Group's business, it was judged that this is a more effective means of accelerating decision making and operational execution.

Daikin entrusts the CEO with the responsibility for making management decisions, including those involving the overall management of the Group, while it assigns the COO the responsibility for executing operations. This system is used to give due attention to both decision making and operational execution processes while seeking to accelerate both kinds of processes with respect to management tasks, including Group management tasks.

The top deliberative unit in the Group's management system is the Group Steering Meeting.

In addition, to further strengthen corporate governance, the Group has established support committees and other units, such as the Corporate Ethics & Risk Management Committee, the Internal Control Construction Committee, and the Disclosure Committee.

## 3. Increasing the Sophistication of Speedy Management

To facilitate speedy decision making based on substantive discussions, the Board of Directors has been designed to include a small number of members. As of July 2010, the Board of Directors included 10 members.

Since 2004, Daikin has employed an Executive Officer System to accelerate the speed of execution based on autonomous judgments and decisions in units handling each region, division, and function. In parallel to the Executive Officer System, the Board of Directors is responsible for making speedy strategic decisions and performing sound supervision for the entire Group.

The Group Steering Meeting quickly and in a timely manner determines the Group's strategic direction regarding important management policies and strategies as well as quickly resolving problems.

In addition, the Group Management Meeting aims to unify the Group's decisions by thoroughly sharing important management policies and the basic strategies of the Group and supporting and expediting the Group companies' problem-solving efforts. To further increase the Group's overall corporate value and ensure the Group lives up to its responsibilities to society, the Group Management Meeting aims to ensure that the Group is characterized by a unified understanding and integrated corporate operations.

## 4. Systems for Increasing Transparency and Soundness

Daikin employs a Board of Corporate Auditors and seeks to nominate two or more outside members—with no relationship of interest with the Company—to both its Board of Directors and its Board of Corporate Auditors. As of July 2010, Daikin's 10 directors included two outside directors, and the Company's four corporate auditors included two outside corporate auditors.

The outside directors are assigned assistants in the Management Planning Office who strive to provide the outside directors with early notice of Board of Directors meetings. In addition, in the case that an outside director is not able to attend a Board of Directors meeting, the assistants provide the outside director with related materials and subsequently provide the outside director with an explanation



of the proceedings of the meeting, thereby ensuring that the outside directors can effectively contribute to Daikin's corporate governance system.

The outside corporate auditors attend meetings of the Board of Directors as well as other important meetings and receive reports. In addition, they are able to express diverse opinions.

To ensure effective audit functions, the Board of Corporate Auditors receives reports on important issues related to management and performance when necessary and also investigates relevant units, confirms approval documents, and regularly exchanges opinions with representative directors, executive officers, and the independent auditors.

To strengthen Groupwide auditing and supervision functions for all Group companies, including overseas subsidiaries, principal Group companies appoint Group auditors. The corporate auditors and Group auditors regularly hold Group Auditors' meetings and otherwise work to increase the smoothness of information flows.

Within Daikin, the corporate auditors have established an Auditing Department, with staff who assist in auditing activities. The staff of the Auditing Department report directly to the corporate auditors and perform their duties in accordance with the corporate auditors' instructions, and such decisions relating to the staff as personnel reassignments and evaluations are made with due deference to the opinions of the Board of Corporate Auditors.

To ensure the transparency of management with respect to corporate officer appointment and compensation, Daikin has established its Personnel and Compensation Advisory Committee, which is chaired by an outside director and conducts deliberations regarding such issues as corporate officer selection standards, corporate officer candidates, and corporate officer remuneration.

## 5. Remuneration of Corporate Officers

Daikin's corporate officer remuneration system is designed to accord with the Group's management policy and respond to shareholders' expectations by increasing corporate officers' motivation to promote a sustained increase in Group performance over the medium-to-long term and thereby contributing to a rise in the Group's corporate value. Directors' remuneration includes "fixed compensation," "performance-linked compensation" that reflects the Group's short-term

performance and job responsibilities, and "stock options" that reflect the Group's long-term performance. The remuneration of outside directors and corporate auditors includes "fixed compensation" only.

Compensation levels are determined based on an analysis and comparison of data from an outside specialized institution on the remuneration of corporate officers active in approximately 200 Japanese companies listed on the First Section of the Tokyo Stock Exchange as well as based on consideration of Daikin's performance and remuneration levels compared to those of other leading manufacturing companies in Japan.

The performance-linked compensation of Daikin directors is given a somewhat higher ratio of linkage with performance than average to ensure that the incentive effect of that compensation is sufficient.

There are three Companywide performance-linked evaluation indices—net sales, the ratio of operating income to net sales, and the return on equity (ROE) ratio. These indices were selected in view of their use as Companywide performance targets in the context of numerical corporate management, their close correlation with stock value, their close interrelationship, and their simplicity as indices as well as in view of trends regarding other companies and other factors. The sector performance-linked indices used are net sales and operating income, as these are the most important performance indices used within Daikin and are used by the Company's business departments as daily operational execution targets.

The remuneration of directors and corporate auditors is determined so as to fall within the aggregate remuneration ceiling of directors and corporate auditors as determined by a resolution of the general shareholders' meeting. Based on a report from the Compensation Advisory Committee (composed of four directors other than the president or chairman and chaired by an outside director) and in accordance with the Company's Articles of Incorporation, the directors' remuneration is determined based on a resolution of the Board of Directors while the corporate auditors' remuneration is determined based on a resolution of the Board of Corporate Auditors.



## Directors, Auditors, and Executive Officers (As of June 29, 2010)

Position(s)	Name	Responsibilities & Principal Jobs
Chairman of the Board and CEO	<b>Noriyuki Inoue</b>	
President and COO	<b>Yukiyoshi Okano</b>	Chairman of the CSR Committee, the Corporate Ethics/Risk Management Committee, and the Development Committee for Operational Adequacy Promotion System
Outside Director	<b>Chiyono Terada</b>	President and CEO of Art Corporation
Outside Director	<b>Kosuke Ikebuchi</b>	Senior Advisor to the Board and Senior Technical Executive of Toyota Motor Corporation
Director and Senior Executive Officer	<b>Guntaroh Kawamura</b>	Responsible for Chemicals Business and General Manager of Yodogawa Plant
Director and Senior Executive Officer	<b>Masanori Togawa</b>	Responsible for Corporate Communications, Human Resources, General Affairs, and Facilities Operations and General Manager of the Secretariat Office and the Human Resources Division
Director and Senior Executive Officer	<b>Takeshi Ebisu</b>	General Manager of the Corporate Planning Department and Member of Technology and Innovation Center Development Department
Director and Senior Executive Officer	<b>Jiro Tomita</b>	General Manager of Air-Conditioning Manufacturing Division
Director and Executive Officer	<b>Koichi Takahashi</b>	Responsible for Accounting, Finance, and Budget Operations and General Manager of the Finance and Accounting Division
Director and Executive Officer	<b>Osamu Tanabe</b>	Responsible for Air-Conditioning Development Business (including Applied Solution Division and Refrigeration Division) and Deputy General Manager of Air-Conditioning Manufacturing Division
Corporate Auditor	<b>Shinichi Fujita</b>	
Corporate Auditor	<b>Yutaka Kato</b>	
Outside Corporate Auditor	<b>Yoshiyuki Kaneda</b>	Former officer of Sony Corporation
Outside Corporate Auditor	<b>Hitoshi Murakami</b>	Senior Advisor to Sumitomo Trust & Banking Co., Ltd.
Senior Executive Officer	<b>Katsuhiko Takagi</b>	Chairman of the Board and CEO of O.Y.L. Industries Bhd
Senior Executive Officer	<b>Osamu Okumura</b>	Responsible for Oil Hydraulics Business Electronic System, Corporate Ethics, Legal Affairs, Compliance, and Logistics Operations
Senior Executive Officer	<b>Ken Tayano</b>	Responsible for China Region Business, President of the Board of Daikin (China) Investment Co., Ltd., and Member of Air-Conditioning Global Committee
Senior Executive Officer	<b>Junichi Sato</b>	Responsible for Global Air-Conditioning Business (excluding Japan), General Manager of Global Strategy Division, Member of Global Air-Conditioning Committee, and F.J. Project Leader
Senior Executive Officer	<b>Kunikazu Torikoshi</b>	Responsible for Technology Fusion Strategies and Technology Alliance and Coordination Business, General Manager of the Technology Innovation Development Department, and General Manager of Sakai Plant
Senior Executive Officer	<b>Yukio Hayashi</b>	Responsible for Liaison Business and General Manager of Tokyo Branch
Senior Executive Officer	<b>Kiyohiko Ihara</b>	Responsible for Chemicals Research/Technology/Product Commercialization Promotion/Environment/Safety and Chemicals Patents, Member of Technology and Innovation Center Development Department
Senior Executive Officer	<b>Kosei Uematsu</b>	General Manager of New York Branch, President and Member of the Board of Daikin Holdings (USA), Inc., President and Member of the Board of Daikin U.S. Corporation, and Member of Global Air-Conditioning Committee
Director and Senior Executive Officer	<b>Shigeki Hagiwara</b>	Responsible for Applied Solution Business and Service Operations, General Manager of Applied Solution Business
Senior Executive Officer	<b>Seiji Ideno</b>	Responsible for Oil Hydraulics China Business
Senior Executive Officer	<b>Takeshi Matsuzaki</b>	Global Procurement Business, General Manager of Global Procurement Division, and Member of Technology and Innovation Center Development Department
Senior Executive Officer	<b>Hiroo Yoshioka</b>	Responsible for strengthening Air-Conditioning Overseas Base, Air-Conditioning Manufacturing Technology, and Chemicals Manufacturing Technology, Deputy General Manager of Air-Conditioning Manufacturing Division, and Member of Global Air-Conditioning Committee
Senior Executive Officer	<b>Susumu Okano</b>	General Manager of Corporate Communication Department and Leader of the Corporate Communication Department's Management IR Group
Senior Executive Officer	<b>Shinya Okada</b>	Responsible for PL/Quality, Air-Conditioning/Refrigeration QA, CSR/Global Environment, Defense Systems, and Training Business, Deputy General Manager of Air-Conditioning Manufacturing Division, General Manager of Shiga Plant, and Member of Technology and Innovation Center Development Department
Senior Executive Officer	<b>Masatsugu Minaka</b>	Responsible for Global Strategy Division's Operations regarding Air-Conditioning Operations in the Europe/Middle East/Africa Region, General Manager of the Düsseldorf Office, President of Daikin Europe N.V., and Member of Air-Conditioning Global Committee
Senior Executive Officer	<b>Yasushi Yamada</b>	Responsible for Safety
Executive Officer	<b>Satoru Akama</b>	Responsible for Proposal Marketing, President of Tokyo Daikin Air Conditioning Co., Ltd.
Executive Officer	<b>Masanori Fujikawa</b>	Responsible for Business Flow Innovation Business, Deputy General Manager of Global Procurement Division, and General Manager of Business Flow Innovation Business
Executive Officer	<b>Katsuyuki Sawai</b>	General Manager of the Refrigeration Division, Deputy General Manager of Air-Conditioning Manufacturing Division, and T.J. Project Leader
Executive Officer	<b>Toshitaka Tsubouchi</b>	General Manager of Japan Air-Conditioning Business
Executive Officer	<b>Hiroo Sakai</b>	General Manager of Chemicals Division
Executive Officer	<b>Satokazu Tayama</b>	General Manager of Consolidated Management Administration Group, Finance and Accounting Division

# Compliance

## Compliance Systems and Performance

Reorganized in 2007 to also serve as an organization for promoting ethics, the Corporate Ethics & Risk Management Committee comprehensively promotes compliance (business ethics and legal compliance) and risk management for the Daikin Group as a whole.

More specifically, based on the Group Compliance Policy, Daikin is working in the following ways to deal thoroughly with situations that occur on a day-to-day basis.

1. Daikin strives to ensure that each employee autonomously regulates his or her behavior in accordance with such fundamental management policies and behavior guidelines as those articulated in *Daikin's Group Philosophy and Corporate Ethics Handbook*.
2. The Company works through activities that include those of the Corporate Ethics & Risk Management Committee (composed of directors and department managers and chaired by the president) and that are carried out in large part by the Law, Compliance & Intellectual Property Center to ensure rigorous legal compliance throughout the Group. Each division and Group company appoints "compliance and risk management leaders" (CRLs) who work to ensure thorough legal compliance and risk management in their respective divisions and companies and also organize CRL meetings and Group CRL meetings to share information, identify problems, and promote the execution of counter-measures.
3. The CRLs of each division and Group company gather the latest legal and regulatory information, adjust internal regulations and manuals to harmonize with changes in the external legal and regulatory environment, conduct monthly checks to confirm that compliance with respect to the regulations and manuals is rigorous, and play a central role in "daily triple check" compliance self-assessment activities by each employee. The results of checks are reported at monthly CRL meetings, and related information is shared at those meetings.
4. In accordance with Daikin's unique "compliance self-assessment system," all employees of each division and Group company annually perform self-checks with respect to legal compliance and risks. After receiving the results, the Law, Compliance & Intellectual Property Center performs legal audits of each division and Group company. At the same time, the Internal Auditing Department conducts a legal compliance audit.

