



Annual Report 2006

Fiscal Year Ended March 31, 2006

PROFILE

Profile

Founded in 1924, Daikin Industries, Ltd., has grown to become a leading producer of air-conditioning systems and fluorochemical products. Today, as the world has become a single global market and we face megacompetition, we are stepping up our efforts to expand our operations globally and continue to meet new challenges.

In addition, in our oil hydraulics and electronics-related divisions, we are combining our advanced technology and R&D capabilities in fields outside our core businesses to create innovative products and systems that contribute to industry and to the lives of our customers.

In fiscal 2006, Daikin prepared and began to implement a new strategic management plan, FUSION 10, with the goal of building on all its accomplishments to date to achieve major breakthroughs in performance. Under FUSION 10, we are aiming to maximize our corporate value as a "global and excellent company" by implementing our priority strategies and working to strengthen our corporate position and performance through innovation.

Corporate Data As of March 31, 2006

Head Office

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Facsimile: 81-3-6716-0200

Fiscal Year-End Date

March 31 on an annual basis

Date of Founding: October 25, 1924

Date of Establishment: February 11, 1934

Paid-in Capital: ¥28,023 million

Number of Shares of

Common Stock Issued: 263,813 thousand

Number of Shareholders: 11,508

Major Shareholders

Japan Trustee Services Bank, Ltd.
The Master Trust Bank of Japan, Ltd.
Chase Manhattan Bank
State Street Bank and Trust Company
Northern Trust Company
Matsushita Electric Industrial Co., Ltd.
The Bank of New York
Trust & Custody Services Bank, Ltd.
Sumitomo Mitsui Banking Corporation
BBH

Number of Subsidiaries and Affiliated Companies

Domestic: 59 Overseas: 59

Number of Employees

21,996 (Consolidated)
6,674 (Non-consolidated)

Stock Exchange Listings

Tokyo, Osaka, Nagoya, Fukuoka, Sapporo

Newspapers for Official Notices

The Sankei Shimbun (Osaka)
Nihon Keizai Shimbun (Tokyo)

Transfer Agent and Register

Daiko Shoken Business Co., Ltd.
2-4-6, Kitahama, Chuo-ku,
Osaka 541-8583, Japan

Ordinary General Meeting of Shareholders

June

Auditor: Deloitte Touche Tohmatsu

CORPORATE DATA

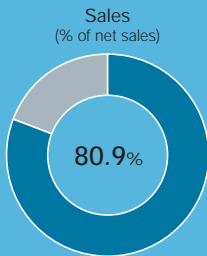
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Forward-Looking Statements

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.

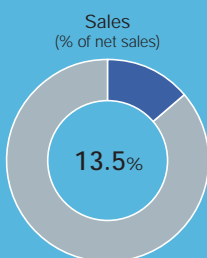
Air Conditioning



- MAJOR PRODUCTS & SERVICES
- Room air-conditioning systems
 - Air cleaners
 - Dehumidifiers
 - Packaged air-conditioning systems
 - Medium- and low-temperature air-conditioning systems
 - Marine-type container refrigeration
 - Water-chilling units
 - Absorption refrigerators
 - Air-handling units

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.

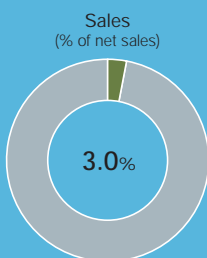
Chemicals



- MAJOR PRODUCTS & SERVICES
- Fluorocarbons
 - Fluoroplastics
 - 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.

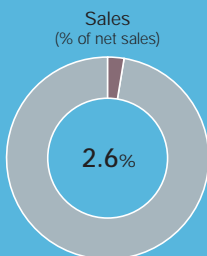
Oil Hydraulics



- MAJOR PRODUCTS & SERVICES
- Pumps and motors
 - Control valves
 - Stack valves
 - Positioning motors
 - Oil-cooling units
 - Power packages
 - Hydrostatic transmissions
 - Centralized lubrication units and systems
 - Multilevel car-parking systems

Daikin's unique hydraulic technologies are contributing to the development of industry by unleashing the potential of power control.

Defense



- MAJOR PRODUCTS & SERVICES
- Ammunition
 - Aircraft parts
 - Safety and arming devices
 - Warheads
 - Home-use oxygen therapy equipment

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

Electronics

- MAJOR PRODUCTS & SERVICES
- Network management systems
 - Computer graphics systems
 - DVD-authoring systems
 - CAD/CAM/CAE systems

From our unique graphics technologies to the conception of total network environments, Daikin provides a host of next-generation solutions.