5. The Law, Compliance & Intellectual Property Center operates a corporate ethics consultation window service. When that service receives reports of problematic conduct, it investigates the facts and determines preventative countermeasures in consultation with the managers of relevant departments. This system provides for rapid corporate response measures.
6. By promoting thorough compliance with its *Handbook for Corporate Ethics*, Daikin as an organization maintains a resolute resistance to antisocial forces that threaten social order and healthy corporate business activities.
7. Compliance education programs, corporate ethics education programs, and other programs are implemented at regular intervals and as needed for each stratum of managers and ordinary employees as a means of further enhancing compliance consciousness.

## Measures to Improve Internal Controls

Japan's Financial Instruments and Exchange Law (also referred to as the Japanese version of the U.S. Sarbanes-Oxley Act, or J-SOX) took effect during fiscal 2009. Daikin began responding to J-SOX in fiscal 2006 by introducing systems designed to ensure the appropriateness of all operational processes throughout the Daikin Group that could affect financial reporting.

Daikin is continually evaluating these systems to ensure they are properly functioning so that the Company is able to effectively and appropriately provide the internal control reports required by J-SOX. We are preparing to make corrections to the systems if needed to ensure our sustained compliance with J-SOX and related regulations.

In addition to its internal control systems, the Daikin Group has established global accounting regulations and is working to ensure that each Group company is well aware of these regulations as well as to make further improvements with respect to the effectiveness and appropriateness with which the regulations are followed.

Daikin is naturally taking measures to attain such internal control objectives as those associated with ensuring the dependability of financial reports and increasing the effectiveness and efficiency of related operations. In addition, the Company is doing its utmost to work through its actions to earn still greater trust and confidence on the parts of shareholders and diverse other stakeholders.

# Corporate Social Responsibility (CSR)

## Fundamental CSR Policies

The Daikin Group is endeavoring to act as an exemplary corporate citizen and conscientiously fulfill all of its responsibilities to society. The Group's fundamental corporate social responsibility (CSR) policies are as follows.

1. By ensuring the thorough application of its Group Philosophy, the Daikin Group will execute its social responsibilities worldwide with respect to all stakeholders, thereby increasing its corporate value and contributing to society's sustainable development.
2. Based upon the solid foundation of rigorous legal compliance and corporate ethics, the Daikin Group will undertake CSR initiatives with emphasis on contributing to society. These initiatives will include those to create and offer new value by anticipating the future needs of customers; to take measures throughout business operations that sustain and improve the environment and to promote new product development and technological innovation that facilitates society's environmental friendliness; to build friendly yet competitive relations with all suppliers and other business partners; and to cultivate workplaces that foster pride and enthusiasm in each employee. Furthermore, acting as a good corporate citizen, the Daikin Group will demonstrate its usefulness and high level of sensitivity to each community in which it operates by undertaking activities that contribute to society.
3. Rather than simply undertaking business activities that reflect consideration of CSR, the Daikin Group will proactively incorporate CSR initiatives in all its business activities and integrate and unify such initiatives with business activities to realize truly sustained CSR programs and promote improved business performance.
4. The Daikin Group will pursue CSR in a distinctive Daikin manner that leverages Daikin's strengths regarding its traditional corporate culture—which emphasizes freedom and boldness, thorough customer-oriented management, warm hospitality, and other virtues—as well as its world-leading technologies and other special Daikin resources.
5. The Daikin Group will undertake CSR while engaging in widespread two-way communications within society, living up to its responsibility to explain its actions, and maintaining a high level of transparency.

Based on these policies and due consideration of its own special characteristics, the Daikin Group is currently

implementing CSR programs while placing particularly strong emphasis on four CSR themes—"the natural environment," "customer satisfaction and quality", "human resources," and "contributions to society."

### •Environment

As a world leader in the manufacture of air-conditioning equipment, Daikin is striving to leverage the energy-saving technologies incorporated in its offerings to help customers reduce their CO<sub>2</sub> emissions. The Group has also progressively lowered the level of CO<sub>2</sub> emissions associated with its own manufacturing processes, aiming to cut emissions to half the fiscal 2006 level (to 1.4 million tons or less) by fiscal 2011. By making the kind of contributions that are optimal for each country and region of the world, the Daikin Group is endeavoring to promote the global spread of a "green-hearted" spirit that cherishes the Earth and emphasizes environmental friendliness as well as the inheritance of that "green-hearted" spirit by future generations.

### •Product Quality/Customer Satisfaction

Besides doing its utmost to ensure the safety and increasingly high quality of its products in line with customers' expectations, Daikin is intent on promoting ever-higher levels of customer satisfaction by realizing an unparalleled level of service quality with respect to speed, dependability, and cordial solicitude. In both air-conditioning equipment and chemicals operations, including service departments, Daikin has obtained a growing number of international ISO 9001 certifications of its quality management systems. In addition, to make its air-conditioning products easy to use for as many people as possible, regardless of whether those people are elderly or disabled, Daikin is employing universal design concepts during its product development processes.

### •Human Resources

In line with its corporate philosophy, the Daikin Group is promoting "people-oriented" management. Daikin has established personnel and remuneration systems that emphasize the principles of "equal opportunity" and "fairness". Moreover, the Company welcomes and respects diverse employees, regardless of their age, gender, nationality, race, or special needs, and it is seeking to create workplaces that help all employees to maintain a good work-life balance. Aiming to enhance workers' mental and physical health as well as augment worker satisfaction, Daikin is engaged in employee health and safety programs and is proactively moving ahead with the creation of human resource development facilities and programs.

## •Contribution to Society

As it has expanded its business presence throughout the world, the Daikin Group has sought to establish strong roots in many regional and local societies and undertake CSR activities that make tangible contributions to those societies. Many of these contributions stem from Group employee participation in such programs as those involving the promotion of arts, culture, and sports; educational activities; disaster relief assistance; regional safety promotion; and the provision of support to the needy.

## For the Benefit of the World, For the Benefit of Society

The following sections describe recent events that concretely illustrate the state of the Daikin Group's CSR activities.

### •Development of the "Circle of Life" Environmental Education Program, Which Teaches Elementary School Students about Biodiversity

The year 2010 has been designated the "International Year of Biodiversity". To promote wider-spread understanding in society of the importance of biodiversity, it is important to teach the children who will soon be taking charge of society about the special natural phenomena and living organisms of individual regions as well as about the interrelationships among those phenomena and organisms.

In cooperation with an international environmental protection NGO, Conservation International (CI), the Daikin Group has developed the "Circle of Life" environmental education program for elementary school students, which has a central focus on biodiversity. This program discusses a Daikin-supported afforestation program in Indonesia and encourages participants to engage in role-playing activities as a means of enhancing children's interest.

Going on to discuss forest-related issues around the world, the basic form of the program includes four classes in which instructors explain such issues as "the relationship between living beings and the environment" and "the relationship between people living in Japan and the world's environmental problems." The participating children learn that solving environmental problems requires diverse parts of society to make efforts to realize sustainability. They also learn what they themselves can do to help. Since April 2010, Daikin has been providing educational materials for this program to interested elementary schools free of charge.

Daikin also responds to requests to dispatch its own employees to schools to teach a course on the environment-related efforts of manufacturing companies.

The Daikin Group's corporate philosophy calls for the Group to be a leader with respect to society's environmental protection measures. As it expands its business activities throughout the world, Daikin will continue to be true to its corporate philosophy by proactively considering the environment from various perspectives and undertaking diverse environmental initiatives.

### •Visualization of the Global Warming Impact of Refrigerants in Refrigerators and Air Conditioners

In August 2009, the Japan Refrigeration and Air Conditioning Industry Association announced that it would be implementing measures based on a policy goal of visualizing (making visible) the global warming impact of refrigerants used in refrigeration and air-conditioning equipment. In response, the Daikin Group began attaching "Fluoron Visualization" stickers to refrigeration and air-conditioning equipment shipped in Japan from the autumn of 2009.

Currently, most refrigeration and air-conditioning equipment uses hydrofluorocarbons (HFCs) and other refrigerants that do not harm the ozone layer. However, the greenhouse gas effect of those refrigerants is about 1,300 to 4,000 times higher than that of CO<sub>2</sub>, so there is concern that they might have a large global warming promotion impact if they were to be released into the atmosphere. This warrants taking due care to prevent leakage when refrigeration and air-conditioning equipment is installed, moved, and disposed of.

To reduce the environmental impact of refrigerants, the Daikin Group believes that "Fluoron Visualization" is a good first step toward ensuring that all its customers have a proper understanding of this issue. Going forward, Daikin will be seeking to increase the effectiveness of "Fluoron Visualization" by improving its labeling methods and considering the optimal locations for attaching stickers. Daikin is also working to reduce the amount of refrigerant that leaks when products are being used and increase the rate of refrigerant recovery when refrigeration and air-conditioning equipment is retired.

Moreover, the Daikin Group aims to effectively leverage its sophisticated environmental technologies to offer equipment with improved energy-conservation performance, reduce the amount of refrigerant used in air-conditioning equipment, develop systems for detecting refrigerant leakage from equipment, and move ahead with diverse other measures for preventing global warming.

## Seven-Year Financial Highlights

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

	2004	2005	2006	2007
<b>Operating Results (for the year):</b>				
Net sales	¥625,080	¥729,414	¥792,837	¥911,749
Gross profit	212,402	256,289	269,906	312,688
Selling, general and administrative expenses	165,482	196,083	203,359	231,934
Research and development expenses (Note 1)	23,817	24,583	26,648	27,204
Operating income	46,920	60,206	66,547	80,754
EBITDA (Note 2)	50,298	64,898	71,239	87,008
Net income	26,869	38,083	40,146	45,420

<b>Cash Flows (for the year):</b>				
Net cash provided by operating activities	¥ 40,306	¥ 43,970	¥ 63,511	¥ 83,725
Net cash used in investing activities	(31,594)	(42,091)	(63,420)	(305,251)
Free cash flow (Note 3)	8,711	1,879	91	(221,526)
Net cash provided by (used in) financing activities	2,182	3,534	(4,284)	245,975

<b>Financial Position (at year-end):</b>				
Total assets	¥534,726	¥615,596	¥716,440	¥1,161,364
Total interest-bearing liabilities	148,949	166,442	172,995	456,074
Total shareholders' equity	234,029	271,716	340,523	397,542

<b>Per Share Data:</b>				
Net income (basic)	¥101.57	¥ 144.24	¥ 152.11	¥ 172.66
Shareholders' equity	888.29	1,031.73	1,293.41	1,511.47
Cash dividends	14.00	18.00	22.00	28.00

<b>Ratios:</b>				
Gross profit margin	33.98%	35.14%	34.04%	34.30%
Operating income margin	7.51	8.25	8.39	8.86
EBITDA margin	8.05	8.90	8.99	9.54
Return on shareholders' equity (ROE)	12.24	15.06	13.11	12.31
Shareholders' equity ratio	43.77	44.14	47.53	34.23

**Notes:**

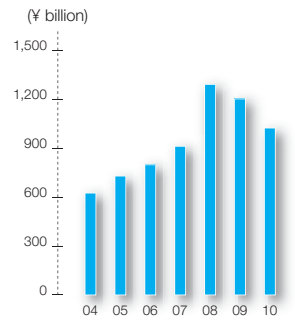
1. R&D expenses are included within general administrative expenses and manufacturing expenses.
2. EBITDA = Operating income + depreciation and amortization.
3. Free cash flow = Net cash provided by operating activities + net cash used in investing activities.



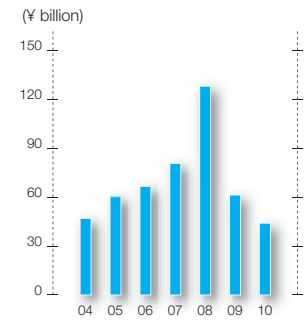
Millions of yen

2008	2009	2010
¥1,291,081	¥1,202,420	<b>¥1,023,964</b>
441,549	363,660	<b>319,301</b>
313,451	302,266	<b>275,263</b>
32,075	30,535	<b>28,220</b>
128,098	61,394	<b>44,038</b>
145,892	80,483	<b>62,817</b>
74,822	21,755	<b>19,391</b>
¥103,329	¥62,238	<b>¥129,227</b>
(76,428)	(99,302)	<b>(39,848)</b>
26,902	(37,065)	<b>89,379</b>
3,367	48,382	<b>(34,942)</b>
¥1,210,094	¥1,117,418	<b>¥1,139,656</b>
356,928	417,919	<b>399,313</b>
545,641	471,686	<b>496,179</b>
¥ 262.24	¥ 74.51	<b>¥ 66.44</b>
1,867.79	1,615.98	<b>1,701.29</b>
38.00	38.00	<b>32.00</b>
34.20%	30.24%	<b>31.19%</b>
9.92	5.11	<b>4.30</b>
11.30	6.69	<b>6.13</b>
15.87	4.28	<b>4.01</b>
45.09	42.21	<b>43.54</b>

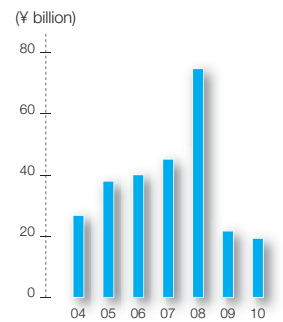
Net Sales



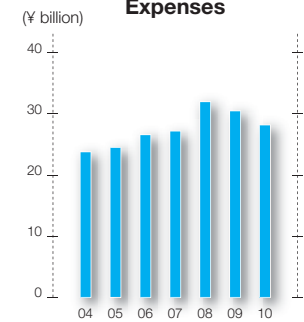
Operating Income



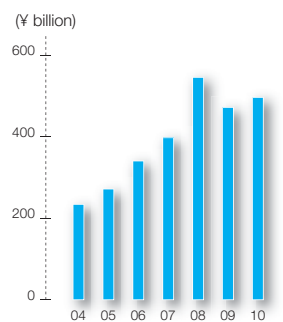
Net Income



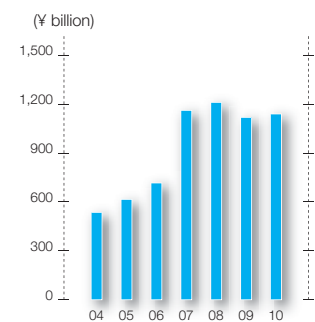
Research and Development Expenses



Shareholders' Equity



Total Assets



## Financial Review

### Overview of Net Sales

During fiscal 2010, support from the rapid economic growth of China, India, and other emerging countries finally applied a brake to the recessionary trends seen in the global economy since the financial crisis. Because of such problems as the stubbornly high unemployment rates of the industrialized countries and the noteworthy fiscal deterioration of southern European countries during the latter half of the fiscal year, however, the degree of economic recovery varied greatly in different countries and regions. Japan has been maintaining a trend of gradual economic recovery owing to an uptrend in export and manufacturing activities, a revival of previously flagging personal consumption, and other factors. There remained numerous causes for concern regarding prospective trends in the Japanese economy, however, such as the continued severity of the country's employment situation and the progress of deflation.

Amid this business environment, the Daikin Group moved at the start of 2009 to adopt its "Creative Challenge and Change" management theme and did its utmost to implement policies related to three top-priority strategic objectives—the execution of thorough measures to generate profit in the short term, the acceleration of moves to generate results from medium- to long-term strategic themes designed with an eye to the future, and the transformation of the Group's corporate constitution to facilitate measures to capitalize on opportunities presented by the current recessionary trends.

With respect to consolidated performance during fiscal 2010, the Group proactively strove to increase its sales and profit through such measures as those to increase the market shares of existing products, expand sales of environment-related products for which demand has remained robust despite recessionary trends, and move still further ahead with comprehensive cost reduction programs. As a result, however, of the decline in demand and the impact of foreign currency factors accompanying the appreciation of the yen, Daikin reported a decline in consolidated net sales of 14.8%, to ¥1,023,964 million. Regarding the Group's profitability, consolidated operating income fell 28.3%, to ¥44,038 million, and consolidated net income decreased 10.9%, to ¥19,391 million.

### Impact of Changes in Currency Exchange Rates

Compared to the previous fiscal year, the yen appreciated against the U.S. dollar and the euro. As a result of these movements in foreign currency exchange rates, Daikin sales were estimated to be ¥70.0 billion lower and operating income

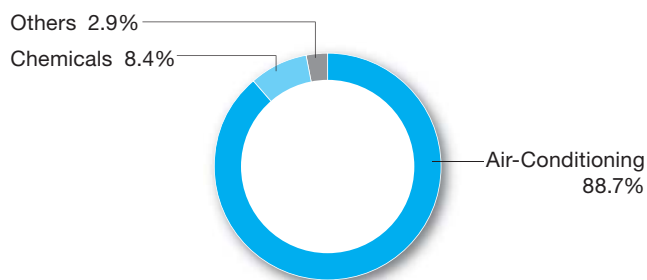
¥13.0 billion lower than they would have been without movements in exchange rates.

The impact of changes in foreign exchange rates was estimated based on a comparison of the yen value of non-yen transactions by each overseas subsidiary and other Group companies when converted at the exchange rates shown below.

	Fiscal 2009	Fiscal 2010
Yen-U.S. dollar rate	¥101	¥93
Yen-euro rate	¥143	¥131

### Net Sales by Product Segment

#### Sales by Industry Segments



### Air-Conditioning

Total sales of air-conditioning and refrigeration products in Japan and overseas amounted to ¥908,565 million, down 14.2% from the previous year, and operating income from those products totaled ¥45,785 million, down 36.1%.

### Japan

Demand in Japan for residential air-conditioning systems fell below the same period of the previous year during the first half of the fiscal year owing to unfavorable weather conditions and the low level of new housing construction starts. In the second half, however, demand was supported by the accelerated purchase of products in accord with previous standards in anticipation of stricter standards associated with the revised Energy Conservation Act and exceeded the level in the same period of the previous year. However, demand for fiscal 2010 as a whole was lower than that in fiscal 2009.

Daikin worked to expand its market share through marketing activities that emphasized the themes of energy conservation and comfortable living spaces and focused primarily on high-value-added products featuring such functions as exclusive URURU humidification functions, ultra-quiet automatic filter-cleaning functions, and *Eraberu Kiryu* functions

(These allow users to choose from among 12 kinds of airflow settings.). The Group also launched highly differentiated new products with such distinctive systems as the Clean ZEAS-Q system, which features an automatic filter-cleaning function, and the Flash Streamer ZEAS-Q system, which features a unique streamer technology to control and dispose of

harmful microorganisms and pollen. These initiatives enabled the Group to increase its domestic market share to a record high level. In addition, demand associated with the emergence of new influenza strains provided supportive conditions for sales of air purifiers, and the Group's unit sales of air purifiers roughly doubled, to a level in excess of 500,000.

#### Unit Sales of Air-Conditioning Systems in the Japanese Air-Conditioning Industry (Fiscal 2010)

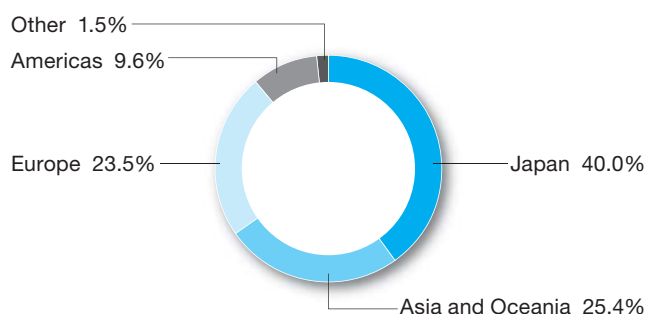
(1,000 units)

	First half	Year on year	Second half	Year on year	Full year	Year on year
Residential use	4,408	(17%)	2,336	3%	6,744	(11%)
Commercial use	329	(21%)	277	(11%)	606	(17%)

#### Overseas

Demand for air conditioners was weak in each overseas region, and the Daikin Group strove to overcome the challenges presented by this demand weakness by working to increase its market shares, expand the geographic scope of heating systems business from Europe into other regions throughout the world, and leverage its cooperation with China-based Gree Electric Appliances, Inc., of Zhuhai, to establish a presence in high-volume segments of residential air-conditioner markets. However, the appreciation of the yen, particularly against the euro, had a negative impact on performance. Reflecting this, overall overseas sales of air conditioners and related products fell below the level in the previous fiscal year.

#### Sales by Geographical Segments



#### Europe Region

Amid a demand environment that continued to be harsh, the Daikin Group leveraged the networks it has built up over numerous years to strengthen its business base and recruit additional marketing agents, and thereby strove to increase the market shares of its existing products while reducing fixed

costs. On the other hand, the Group's new business in heating systems suffered from the negative impact of such situations as a drop in new housing construction starts in France, which is currently the largest market for Daikin's heating systems products. While these factors restrained demand, Daikin's efforts to establish additional marketing agents, strengthen its service systems, launch new products designed to stimulate replacement demand, and launch Daikin Altherma high-temperature water heater systems boosted sales to a level 7% higher than in the previous fiscal year.

#### China

The government's large-scale stimulus programs got China's economic recovery on track. This, the benefits of the Daikin Group's efforts since the start of the year to strengthen its marketing networks in regional cities and inland regions, and the Group's launch of new products and sales promotion measures caused unit sales volume to surpass the level in the previous fiscal year.

Positioning fiscal 2010 as a year for renewed business creation, the Group shifted away from its previous variable refrigerant volume (VRV)-centered business structure and began implementing a strategy for transforming its business in China by marketing a full lineup of air-conditioner products. Daikin also began establishing full-scale business in heater systems by launching heat-pump room- and water-heating equipment products in August 2009 as well as by taking such measures as those to develop new marketing agencies and inaugurate PR programs to enhance recognition of Daikin's name and products.

### Asia/Oceania Region

The impact of the financial crisis on the Asia/Oceania region was relatively light, and the Daikin Group's marketing efforts were able to boost the Group's sales in the region to the level higher than in the previous fiscal year. In Singapore and Thailand, where economic deceleration weakened construction demand and shrank demand for commercial air-conditioning products, the Group developed new marketing agencies, stepped up efforts to obtain small-scale orders, and thereby obtained orders with a greater value than in the previous fiscal year. In Vietnam and other emerging countries where the impact of the financial crisis was relatively light, the Group moved further ahead with measures to develop marketing networks and thereby expand its sales. Business in Australia was facilitated by the government's efforts to promote housing purchases as well as by extremely hot weather, which enabled the Group to expand its sales of residential air-conditioner products.

### North America Region

The weakness of housing and construction market conditions depressed demand for applied products and caused the Daikin Group's sales to drop below the level in the previous fiscal year. Orders began recovering from November, however, reflecting such factors as the launch of air-cooled screw chiller units, DC inverter-equipped turbo chillers, and other strategic products that have an overwhelming advantage over competing products with respect to energy conservation.

In the field of ductless air conditioners, the Group strengthened its marketing network and took other measures that supported the expansion of its sales of mainstay multiple air-conditioning systems for office buildings and thereby sustained its efforts to expand the region's market for such systems. Daikin also began the full-scale marketing of Altherma products in October 2009 and began working to leverage its heat-pump technologies to establish a full-scale presence in the North American heating systems market through such measures as those to build marketing systems, provide support to marketing agencies, and execute product-centered PR programs.

## **Chemicals**

The Daikin Group's total sales in the chemicals segment declined 15.4%, to ¥86,224 million. Against the backdrop of

large drops in demand for fluorochemicals, the Group took thorough measures to strengthen its constitution through comprehensive cost reductions and inventory right-sizing. The maintenance of cost-reduction measures along with sales-promotion measures in response to a demand recovery that began midway through the year enabled the Group to improve the profitability of the chemicals segment, which generated ¥710 million in operating income, an improvement of ¥10,218 million from the previous fiscal year.

Although a trend of recovery in semiconductor- and automobile-related demand for fluoropolymer resins began during the latter half of fiscal 2010, the large negative impact of the demand drop during the first half of the year kept the Group's fiscal 2010 fluoropolymer resins sales in each region of the world below their fiscal 2009 levels.

In the chemical products sector, sales of water and oil repellents exceeded their level in the previous fiscal year. In particular, intense sales-promotion measures for strong anti-smudge surface coating agents for LCD applications boosted sales of those coating agents to a level considerably higher than in the previous fiscal year. Sales of semiconductor-etching products were also relatively strong, and domestic sales of those products were roughly the same as in fiscal 2009.

In the fine chemical products field, the impact of a drop in demand caused sales of chemical compounds used as pharmaceutical intermediates to fall below the level in the previous fiscal year.

## **Others**

Negatively impacted by drops in demand for mainstay oil hydraulic equipment products for applications related to machine tools and general-use industrial machinery, Daikin's industrial machinery-related oil hydraulic equipment business generated ¥29,175 million in sales, down 29.0% from the fiscal 2009 level, and recorded a ¥2,578 million operating loss.

Sales of oil hydraulic equipment for construction equipment and vehicles dropped below the level in the previous year as the impact of the global market weakness depressed demand associated with the mainstay Japanese market as well as shipments to the United States and Europe.

In the defense business, sales to Japan's Ministry of Defense decreased, but efforts to promote sales of household medical-care products kept sector sales in accordance with target levels.

## Costs, Expenses, and Earnings

During fiscal 2010, the Daikin Group strove to increase the market shares of its existing products, promote greater sales of environment-friendly products for which demand was robust despite recessionary conditions, and move still further ahead with comprehensive cost reductions. Reflecting the impact of a drop in demand as well as of currency exchange rate fluctuations, however, consolidated net sales in the fiscal year were restrained to ¥1,023,964 million, down 14.8% from the level in the previous fiscal year. Operating income amounted to ¥44,038 million, down 28.3%, while net income totaled ¥19,391 million, down 10.9%.

The operating income ratio declined 0.8 percentage point, to 4.3%. Despite progress made in reducing cost of sales and selling, general and administrative (SG&A) expenses, the decline in the operating income ratio reflects the impact of such factors as the drop in net sales and a fall in the capacity utilization rate.

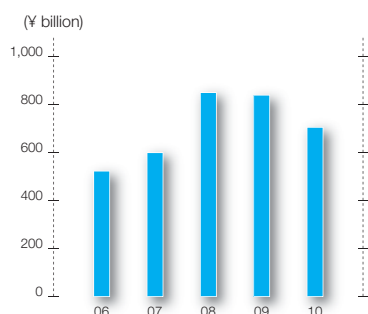
The cost of sales amounted to ¥704,663 million, ¥134,097 million lower than in the previous fiscal year, reflecting the decline in consolidated net sales as well as such efforts as those aimed at reducing costs and fixed expenses.

The cost of sales ratio improved to 68.8%, compared with 69.8% in the previous fiscal year, owing to the sales decline and fixed cost reductions. SG&A expenses decreased ¥27,003 million, to ¥275,263 million, reflecting decreases in product shipment expenses and in sales promotion and advertising expenses.

Other income (expenses)—net amounted to an expense of ¥6,026 million, an improvement of ¥9,394 million compared with the previous year, reflecting foreign exchange gains and gains on the valuation of derivatives.

As a result, net income amounted to ¥19,391 million, 10.9% lower than in the previous fiscal year.

### Cost of Sales



## Outlook for Fiscal 2011

Looking at prospective trends in the global economy, it is anticipated that the economy will continue recovering—supported by the high-growth rates of China, India, and other emerging countries—although there remain risks of a deterioration in economic conditions associated with such factors as the harsh employment environment of industrialized countries, the course of inflation in China, fears of a slump in personal consumption in the United States, and the sovereign risk situation in Europe. Regarding Japan's economy, while there are signs that slack domestic demand may be rising from the bottom, there is no prospect of a complete end to deflationary conditions, so it is expected that the recovery will continue to lack vigor.

Amid this business environment, the Daikin Group is positioning fiscal 2011 as a very important year in which it intends to realize a return to a fundamental trend of increase in revenue and profitability while also drafting new strategic management plans covering fiscal 2011 and subsequent years. This approach was clearly articulated in the Group's New Year's slogan "achieving current targets and pioneering future business." Fiscal 2011 is the final year of Daikin's FUSION 10 strategic management plan, and the Group is concertedly working to execute and realize the benefits of that plan while also preparing the foundation for corporate development in the future.

Specifically, the Group will give top management priority to the "nine Companywide issue themes" listed below so as to quickly overcome problems that have become increasingly conspicuous during the course of efforts to reform and strengthen the Group's constitution. By doing this, the Group intends to realize a V-shaped recovery in its performance.

- Fundamentally strengthen commercial package air-conditioner business and build a global No. 1 position in that field
- Promote comprehensive cost reductions at factories in Japan and strengthen global cost-competitiveness
- Comprehensively raise the level of customer satisfaction regarding product quality, services, etc.
- Promote a sharp surge of sales (air conditioners, chemicals, and hydraulic products) in China, which is the world's largest growth market
- Rapidly expand heat-pump room- and water-heating systems business in Europe, China, and the United States
- Accelerate the global development of applied air-conditioning business
- Accelerate the results of global sales promotion measures for household room air conditioners by increasing competitive



capabilities with respect to relatively low-priced models

- Take proactive measures to expand the Group's positions in the markets of India and Brazil (Latin America)
- Use Flash Streamer technology to develop commercial business and then expand such business globally

Daikin's outlook on a consolidated basis for fiscal 2011 is for a 12.8% increase in net sales, to ¥1,155.0 billion, a 65.8% increase in operating income, to ¥73.0 billion, and a 90.8% increase in net income, to ¥37.0 billion.

Foreign currency exchange rates assumed for fiscal 2011 are ¥120 to one euro and ¥90 to one U.S. dollar.

## Assets

At the end of fiscal 2010, consolidated total assets amounted to ¥1,139,656 million, ¥22,238 million more than at the previous fiscal year-end. Current assets grew ¥25,297 million, to ¥557,131 million, as a consequence of growth in cash and cash equivalents and other factors.

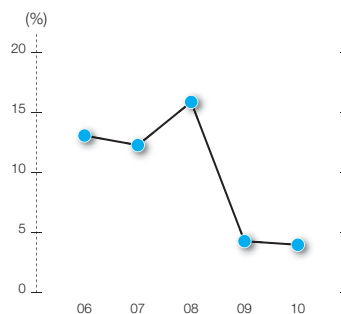
Fixed assets were down ¥3,059 million from the previous fiscal year-end, to ¥582,525 million, despite increases in the market prices of investment securities, reflecting such factors as decreases in tangible fixed assets and goodwill.

## Liabilities and Total Equity

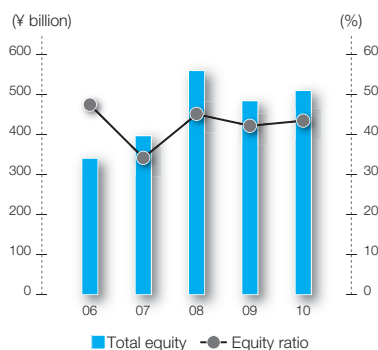
Total liabilities declined ¥3,337 million, to ¥629,594 million, as increases associated with the issuance of bonds were more than offset by decreases in commercial paper outstanding and other factors. The ratio of interest-bearing debt declined to 35.0%, from 37.4% at the end of the previous fiscal year. Positively impacted by such factors as the recording of net income and changes in the net unrealized (loss) gain on available-for-sale securities account owing to fluctuations in market prices of securities, total equity rose ¥25,575 million, to ¥510,061 million.

As a consequence, the ratio of shareholders' equity to total assets grew to 43.5%, compared with 42.2% at the end of the previous fiscal year, and net assets per share increased to ¥1,701.29, versus ¥1,615.98 at the end of the prior year.

## ROE



## Total Equity and Equity Ratio



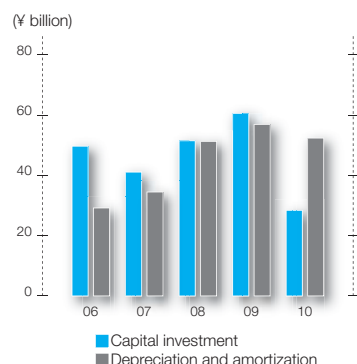
## Cash Flows

### Capital Investment

In accordance with the Daikin Group's fundamental strategy of "concentrating management assets in business fields that offer higher profitability," the Company implemented capital investments during fiscal 2010 with a total value of ¥30,490 million, largely in the air-conditioning and chemicals business fields. In fiscal 2011, Daikin will work to generate greater short-term profit by tightening the focus of capital investments and eliminating investment projects other than those related to major corporate themes. As a result, capital investments for fiscal 2011 are expected to amount to ¥32.0 billion.

Business segment	Company name	Investment amount (¥ million)
Air-conditioning	Daikin	9,752
	Daikin Europe N.V.	2,292
Chemicals	Daikin	3,692
	Daikin America, Inc.	908

## Capital Investment and Depreciation and Amortization



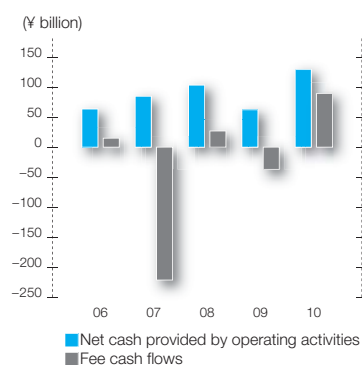
Net cash provided by operating activities amounted to ¥129,227 million, up ¥66,989 million compared with the previous fiscal year, reflecting such factors as rises in trade notes and accounts payable and in inventories.

Net cash used in investing activities amounted to ¥39,848 million, down ¥59,454 million compared with the previous fiscal year, mainly owing to a drop in payment for purchases of property, plant and equipment.

Net cash used in financing activities amounted to ¥34,942 million, a change of ¥83,323 million from ¥48,382 million of net cash provided by financing activities in the previous fiscal year. Despite the issuance of corporate bonds, the change reflected such factors as the repayment of short-term borrowings.

Consequently, cash and cash equivalents at March 31, 2010, amounted to ¥159,325 million.

## Net Cash Provided by Operating Activities and Free Cash Flows



## Dividends

Regarding returns to shareholders, Daikin has a fundamental policy of maintaining the ratio of cash dividends to net assets (consolidated basis) at 2.0% or higher and seeking to set

stable levels of dividends based on a comprehensive consideration of such factors as the Company's consolidated performance, financial position, and funding requirements.

The Company employs internal reserves for strategic investments designed to further strengthen its management structure as well as to accelerate its global business development, accelerate its development of products that contribute to the global environment with the objectives of increasing the scale of its business operations, and raising the level of its competitiveness.

Dividends applicable to fiscal 2010 amounted to ¥32 per share (a ¥16 per share interim dividend and a ¥16 per share year-end dividend), down ¥6 per share from the level in the previous fiscal year. Because of uncertainties regarding the future business environment, no decision has yet been finalized regarding the proposed level of dividends for the current fiscal year.

## Principal Risks Associated with the Daikin Group's Operations

Principal external risk factors with the potential for affecting the Daikin Group's performance and financial condition include the following:

- Sharp changes in politico-economic conditions or supply-demand relationships in principal markets (Japan, Europe, North America, and China and other Asian countries other than Japan, etc.)
- Cold summer weather and other unusual weather patterns accompanied by reduced demand for air conditioners
- Large fluctuations in currency exchange rates
- Major product quality claims
- Major problems with manufacturing systems
- Major changes in the market prices of negotiable securities and other assets
- Product liability
- Improper use of the Group's intellectual property by third parties
- Leakage of personal information or other confidential information
- Unforeseen accidental damage to manufacturing or other facilities due to earthquakes or other natural disasters
- Lawsuits filed against the Company
- Other risks that are difficult to foresee

# Consolidated Balance Sheets

Daikin Industries, Ltd. and Consolidated Subsidiaries  
March 31, 2010 and 2009

ASSETS	Millions of yen	
	2010	2009
<b>Current assets:</b>		
Cash and cash equivalents (Note 15)	¥ 159,325	¥ 104,323
Short-term investments (Notes 7 and 15)	714	919
Trade receivables (Notes 6, 7 and 15):		
Notes	19,991	15,878
Accounts	161,147	162,370
Allowance for doubtful receivables	(5,087)	(5,104)
Inventories (Notes 3 and 7)	185,165	216,645
Deferred tax assets (Note 11)	10,564	9,782
Prepaid expenses and other current assets (Note 7)	25,312	27,021
<b>Total current assets</b>	<b>557,131</b>	<b>531,834</b>
<b>Property, plant and equipment (Note 7):</b>		
Land	29,607	27,825
Buildings and structures	179,803	168,758
Machinery and equipment	355,949	340,612
Furniture and fixtures	112,550	107,324
Lease assets (Note 14)	3,903	3,169
Construction in progress	9,278	21,891
Total	691,090	669,579
Accumulated depreciation	(456,439)	(426,496)
<b>Net property, plant and equipment</b>	<b>234,651</b>	<b>243,083</b>
<b>Investments and other assets:</b>		
Investment securities (Notes 4 and 15)	112,644	89,472
Investments in and advances to unconsolidated subsidiaries and associated companies (Note 15)	4,950	5,275
Goodwill (Note 5)	182,867	193,405
Deferred tax assets (Note 11)	9,709	18,961
Other assets	37,704	35,388
<b>Total investments and other assets</b>	<b>347,874</b>	<b>342,501</b>
<b>Total</b>	<b>¥1,139,656</b>	<b>¥1,117,418</b>

See notes to consolidated financial statements.

LIABILITIES AND EQUITY	Millions of yen	
	2010	2009
<b>Current liabilities:</b>		
Short-term borrowings (Notes 7 and 15)	¥ 86,730	¥ 194,880
Current portion of long-term debt (Notes 7 and 15)	13,381	29,418
Current portion of long-term lease obligations (Note 14)	1,431	1,237
Trade payables (Notes 6 and 15):		
Notes	7,072	8,645
Accounts	90,662	71,493
Construction payable	5,381	8,978
Income taxes payable (Note 15)	8,114	8,742
Deferred tax liabilities (Note 11)	971	3
Accrued expenses	49,077	48,169
Other current liabilities (Note 6)	58,715	57,560
<b>Total current liabilities</b>	<b>321,534</b>	<b>429,125</b>
<b>Long-term liabilities:</b>		
Long-term debt (Notes 7 and 15)	296,208	190,779
Long-term lease obligations (Note 14)	1,562	1,606
Liabilities for retirement benefits (Note 8)	4,469	3,939
Deferred tax liabilities (Note 11)	2,649	1,266
Long-term accounts payable	1,752	5,768
Other long-term liabilities	1,421	449
<b>Total long-term liabilities</b>	<b>308,061</b>	<b>203,807</b>
<b>Commitments and contingent liabilities</b> (Notes 14 and 16)		
<b>Equity</b> (Notes 9, 10 and 19):		
Common stock—authorized, 500,000,000 shares; issued 293,113,973 shares in 2010 and 2009	85,032	85,032
Capital surplus	82,977	82,977
Stock acquisition rights	1,015	764
Retained earnings	375,952	366,836
Unrealized loss on available-for-sale securities	(501)	(15,398)
Deferred gain on derivatives under hedge accounting	162	465
Foreign currency translation adjustments	(41,916)	(43,481)
Treasury stock, at cost: 1,465,756 shares in 2010 and 1,225,087 shares in 2009	(5,528)	(4,744)
Total	497,193	472,451
Minority interests	12,868	12,035
<b>Total equity</b>	<b>510,061</b>	<b>484,486</b>
<b>Total</b>	<b>¥1,139,656</b>	<b>¥1,117,418</b>

# Consolidated Statements of Income

Daikin Industries, Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2010 and 2009

	Millions of yen	
	2010	2009
<b>Net sales</b> (Note 6)	<b>¥1,023,964</b>	¥1,202,420
<b>Cost of sales</b> (Notes 6 and 13)	<b>704,663</b>	838,760
<b>Gross profit</b>	<b>319,301</b>	363,660
<b>Selling, general and administrative expenses</b> (Notes 6 and 13)	<b>275,263</b>	302,266
<b>Operating income</b>	<b>44,038</b>	61,394
<b>Other income (expenses):</b>		
Interest and dividend income	3,933	4,574
Interest expense	(6,719)	(7,033)
Exchange gains (losses)	946	(5,556)
Gain (loss) on valuation of derivatives	1,136	(1,171)
Loss on disposals of property, plant and equipment	(967)	(1,705)
Gain on sales of investment securities	13	3
Write-down of investment securities	(3,634)	(2,775)
Equity in earnings of unconsolidated subsidiaries and associated companies	345	538
Loss on termination of defined benefit pension plan		(1,222)
Loss on cancellation of lease contracts	(1,041)	(0)
Gain on reversal of stock acquisition rights	13	
Other—net	(51)	(1,073)
<b>Other expenses—net</b>	<b>(6,026)</b>	(15,420)
<b>Income before income taxes and minority interests</b>	<b>38,012</b>	45,974
<b>Income taxes</b> (Note 11):		
Current	16,513	21,392
Deferred	(600)	(202)
Total	15,913	21,190
<b>Minority interests</b>	<b>(2,708)</b>	(3,029)
<b>Net income</b>	<b>¥ 19,391</b>	¥ 21,755
	Yen	
<b>Amounts per common share</b> (Notes 2 and 17):		
Basic net income	¥66.44	¥74.51
Diluted net income	66.43	74.50
Cash dividends applicable to the year	32.00	38.00

See notes to consolidated financial statements.



# Consolidated Statements of Changes in Equity

Daikin Industries, Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2010 and 2009

	Millions of yen											
	Outstanding Number of Common Shares Issued	Common Stock	Capital Surplus	Stock Acquisition Right	Retained Earnings	Unrealized Gain (Loss) on Available- for-Sale Securities	Deferred Gain on Derivatives under Hedge Accounting	Foreign Currency Translation Adjustments	Treasury Stock	Total	Minority Interests	Total Equity
<b>Balance, April 1, 2008</b>	292,132,600	¥85,032	¥82,977	¥ 522	¥351,499	¥ 10,102	¥371	¥ 19,160	¥(3,500)	¥546,163	¥13,824	¥559,987
Adjustment of retained earnings due to an adoption of PITF No. 18 (Note 2)					4,750					4,750		4,750
Effect of change of the fiscal year-end of certain consolidated subsidiary (Note 2)					(14)					(14)		(14)
Net income					21,755					21,755		21,755
Cash dividends, ¥38 per share					(11,097)					(11,097)		(11,097)
Repurchase of treasury stock	(310,281)								(1,487)	(1,487)		(1,487)
Disposal of treasury stock	66,567				(57)				243	186		186
Net change in the year				242		(25,500)	94	(62,641)		(87,805)	(1,789)	(89,594)
<b>Balance, March 31, 2009</b>	291,888,886	85,032	82,977	764	366,836	(15,398)	465	(43,481)	(4,744)	472,451	12,035	484,486
Effect of change of the fiscal year-end of certain consolidated subsidiary (Note 2)					2					2		2
Net income					19,391					19,391		19,391
Cash dividends, ¥35 per share					(10,217)					(10,217)		(10,217)
Repurchase of treasury stock	(295,469)								(995)	(995)		(995)
Disposal of treasury stock	54,800				(60)				211	151		151
Net change in the year				251		14,897	(303)	1,565		16,410	833	17,243
<b>Balance, March 31, 2010</b>	<b>291,648,217</b>	<b>¥85,032</b>	<b>¥82,977</b>	<b>¥1,015</b>	<b>¥375,952</b>	<b>¥ (501)</b>	<b>¥162</b>	<b>¥(41,916)</b>	<b>¥(5,528)</b>	<b>¥497,193</b>	<b>¥12,868</b>	<b>¥510,061</b>

See notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

Daikin Industries, Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2010 and 2009

	Millions of yen	
	2010	2009
<b>Operating activities:</b>		
Income before income taxes and minority interests	¥ 38,012	¥ 45,974
Adjustment for:		
Income taxes—paid	(14,113)	(31,952)
Depreciation and amortization	52,424	56,931
Gain on sales of investment securities	(13)	(3)
Write-down of investment securities	3,634	2,775
Loss on disposals of property, plant and equipment	967	1,705
Equity in earnings of unconsolidated subsidiaries and associated companies	(345)	(538)
Changes in assets and liabilities, net of effects of the purchase of subsidiaries:		
Trade notes and accounts receivable	309	21,376
Inventories	33,055	(3,885)
Other current assets	(1,168)	169
Prepaid pension cost	1,841	(893)
Trade notes and accounts payable	16,154	(31,191)
Accrued expenses	397	(972)
Other current liabilities	1,066	4,271
Liabilities for retirement benefits	(116)	(248)
Account payable for transaction to defined contribution pension plan	(3,946)	(707)
Other—net	1,069	(574)
Total adjustments	91,215	16,264
Net cash provided by operating activities	129,227	62,238
<b>Investing activities:</b>		
Payment for purchases of property, plant and equipment	(29,984)	(61,381)
Proceeds from sales of property, plant and equipment	2,146	442
Payments for acquisition of newly consolidated subsidiaries, net of cash and cash equivalents acquired (Note 12)	(4,598)	(8,792)
Payments for transfer of business	(465)	(731)
Increase in investments in and advances to unconsolidated subsidiaries and associated companies	(4,984)	(3,685)
Payments for acquisition of investment securities	(2,081)	(19,287)
Proceeds from sales of investment securities	34	5
Other—net	84	(5,873)
Net cash used in investing activities	(39,848)	(99,302)
<b>Financing activities:</b>		
Net (decrease) increase in short-term borrowings	(108,616)	66,728
Increase in long-term debt	120,031	11,260
Repayments of long-term debt	(30,821)	(13,660)
Payments of cash dividends	(10,217)	(11,097)
Other—net	(5,319)	(4,849)
Net cash (used in) provided by financing activities	(34,942)	48,382
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>380</b>	<b>(17,394)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>54,817</b>	<b>(6,076)</b>
<b>Effect of change of the fiscal year-end of consolidated subsidiaries</b>	<b>185</b>	<b>(85)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>104,323</b>	<b>110,484</b>
<b>Cash and cash equivalents, end of year</b>	<b>¥159,325</b>	<b>¥104,323</b>

See notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Daikin Industries, Ltd. and Consolidated Subsidiaries  
Years Ended March 31, 2010 and 2009

## 1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of Daikin Industries, Ltd. (the "Company") have been prepared in accordance with the provisions set forth in the Japanese Financial Instruments and Exchange Act and its related accounting regulations and in conformity with accounting principles generally accepted in Japan (the "Japanese GAAP"), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

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 in the 2009 consolidated financial statements to conform to the classification used in 2010.

## 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 in which 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 or accounted for using the equity method, respectively, the effect on the accompanying consolidated financial statements would not have been material.

For the year ended March 31, 2010, the Company consolidated the operating results of a consolidated subsidiary, Daikin Airconditioning Poland Sp. z o.o. for the 15-month period ended March 31, 2010, because that subsidiary changed its fiscal year-end from December 31 to March 31.

For the year ended March 31, 2009, the Company consolidated the operating results of a consolidated subsidiary, Daikin Sweden AB, for the 15-month period ended March 31, 2009, because that subsidiary changed its fiscal year-end from December 31 to March 31.

The Company included the subsidiaries' operating results for the 12-month period in the consolidated statements of income, and included their operating results for the 3-month period in the consolidated statements of changes in equity as effect of change of the fiscal year-end of consolidated subsidiaries.

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 3 to 20 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.

### Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements

In May 2006, the Accounting Standards Board of Japan (the "ASBJ") issued ASBJ Practical Issues Task Force (PITF) No. 18, "Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements". PITF No. 18 prescribes: (1) the accounting policies and procedures applied to a parent company and its subsidiaries for similar transactions and events under similar circumstances should, in principle, be unified for the preparation of the consolidated financial statements, (2) financial statements prepared by foreign subsidiaries in accordance with either International Financial Reporting Standards or the generally accepted accounting principles in the United States of America tentatively may be used for the consolidation process, (3) however, the following items should be adjusted in the consolidation process so that net income is accounted for in accordance with Japanese GAAP unless they are not material: 1) amortization of goodwill; 2) scheduled amortization of actuarial gain or loss of pensions that has been directly recorded in the equity; 3) expensing capitalized development costs of research and development; 4) cancellation of the fair value model accounting for property, plant and equipment and investment properties and incorporation of the cost model accounting; 5) recording the prior years' effects of changes in accounting policies in the income statement where retrospective adjustments to financial statements have been incorporated; and 6) exclusion of minority interests from net income, if contained. PITF No. 18 was effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted.

The Company applied this accounting standard effective April 1, 2008. In addition, the Company adjusted the beginning balance of retained earnings at April 1, 2008 as if this accounting standard had been retrospectively applied.

### 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 which mature within three months of the date of acquisition. Time deposits that mature in more than three months but within a year of the date of acquisition are recorded as short-term investments.

#### **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 principally stated at the lower of cost, determined by the average method, or net selling value. Inventories of consolidated foreign subsidiaries are principally stated at the lower of cost, determined by the average 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 principally computed by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998. 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 from 15 to 50 years for buildings and structures and from 5 to 15 years for machinery and equipment. The useful lives for lease assets are the terms of the respective leases.

#### **Long-Lived Assets**

The Group reviews its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

#### **Leases**

In March 2007, the ASBJ issued ASBJ Statement No. 13, "Accounting Standard for Lease Transactions", which revised the previous accounting standard for lease transactions issued in June 1993. The revised accounting standard for lease transactions was effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted for fiscal years beginning on or after April 1, 2007.

Under the previous accounting standard, finance lease transactions that deem to transfer ownership of the leased property to the lessee were to be capitalized. However, other finance lease transactions were permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the note to the lessee's financial statements. The revised accounting standard requires that all finance lease transactions should be capitalized to recognize lease assets and lease obligations in the balance sheet. In addition, the accounting standard permits lease transactions which existed at the transition date and do not transfer ownership of the leased property to the lessee to be accounted for as operating lease transactions.

The Company and its consolidated domestic subsidiaries applied the revised accounting standard effective April 1, 2008. In addition, the Company and its consolidated domestic subsidiaries accounted for leases which existed at the transition date and do not transfer ownership of the leased property to the lessee as operating lease transactions.

All other leases are accounted for as operating leases.

#### **Investment Securities**

Under Japanese accounting standards 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 equity. The cost of securities sold is principally determined based on the moving-average method.

Non-marketable available-for-sale securities are stated at cost principally 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.

#### **Employees' Retirement Benefits**

The Company and its consolidated domestic subsidiaries have non-contributory funded pension plans covering substantially all of its employees. Effective April 1, 2000, the Company and its consolidated domestic subsidiaries 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. Certain consolidated foreign subsidiaries have pension plans.

Based on an agreement between labor and management in October 2008, certain of the Company's consolidated subsidiaries implemented a defined benefit pension plan and a defined contribution pension plan effective January 1, 2009, and then terminated the former qualified defined benefit pension plan.

In July 2008, the ASBJ issued ASBJ Statement No. 19 "Partial Amendment to Accounting Standard for Retirement Benefit (Part 3)". This standard was effective for the end of the fiscal years beginning on or after April 1, 2009 with early adoption permitted for the end of the fiscal years beginning on or before March 31, 2009.

Under the previous accounting standard, the discount rate were permitted to be determined taking into consideration fluctuations in the yield of bonds over a certain period. This amendment to accounting standard requires that the discount rate should be determined by the yield of bonds at the end of the fiscal year.

The Company and its consolidated domestic subsidiaries applied this amendment to accounting standard effective April 1, 2009. There is no effect of this change on projected benefit obligation, operating income and income before income taxes and minority interests.

### **Stock Options**

The ASBJ issued ASBJ Statement No. 8, "Accounting Standard for Stock Options" and related guidance applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions.

The Company has applied this accounting standard for stock options to those granted on and after May 1, 2006.

### **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 statements 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 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 equity.

### **Bonuses to Directors and Corporate Auditors**

Bonuses to directors and corporate auditors are accrued at the year-end to which such bonuses are attributable.

### **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. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

### **Derivative Financial Instruments**

The Group uses foreign exchange forward contracts, currency swaps and currency options to hedge foreign exchange risk associated with certain assets and liabilities denominated in foreign currencies.

The Group uses mainly interest rate swaps and interest rate options to manage its exposures to fluctuations in interest rates.

The Group uses commodity future contracts to hedge the risk of fluctuation of commodity prices for materials. 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 consolidated 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 are recognized and included in interest expense or income.

### **Amounts per Common Share**

Basic net income per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share of common stock assumes full exercise of the outstanding stock options which have dilutive effect at the beginning of the year (or at the time of issuance).

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.



## New Accounting Pronouncements

### Business Combinations

In December 2008, the ASBJ issued a revised accounting standard for business combinations, ASBJ Statement No. 21, "Accounting Standard for Business Combinations". Major accounting changes under the revised accounting standard are as follows:

- (1) The current accounting standard for business combinations allows companies to apply the pooling of interests method of accounting when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. The revised standard requires to account for such business combination by the purchase method and the pooling of interests method of accounting is no longer allowed.
- (2) The current accounting standard accounts for the research and development costs to be charged to income as incurred. Under the revised standard, in-process research and development acquired in a business combination is capitalized as an intangible asset.
- (3) The current accounting standard accounts for a bargain purchase gain (negative goodwill) to be systematically amortized within 20 years. Under the revised standard, the acquirer recognizes a bargain purchase gain in profit or loss on the acquisition date after reassessing whether it has correctly identified all of the assets acquired and all of the liabilities assumed with a review of such procedures used.

This standard is applicable to business combinations undertaken on or after April 1, 2010 with early adoption permitted for fiscal years beginning on or after April 1, 2009.

### Unification of Accounting Policies Applied to Foreign Associated Companies for the Equity Method

The current accounting standard requires unification of accounting policies within the consolidation group. However, the current guidance allows application of the equity method to the financial statements of foreign associated companies which have been prepared in accordance with generally accepted accounting principles in their respective jurisdictions without unification of accounting policies.

In December 2008, the ASBJ issued ASBJ Statement No. 16 (Revised 2008), "Revised Accounting Standard for Equity Method of Accounting for Investments". The new standard requires adjustments to be made to conform the associate's accounting policies for similar transactions and events under similar circumstances to those of the parent company when the associate's financial statements are used in applying the equity method unless it is impracticable to determine adjustments. In addition, financial statements prepared by foreign associated companies in accordance with either International Financial Reporting Standards or the generally accepted accounting principles in the United States tentatively may be used in applying the equity method if the following items are adjusted so that net income is accounted for in accordance with Japanese GAAP unless they are not material: 1) amortization of goodwill; 2) scheduled amortization of actuarial gain or loss of pensions that has been directly recorded in the equity; 3) expensing capitalized development costs of research and development; 4) cancellation of the fair value model accounting for property, plant, and equipment and investment properties and incorporation of the cost model accounting; 5) recording the prior years' effects of changes in accounting policies in the income statement where retrospective adjustments to the financial statements have been incorporated; and 6) exclusion of minority interests from net income, if contained.

This standard is applicable to equity method accounting for investments on or after April 1, 2010 with early adoption permitted for fiscal years beginning on or after April 1, 2009.

### Asset Retirement Obligations

In March 2008, the ASBJ published a new accounting standard for asset retirement obligations, ASBJ Statement No. 18 "Accounting Standard for Asset Retirement Obligations" and ASBJ Guidance No. 21 "Guidance on Accounting Standard for Asset Retirement Obligations". Under this accounting standard, an asset retirement obligation is defined as a legal obligation imposed either by law or contract that results from the acquisition, construction, development and the normal operation of a tangible fixed asset and is associated with the retirement of such tangible fixed asset.

The asset retirement obligation is recognized as the sum of the discounted cash flows required for the future asset retirement and is recorded in the period in which the obligation is incurred if a reasonable estimate can be made. If a reasonable estimate of the asset retirement obligation cannot be made in the period the asset retirement obligation is incurred, the liability should be recognized when a reasonable estimate of asset retirement obligation can be made. Upon initial recognition of a liability for an asset retirement obligation, an asset retirement cost is capitalized by increasing the carrying amount of the related fixed asset by the amount of the liability. The asset retirement cost is subsequently allocated to expense through depreciation over the remaining useful life of the asset. Over time, the liability is accreted to its present value each period. Any subsequent revisions to the timing or the amount of the original estimate of undiscounted cash flows are reflected as an increase or a decrease in the carrying amount of the liability and the capitalized amount of the related asset retirement cost. This standard is effective for fiscal years beginning on or after April 1, 2010 with early adoption permitted for fiscal years beginning on or before March 31, 2010.

### Measurement of Inventories

In September 2008, the ASBJ issued ASBJ Statement No. 9 (revised 2008), "Accounting Standard for Measurement of Inventories". Under this accounting standard, the Last-In, First-Out (LIFO) method is no longer permitted. This standard is

applicable for fiscal years beginning on or after April 1, 2010 with early adoption permitted for fiscal years beginning on or before March 31, 2010.

### Accounting Changes and Error Corrections

In December 2009, ASBJ issued ASBJ Statement No. 24 "Accounting Standard for Accounting Changes and Error Corrections" and ASBJ Guidance No. 24 "Guidance on Accounting Standard for Accounting Changes and Error Corrections". Accounting treatments under this standard and guidance are as follows:

#### (1) Changes in Accounting Policies

When a new accounting policy is applied with revision of accounting standards, a new policy is applied retrospectively unless the revised accounting standards include specific transitional provisions. When the revised accounting standards include specific transitional provisions, an entity shall comply with the specific transitional provisions.

#### (2) Changes in Presentations

When the presentation of financial statements is changed, prior period financial statements are reclassified in accordance with the new presentation.

#### (3) Changes in Accounting Estimates

A change in an accounting estimate is accounted for in the period of the change if the change affects that period only, and is accounted for prospectively if the change affects both the period of the change and future periods.

#### (4) Corrections of Prior Period Errors

When an error in prior period financial statements is discovered, those statements are restated.

This accounting standard and the guidance are applicable to accounting changes and corrections of prior period errors which are made from the beginning of the fiscal year that begins on or after April 1, 2011.

### Segment Information Disclosures

In March 2009, the ASBJ revised ASBJ Statement No. 17 "Accounting Standard for Segment Information Disclosures" and issued ASBJ Guidance No. 20 "Guidance on Accounting Standard for Segment Information Disclosures". Under the standard and guidance, an entity is required to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available and such information is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, segment information is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments.

This accounting standard and the guidance are applicable to segment information disclosures for the fiscal years beginning on or after April 1, 2010.

## 3. Inventories

Inventories at March 31, 2010 and 2009 consisted of the following:

	Millions of yen	
	2010	2009
Finished products and merchandise	¥111,867	¥133,741
Semi-finished products and work-in-process	41,860	44,451
Raw materials and supplies	31,438	38,453
Total	¥185,165	¥216,645

## 4. Investment Securities

The acquisition costs and aggregate fair values of marketable available-for-sale securities included in investment securities at March 31, 2010 and 2009 were as follows:

	Millions of yen			
	2010			Fair Value
	Cost	Unrealized Gains	Unrealized Losses	
Securities classified as available-for-sale:				
Equity securities	¥104,729	¥15,487	¥(16,621)	¥103,595
Debt securities	200	4		204
Other	503	62	(88)	477
Total	¥105,432	¥15,553	¥(16,709)	¥104,276

	Millions of yen			
	2009			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥106,638	¥8,466	¥(34,777)	¥80,327
Other	503		(138)	365
Total	¥107,141	¥8,466	¥(34,915)	¥80,692

Available-for-sale securities whose fair value was not readily determinable as of March 31, 2009 were as follows. The similar information for 2010 is disclosed in Note 15.

	Millions of yen
	Carrying Amount
	2009
Available-for-sale:	
Equity securities	¥7,200
Other	1,580
Total	¥8,780

Proceeds from sales of available-for-sale securities for the year ended March 31, 2009 were ¥5 million. Gross realized gains on these sales principally computed on the moving average cost basis were ¥3 million for the year ended March 31, 2009.

The information of available-for-sale securities which were sold during the year ended March 31, 2010 was as follows:

	Millions of yen		
	March 31, 2010		
	Proceeds	Realized Gains	Realized Loss
Available-for-sale:			
Equity securities	¥34	¥13	¥

The impairment losses on marketable available-for-sale securities for the years ended March 31, 2010 and 2009 were ¥3,616 million and ¥2,633 million, respectively.

## 5. Goodwill

Goodwill at March 31, 2010 and 2009 consisted of the following:

	Millions of yen	
	2010	2009
Consolidation goodwill	¥181,842	¥192,295
Other	1,025	1,110
Total	¥182,867	¥193,405

Amortization of goodwill was ¥12,112 million and ¥12,120 million for the years ended March 31, 2010 and 2009, respectively.

## 6. Related Party Transactions

Receivables and payables, with respect to transactions with unconsolidated subsidiaries and associated companies at March 31, 2010 and 2009 were as follows:

	Millions of yen	
	2010	2009
Trade notes and accounts receivable	¥1,563	¥2,032
Trade notes and accounts payable	1,015	565

Sales to and purchases from unconsolidated subsidiaries and associated companies for the years ended March 31, 2010 and 2009 were as follows:

	Millions of yen	
	2010	2009
Sales	¥8,874	¥15,887
Purchases	7,620	10,673

Material transactions and balances with related individuals for the years ended March 31, 2010 and 2009 were as follows:

**(1) 2010**

(a) The Company

Name	Description of Post	Ownership of the Company (%)	Millions of yen	
			Transactions	Resulting Account Balances
			Description of Transaction	Account
Chiyono Terada	Outside Director/CEO and President of Art Corporation	0.00	Commission for moving business and delivery business	Other current liabilities
			2010	2010
			¥362	¥31

(b) The Company's consolidated subsidiaries

Name	Description of Post	Ownership of the Company (%)	Millions of yen	
			Transactions	Resulting Account Balances
			Description of Transaction	Account
Chiyono Terada	Outside Director/CEO and President of Art Corporation	0.00	Commission for moving business and delivery business	Other current liabilities
			2010	2010
			¥56	¥5
			Sales of products and other	Accounts receivable
			44	8

**(2) 2009**

(a) The Company

Name	Description of Post	Ownership of the Company (%)	Millions of yen	
			Transactions	Resulting Account Balances
			Description of Transaction	Account
Chiyono Terada	Outside Director/CEO and President of Art Corporation	0.00	Commission for moving business and delivery business	Other current liabilities
			2009	2009
			¥217	¥33

(b) The Company's consolidated subsidiaries

Name	Description of Post	Ownership of the Company (%)	Millions of yen	
			Transactions	Resulting Account Balances
			Description of Transaction	Account
Chiyono Terada	Outside Director/CEO and President of Art Corporation	0.00	Commission for moving business and delivery business	Other current liabilities
			2009	2009
			¥40	¥ 3
			Sales of products and other	Accounts receivable
			¥79	¥14

**7. Short-Term Borrowings and Long-Term Debt**

Short-term borrowings of the Group at March 31, 2010 and 2009 consisted of the following:

	Millions of yen	
	2010	2009
Bank overdrafts and notes to banks	¥69,730	¥ 74,880
Commercial paper	17,000	120,000
Total	¥86,730	¥194,880

Unused short-term bank credit lines were ¥75,000 million at March 31, 2010. Weighted average interest rates of bank overdrafts and notes to banks at March 31, 2010 and 2009 were 1.06% and 1.51%, respectively.

Weighted average interest rates of commercial paper at March 31, 2010 and 2009 were 0.11% and 0.46%, respectively.

Long-term debt at March 31, 2010 and 2009 consisted of the following:

	Millions of yen	
	2010	2009
0.82% unsecured bonds, due October 2009		¥ 20,000
1.00% unsecured bonds, due 2014	¥ 30,000	
1.42% unsecured bonds, due 2016	30,000	
1.86% unsecured bonds, due 2019	40,000	
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 1.75% (2010), 1.40% (2009), due through 2019	21,000	1,500
Collateralized loans from banks and others, payable in foreign currencies, with interest ranging from 3.00% to 7.63% (2010), and from 4.00% to 7.63% (2009), due through 2012	694	1,012
Collateralized loans from banks with:		
Floating interest at 1.14% (2009), due through 2010		2,290
Unsecured loans from banks and others, payable in foreign currencies, with interest ranging from 0.83% to 5.70% (2010), and from 2.00% to 7.91% (2009), due through 2018	14,593	21,317
Unsecured loans from banks and others with interest ranging from 0.49% to 3.55% (2010), and from 0.71% to 6.10% (2009), due through 2027	172,102	172,878
Total	309,589	220,197
Less current portion	(13,381)	(29,418)
Long-term debt, less current portion	¥296,208	¥190,779

Annual maturities of long-term debt outstanding at March 31, 2010 were as follows:

Years ending March 31,	Millions of yen
2011	¥ 13,381
2012	2,440
2013	56,954
2014	11,553
2015	80,073
2016 and thereafter	145,188
Total	¥309,589

At March 31, 2010, property, plant and equipment, trade accounts receivables, inventories and prepaid expense and other current assets with a book value of ¥43,600 million, ¥11,775 million, ¥6,795 million and ¥993 million, respectively, were pledged as collateral for short-term borrowings and long-term debt, and short-term investments with a book value of ¥643 million were pledged as collateral for a supplier's borrowings of ¥418 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 these rights 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.

Based on an agreement between labor and management in October 2008, certain of the Company's consolidated subsidiaries implemented a defined benefit pension plan and a defined contribution pension plan effective January 1, 2009, and then terminated the former qualified defined benefit pension plan.



The liabilities for employees' retirement benefits at March 31, 2010 and 2009 consisted of the following:

	Millions of yen	
	2010	2009
Projected benefit obligation	¥69,068	¥64,422
Fair value of plan assets	(67,355)	(59,368)
Unrecognized prior service cost	218	280
Unrecognized actuarial gain	(9,724)	(15,502)
Net asset	(7,793)	(10,168)
Prepaid pension cost	(12,262)	(14,107)
Liabilities for retirement benefits	¥ 4,469	¥ 3,939

The components of net periodic benefit costs for the years ended March 31, 2010 and 2009 were as follows:

	Millions of yen	
	2010	2009
Service cost	¥3,137	¥3,071
Interest cost	1,968	2,491
Expected return on plan assets	(1,950)	(2,702)
Amortization of prior service cost	(33)	(25)
Recognized actuarial loss (gain)	1,927	588
Net periodic benefit costs	5,049	3,423
Loss on transfer to a defined contribution pension plan		1,222
Contribution to defined contribution pension plan and other	3,039	2,287
Total	¥8,088	¥6,932

Assumptions used for the years ended March 31, 2010 and 2009 were set forth as follows:

	2010	2009
Discount rate	Mainly 2.0%	Mainly 2.0%
Expected rate of return on plan assets	Mainly 2.5%	Mainly 2.5%
Amortization period of prior service cost	Mainly 10 years	Mainly 10 years
Recognition period of actuarial gain/loss	Mainly 10 years	Mainly 10 years

## 9. Equity

Japanese companies have been subject to the Companies Act of Japan (the "Companies Act"). The significant provisions in the Companies Act that affect financial and accounting matters are summarized below:

### (a) Dividends

Under the Companies Act, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders' meeting. For companies that meet certain criteria such as: (1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) at any time during the fiscal year if the company has prescribed so in its articles of incorporation. However, the Company cannot do so because it does not meet all the above criteria.

The Companies Act permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the Company so stipulate. The Companies Act provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

### (b) Increases/Decreases and Transfer of Common Stock, Reserve and Surplus

The Companies Act requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of the aggregate amount of the legal reserve and additional paid-in capital equals 25% of the common stock. Under the Companies Act, the total amount of additional paid-in capital and legal reserve may be reversed without limitation. The Companies Act also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

### (c) Treasury Stock and Treasury Stock Acquisition Rights

The Companies Act also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by specific formula.

Under the Companies Act, stock acquisition rights are presented as a separate component of equity.

The Companies Act also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of equity or deducted directly from stock acquisition rights.

## 10. Stock Option

The stock options outstanding for the year ended March 31, 2010 were as follows:

Stock Option	Persons Granted	Number of Options Granted	Date of Grant	Exercise Price	Exercise Period
2003 Stock Option	20 directors 19 employees	118,000 shares	2003.7.30	¥2,405	From July 1, 2005 to June 30, 2009
2004 Stock Option	9 directors 40 employees	144,000 shares	2004.7.27	¥2,957	From July 1, 2006 to June 30, 2010
2005 Stock Option	9 directors 44 employees	153,000 shares	2005.7.29	¥2,852	From July 1, 2007 to June 30, 2011
2006 Stock Option	9 directors 44 employees	298,000 shares	2006.7.18	¥3,790	From July 19, 2008 to July 18, 2012
2007 Stock Option	9 directors 42 employees	292,000 shares	2007.7.17	¥4,640	From July 18, 2009 to July 17, 2013
2008 Stock Option	8 directors 44 employees	308,000 shares	2008.7.14	¥5,924	From July 15, 2010 to July 14, 2014
2009 Stock Option	8 directors 42 employees	294,000 shares	2009.7.13	¥3,250	From July 14, 2011 to July 13, 2015

The stock option activity was as follows:

	2002 Stock Option	2003 Stock Option	2004 Stock Option	2005 Stock Option	2006 Stock Option	2007 Stock Option	2008 Stock Option	2009 Stock Option
	(Shares)							
For the year ended March 31, 2009								
Vested								
March 31, 2008—Outstanding	15,000	35,000	100,000	123,500	298,000	292,000		
Granted							308,000	
Exercised	15,000	13,000	10,000	22,200	6,000			
Canceled		22,000	90,000	101,300	292,000	292,000	308,000	
March 31, 2009—Outstanding								
For the year ended March 31, 2010								
Vested								
March 31, 2009—Outstanding		22,000	90,000	101,300	292,000	292,000	308,000	
Granted								294,000
Exercised		22,000	19,000	12,500	1,300			
Canceled					12,000	4,000		
March 31, 2010—Outstanding			71,000	88,800	278,700	288,000	308,000	294,000
Exercise price		¥2,405	¥2,957	¥2,852	¥3,790	¥4,640	¥5,924	¥3,250
Average stock price at exercise		¥3,094	¥3,527	¥3,504	¥3,536			
Fair value price at grant date					¥ 736	¥1,015	¥ 803	¥ 899

The assumptions used to measure fair value of 2009 Stock Option

Estimate method:	Black-Scholes option pricing model
Volatility of stock price:	48.7%
Estimated remaining outstanding period:	4 years
Estimated dividend:	¥38 per share
Interest rate with risk free:	0.5%

## 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 40.6% for the years ended March 31, 2010 and 2009.

The tax effects of significant temporary differences and tax loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2010 and 2009 were as follows:

	Millions of yen	
	2010	2009
Deferred tax assets:		
Tax loss carryforwards	¥12,879	¥ 6,982
Warranty reserve	7,535	4,812
Inventories	6,430	8,252
Investment securities	4,475	2,565
Software and other assets	4,073	4,646
Accrued bonus	3,263	3,083
Account payable other	1,867	1,804
Liabilities for retirement benefits	1,518	1,399
Allowance for doubtful receivables	1,117	968
Unrealized loss on available-for-sale securities	867	11,067
Long-term account payable	714	2,273
Other	5,644	8,353
Less valuation allowance	(12,100)	(8,365)
Total deferred tax assets	¥38,282	¥47,839
Deferred tax liabilities:		
Undistributed earnings of consolidated subsidiaries	¥10,417	¥ 9,250
Prepaid pension cost	4,997	5,738
Deferred gains on sales of property	2,267	2,202
Other	3,948	3,175
Total deferred tax liabilities	¥21,629	¥20,365
Net deferred tax assets	¥16,653	¥27,474

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 year ended March 31, 2009 was as follows:

	2009
Normal effective statutory income tax rate	40.6%
Difference in foreign subsidiaries' tax rate	(21.6)
Unrecognized tax effect on foreign income tax credit	12.7
Valuation allowance	10.1
Amortization of goodwill	9.2
Undistributed earnings of consolidated subsidiaries	(5.6)
Other—net	0.7
Actual effective income tax rate	46.1%

A reconciliation of difference between the normal effective statutory tax rates and the actual effective tax rates is not disclosed since the difference is less than 5% of the normal effective statutory income tax rate for the year ended March 31, 2010.

At March 31, 2010, the Company and certain consolidated subsidiaries had tax loss carryforwards aggregating approximately ¥30,874 million, which are available to be offset against taxable income of the Company and such subsidiaries in future years. These tax loss carryforwards, if not utilized, will expire as follows:

Year ending March 31	Millions of yen
2011	¥ 12
2012	82
2013	325
2014	2,475
2015	878
2016 and thereafter	27,102
Total	¥30,874

## 12. Supplemental Cash Flow Information

The Company acquired certain companies during the year ended March 31, 2009. ROTEX Heating Systems GmbH and its nine subsidiaries were the major component of the acquisitions.

A reconciliation between cash paid for the shares of ROTEX Heating Systems GmbH and its nine subsidiaries and payment for the acquisition of these newly consolidated subsidiaries, net of cash and cash equivalents acquired, was as follows:

	Millions of yen
	2009
Assets	¥9,914
Goodwill	4,287
Liabilities	(6,753)
Cash paid for the shares	7,448
Cash and cash equivalents of consolidated subsidiaries	(209)
Payment for acquisition of shares of newly consolidated subsidiaries, net of cash and cash equivalents acquired	¥7,239

## 13. Research and Development Costs

Research and development costs were ¥28,220 million and ¥30,535 million for the years ended March 31, 2010 and 2009, respectively.

## 14. Leases

The Group leases certain computer equipment and other assets.

Obligations under finance leases and future minimum payments under noncancelable operating leases were as follows:

	Millions of yen	
	2010	
	Finance Leases	Operating Leases
Due within one year	¥1,431	¥1,188
Due after one year	1,562	6,317
Total	¥2,993	¥7,505

### Pro Forma Information for the Years Ended March 31, 2010 and 2009

As discussed in Note 2, the Company and its consolidated domestic subsidiaries account for leases which existed at the transition date and do not transfer ownership of the leased property to the lessee as operating lease transactions. Pro forma information of such leases existing at the transition date, such as acquisition cost, accumulated depreciation, obligations under finance leases and depreciation expense on an "as if capitalized" basis for the year ended March 31, 2010 and 2009, was as follows:

	Millions of yen					
	2010			2009		
	Furniture and Fixtures	Others	Total	Furniture and Fixtures	Others	Total
Acquisition cost	¥2,665	¥1,366	¥4,031	¥3,985	¥1,902	¥5,887
Accumulated depreciation	1,977	945	2,922	2,585	1,118	3,703
Net leased property	¥ 688	¥ 421	¥1,109	¥1,400	¥ 784	¥2,184

Obligations under finance leases:

	Millions of yen	
	2010	2009
Due within one year	¥ 610	¥1,022
Due after one year	499	1,162
Total	¥1,109	¥2,184

The amounts of acquisition cost and obligations under finance leases include the imputed interest expense portion.

Lease payments and depreciation expense under finance leases:

	Millions of yen	
	2010	2009
Lease payments	¥1,006	¥1,799
Depreciation expense	1,006	1,799

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

## 15. Financial Instruments and Related Disclosures

In March 2008, the ASBJ revised ASBJ Statement No. 10 "Accounting Standard for Financial Instruments" and issued ASBJ Guidance No. 19 "Guidance on Accounting Standard for Financial Instruments and Related Disclosures". This accounting standard and the guidance are applicable to financial instruments and related disclosures at the end of the fiscal years ending on or after March 31, 2010 with early adoption permitted from the beginning of the fiscal years ending before March 31, 2010. The Group applied the revised accounting standard and the new guidance effective March 31, 2010.

### Group Policy for Financial Instruments

The Group uses financial instruments, mainly bank loans and bonds, based on its capital financing plan. Short-term bank loans and commercial paper are used to fund its ongoing operations, and cash surpluses are invested in low risk financial assets. Derivatives are used, not for speculative purposes, but to manage exposure to financial risks as described in below.

### Nature and Extent of Risks Arising from Financial Instruments and Risk Management for Financial Instruments

Receivables, such as trade notes and trade accounts are exposed to customer credit risk. The Group manages its credit risk from receivables on the basis of the internal policies, which include monitoring of payment term and balances of major customers to identify the default risk of the customers.

Payment terms of payables, such as trade notes and trade accounts, are less than one year.

Although receivables and payables in foreign currencies are exposed to the market risk of fluctuation in foreign currency exchange rates, the net position of receivables and payables in each foreign currency is hedged by using mainly forward foreign currency contracts and currency swaps. In addition, receivables and payables in foreign currencies which are expected from forecasted transactions are hedged by using forward foreign currency contracts and currency swaps.

Investment securities, mainly equity instruments of customers and suppliers of the Group, are exposed to the risk of market price fluctuations. Investment securities are periodically managed by monitoring market values and financial position of issuers.

Short-term bank loans and commercial paper are mainly used to fund its ongoing operations. Long-term bank loans and bonds are used mainly for capital expenditures and maturities of them are less than nine years and four months after the balance sheet date. Although the payables such as trade notes and trade accounts, bank loans and bonds are exposed to liquidity risk, the Group manages its liquidity risk along with adequate financial planning by the corporate treasury department and has short-term bank credit lines. A part of long-term bank loans which are exposed to market risks from change in interest rates are hedged by using mainly interest rate swaps.

Derivatives mainly include forward foreign currency contracts, interest rate swaps and commodity future contracts, which are used to manage exposure to market risks from changes in foreign currency exchange rates of receivables and payables, from changes in interest rates of bank loans, and from changes in market value fluctuation of the raw materials.

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

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

### Fair Values of Financial Instruments

Fair values of financial instruments are based on quoted price in active markets. If quoted price is not available, other rational valuation techniques are used instead. Instruments for which quoted price is not available, are not included in the following.

	Millions of yen		
	2010		
	Carrying Amount	Fair Value	Unrealized Gain/Loss
Cash and cash equivalents	¥159,325	¥159,325	¥
Short-term investments	714	714	
Trade notes and accounts	181,138	181,138	
Investment securities	104,276	104,276	
Total	¥445,453	¥445,453	¥
Trade payables	¥ 97,733	¥ 97,733	¥
Short-term borrowings	86,730	86,730	
Income taxes payable	8,114	8,114	
Long-term debt	309,590	316,060	6,470
Total	¥502,166	¥508,637	¥6,470



**Assets****Cash and cash equivalents and short-term investments**

The carrying values of cash and cash equivalents and short-term investments approximate fair value because of their short maturities.

**Trade notes and accounts**

The carrying values of trade notes and accounts approximate fair value because of their short maturities.

**Investment securities**

The fair values of equity securities are measured at the quoted market price of the stock exchange for the equity instruments, the fair value of debt securities are measured at the amount to be received through maturity discounted at the Group's assumed corporate discount rate, and the fair values of investment trusts are measured at the constant value. The information of the fair value for the investment securities by classification is included in Note 4.

**Liabilities****Trade payables, short-term borrowings, and income taxes payable**

The carrying values of trade payables, short-term borrowings, and income taxes payable approximate fair value because of their short maturities.

**Long-term debt**

The fair values of bonds are determined at the quoted market price of the over-the-counter market for the corporate bonds, and the fair values of long-term loans are determined by discounting the cash flows related to the loans at the Group's assumed corporate borrowing rate. The fair values of long-term loans with floating interest, which are hedged by the interest rate swaps which qualify for hedge accounting and meet specific matching criteria, are determined by discounting the cash flows related to the loans and the interest rate swaps at the Group's assumed corporate borrowing rate.

**Derivatives**

The fair value of derivatives is measured at quoted price obtained from the financial institution.

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

**Derivative transactions to which hedge accounting is not applied at March 31, 2010**

	Millions of yen			
	2010			
	Contract Amount	Contract Amount Due after One Year	Fair Value	Unrealized Gain (Loss)
Forward exchange contracts:				
Selling: GBP	¥ 1,934		¥ 8	¥ 8
EUR	23,526		134	134
USD	8,663		31	31
AUD	3,468		(29)	(29)
NZD	215		29	29
ZAR	2,375		(53)	(53)
CZK	1,771		(14)	(14)
HKD	725		10	10
PLN	277		(4)	(4)
SGD	1,414		12	12
MYR	201		2	2
CAD	354		4	4
MXN	583		6	6
INR	449		(13)	(13)
Buying: EUR	96		0	0
CZK	12		0	0
Currency swaps:				
Receive JPY/Pay HKD	¥ 248	¥165	¥ 24	¥ 24
Receive JPY/Pay USD	5,915		(284)	(284)
Commodity future contracts:				
Metal				
Buying	¥ 1,183		¥225	¥225

Derivative transactions to which hedge accounting is applied at March 31, 2010

		Millions of yen		
		2010		
	Hedged Item	Contract Amount	Contract Amount Due after One Year	Fair Value
Forward exchange contracts:				
Selling: GBP	Receivables	¥ 4,805		¥ 19
EUR	Receivables	21,323		406
USD	Receivables	1,433		(5)
AUD	Receivables	683		(26)
ZAR	Receivables	1,306		(81)
CZK	Receivables	4,436		101
PLN	Receivables	754		(31)
Buying: USD	Payables	2,512		106
Interest rate swaps:				
Fixed rate payment, floating rate receipt	Long-term debt	¥ 30,000	¥ 30,000	¥(122)
Fixed rate payment, floating rate receipt*	Long-term debt	131,030	122,000	

\*The above interest rate swaps which 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 are recognized and included in interest expense or income. In addition, the fair value of such interest rate swaps is included in long-term debt.

The following is the fair value information for derivative transactions to which hedge accounting is not applied at March 31, 2009. Derivative transactions which qualify for hedge accounting are excluded from the information below.

		Millions of yen		
		2009		
	Contract Amount	Contract Amount Due after One Year	Fair Value	Unrealized Gain (Loss)
Forward exchange contracts:				
Selling: GBP	¥ 4,035		¥ 4,189	¥ (154)
EUR	14,644		14,721	(77)
USD	8,820		8,967	(147)
AUD	2,444		2,536	(92)
ZAR	1,638		1,671	(33)
CZK	7,997		8,103	(106)
HKD	520		515	5
PLN	521		516	5
SGD	620		621	(1)
MYR	475		494	(19)
THB	330		332	(2)
CAD	122		149	(27)
INR	277		276	1
Buying: EUR	125		128	3
CZK	192		202	10
USD	295		305	10
Currency swaps:				
Receive JPY/Pay HKD	¥ 330	¥248	¥ 13	¥ 13
Receive JPY/Pay USD	962		16	16
Commodity future contracts:				
Metal				
Buying	¥ 2,124		¥ 989	¥(1,135)

## Financial instruments whose fair value cannot be reliably determined

	Millions of yen
	Carrying Amount
	2010
Non-listed equity securities	¥ 7,177
Investments in limited partnerships and other investments	1,190
Investments in unconsolidated subsidiaries and associated companies	4,383
Total	¥12,750

## Maturity analysis for financial assets and securities with contractual maturities

	Millions of yen			
	2010			
	Due in One Year or Less	Due after One Year through Five Years	Due after Five Years through Ten Years	Due after Ten Years
Cash and cash equivalents	¥159,325			¥
Short-term investments	714			
Trade receivables	181,138			
Investment securities				
Available-for-sale securities with contractual maturities (Corporate bond)	25	¥100	¥75	
Total	¥341,202	¥100	¥75	¥

Please see Note 7 for annual maturities of long-term debt.

## 16. Commitments and Contingent Liabilities

Commitments for capital expenditures outstanding at March 31, 2010 totaled ¥7,367 million.

Guarantees of bank loans and items of a similar nature at March 31, 2010 were ¥1,321 million.

## 17. Net Income Per Share

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended March 31, 2010 and 2009 was as follows:

	Millions of yen	Thousands of shares	Yen
	Net Income	Weighted Average Shares	EPS
<b>For the year ended March 31, 2010</b>			
Basic EPS			
Net income available to common shareholders	¥19,391	291,867	¥66.44
Effect of dilutive securities			
Stock options		28	
Diluted EPS			
Net income for computation	¥19,391	291,895	¥66.43
<b>For the year ended March 31, 2009</b>			
Basic EPS			
Net income available to common shareholders	¥21,755	291,971	¥74.51
Effect of dilutive securities			
Stock options		45	
Diluted EPS			
Net income for computation	¥21,755	292,016	¥74.50

## 18. 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, 2010 and 2009 was as follows:

### (1) Industry Segments

#### a. Sales and Operating Income

Millions of yen					
2010					
	Air Conditioning	Chemicals	Others	Eliminations and Corporate	Consolidated
Sales to customers	¥908,565	¥86,224	¥29,175		¥1,023,964
Intersegment sales	340	3,682	12	¥(4,034)	
Total sales	908,905	89,906	29,187	(4,034)	1,023,964
Operating expenses	863,120	89,196	31,765	(4,155)	979,926
Operating income (loss)	¥ 45,785	¥ 710	¥ (2,578)	¥ 121	¥ 44,038

#### b. Assets, Depreciation and Capital Expenditures

Millions of yen					
2010					
	Air Conditioning	Chemicals	Others	Eliminations and Corporate	Consolidated
Assets	¥874,177	¥118,987	¥26,675	¥119,817	¥1,139,656
Depreciation	28,382	10,243	1,646		40,271
Capital expenditures	23,985	5,669	836		30,490

#### a. Sales and Operating Income

Millions of yen					
2009					
	Air Conditioning	Chemicals	Others	Eliminations and Corporate	Consolidated
Sales to customers	¥1,059,435	¥101,910	¥41,075		¥1,202,420
Intersegment sales	546	4,684	15	¥(5,245)	
Total sales	1,059,981	106,594	41,090	(5,245)	1,202,420
Operating expenses	988,332	116,103	41,908	(5,317)	1,141,026
Operating income (loss)	¥ 71,649	¥ (9,509)	¥ (818)	¥ 72	¥ 61,394

#### b. Assets, Depreciation and Capital Expenditures

Millions of yen					
2009					
	Air Conditioning	Chemicals	Others	Eliminations and Corporate	Consolidated
Assets	¥857,539	¥126,871	¥29,335	¥103,673	¥1,117,418
Depreciation	29,064	13,595	2,095		44,754
Capital expenditures	47,896	13,300	2,402		63,598

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, 2010 and 2009 were summarized below:

	Millions of yen						
	2010						
	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	Consolidated
Sales to outside customers	¥409,223	¥260,303	¥240,632	¥ 98,034	¥15,772		¥1,023,964
Interarea transfers	86,375	62,758	13,490	5,680	115	¥(168,418)	
Total sales	495,598	323,061	254,122	103,714	15,887	(168,418)	1,023,964
Operating expenses	507,448	285,075	233,533	107,978	15,243	(169,351)	979,926
Operating income (loss)	¥ (11,850)	¥ 37,986	¥ 20,589	¥ (4,264)	¥ 644	¥ 933	¥ 44,038
Assets	¥501,672	¥393,839	¥208,846	¥115,376	¥12,294	¥ (92,371)	¥1,139,656

	Millions of yen						
	2009						
	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	Consolidated
Sales to outside customers	¥476,067	¥285,746	¥300,801	¥124,747	¥15,059		¥1,202,420
Interarea transfers	102,838	84,153	8,998	9,296	873	¥(206,158)	
Total sales	578,905	369,899	309,799	134,043	15,932	(206,158)	1,202,420
Operating expenses	583,006	337,661	285,640	137,911	15,334	(218,526)	1,141,026
Operating income (loss)	¥ (4,101)	¥ 32,238	¥ 24,159	¥ (3,868)	¥ 598	¥ 12,368	¥ 61,394
Assets	¥507,388	¥358,151	¥205,505	¥122,774	¥10,251	¥ (86,651)	¥1,117,418

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, 2010 and 2009 were as follows:

	Millions of yen	
	2010	2009
Asia and Oceania	¥275,709	¥301,832
Europe	228,885	282,434
Americas	108,950	134,707
Other	25,440	35,389
Total sales to foreign customers	¥638,984	¥754,362

## 19. Subsequent Events

Resolutions approved by the Company's Board of Directors meeting held on May 12, 2010, which is subject to approval at the general shareholders' meeting planned to be held on June 29, 2010;

### a. Appropriations of Retained Earnings

Payment of a year-end cash dividend of ¥16 per share to holders of record at March 31, 2010, totaling ¥4,666 million was approved.

### b. Purchase of Treasury Stock

Repurchase up to 400 thousand shares of the Company's common stock (aggregate amount of ¥1,800 million) as treasury stock until the next general shareholders' meeting was approved.



# Independent Auditors' Report



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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets of Daikin Industries, Ltd. (the "Company") and consolidated subsidiaries (the "Group") as of March 31, 2010 and 2009, and the related consolidated statements of income, changes in 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 generally accepted 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, 2010 and 2009, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

*Deloitte Touche Tohmatsu LLC*

June 25, 2010

Member of  
Deloitte Touche Tohmatsu

## Corporate Data (As of March 31, 2010)

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<b>Tokyo Office</b>	JR Shinagawa East Bldg., 2-18-1, Konan, Minato-ku, Tokyo 108-0075, Japan Phone: 81-3-6716-0111 Facsimile: 81-3-6716-0200
<b>Fiscal Year-End Date</b>	March 31 on an annual basis
<b>Date of Founding</b>	October 25, 1924
<b>Date of Establishment</b>	February 11, 1934
<b>Paid-in Capital</b>	¥85,032 million
<b>Number of Shares of Common Stock Issued</b>	293,113 thousand
<b>Number of Shareholders</b>	33,788
<b>Major Shareholders</b>	Japan Trustee Services Bank, Ltd. The Master Trust Bank of Japan, Ltd. Panasonic Corporation State Street Bank and Trust Company Sumitomo Mitsui Banking Corporation Northern Trust Company Trust & Custody Services Bank, Ltd. Chase Manhattan Bank The Bank of New York Mellon Corporation The Bank of Tokyo-Mitsubishi UFJ, Ltd.
<b>Number of Subsidiaries and Affiliated Companies</b>	Subsidiaries: 198 Affiliates: 11
<b>Number of Employees</b>	38,874 (Consolidated)
<b>Stock Exchange Listings</b>	Tokyo, Osaka
<b>Advertising Method</b>	The Company uses the electronic advertising method, posting advertisements on its website ( <a href="http://www.daikin.co.jp/e/koukoku/">http://www.daikin.co.jp/e/koukoku/</a> ). However, when electronic advertising is not possible due to technical problems or other circumstances, the Company will post advertisements in the <i>Nikkei Shimbun</i> .
<b>Shareholder Register Administrator</b>	Daiko Shoken Business Co., Ltd. 2-4-6, Kitahama, Chuo-ku, Osaka 541-8583, Japan
<b>Ordinary General Meeting of Shareholders</b>	June
<b>Auditor</b>	Deloitte Touche Tohmatsu LLC



## ***DAIKIN INDUSTRIES, LTD.***



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CC-A2A(10-09-002)IB