TO OUR SHAREHOLDERS

To Our Shareholders



Noriyuki Inoue
Chairman of the Board
and CEO

Looking Forward to Another Surge of Corporate Development over the Coming Decade

Performance in Fiscal 2006

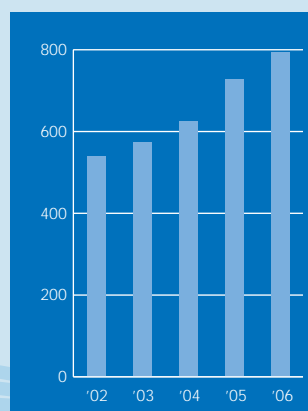
During fiscal 2006, ended March 31, 2006, the world economy was robust, as recovery in IT-related markets and positive economic trends in China and other Asian countries compensated for a slight slowing of growth due to the impact of major hurricanes and contractionary monetary policies in the United States, which has been a locomotive of global economic growth. In Japan, the trend of economic recovery became still more pronounced, owing to such factors as the continued strength of capital investment, a recovery in personal consumption amid rising stock prices and improvement in the income and employment environment, and the continued firmness of exports.

Against this backdrop, the Daikin Group implemented its fiscal 2006 strategy, which called for reinforcing the Group's current business base while taking steps to ensure capabilities for addressing new challenges that will enable a major surge of corporate development in the future. In line with this strategy, the Group worked concertedly to realize safe and stable operations, realize consistently excellent product quality, increase the appeal of its product lines, augment technological capabilities, and otherwise rectify problems and complete tasks required to create a solid base for sustainable corporate growth and development.

As a result, Daikin increased its consolidated net sales 8.8% over the level in the previous fiscal year, to ¥792,857 million. Factors behind the rise included our mainstay Air Conditioning Division's efforts to expand domestic sales of distinctive, high-value-added products in Japan and continued success in achieving strong sales in Thailand and other overseas markets. Also contributing to growth in consolidated net sales were the Chemicals Division's moves to address growing demand for fluororesins in China and other Asian countries and realization of sales growth centered on the automobile-related sector.

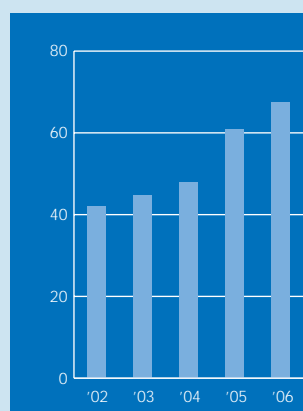
Consolidated Net Sales

(¥ billion)



Operating Income

(¥ billion)



Reflecting the Group's forceful efforts to expand domestic and overseas sales of highly distinctive products while comprehensively reducing costs, consolidated operating income advanced 10.1% over the level in the previous fiscal year, to ¥67,077 million; consolidated ordinary income rose 8.2%, to ¥68,682 million; and net income grew 5.1%, to ¥40,709 million. Thus, we were able to sustain growth in both operating income and ordinary income for the 12th consecutive fiscal year.

Creating the Base for Dynamic Operations

a Decade from Now

Fiscal 2006 was the final year of the Fusion 05 strategic management plan, which covered the five-year period beginning from fiscal 2001 and called for the Daikin Group to give strong management emphasis to its total market capitalization and pursue efficiency management policies to increase such indicators as return on assets and return on equity. Almost all of the FUSION 05 numerical targets have been attained on schedule; some targets were attained during fiscal 2005, and the targets for net sales and total market capitalization were surpassed during fiscal 2006.

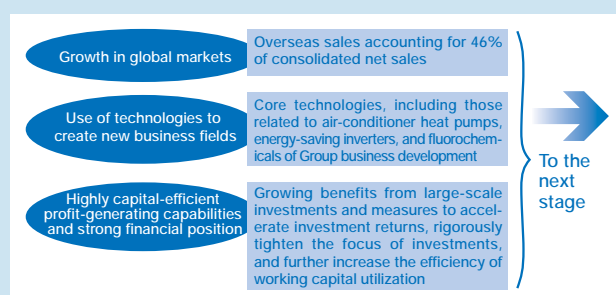
As a result of our two previous strategic management plans, FUSION 21 (fiscal 1996 through fiscal 2001) and FUSION 05, we are confident that we have built a solid foundation for implementing the concrete measures needed to realize our ambitions and dreams during the next decade.

While developing Daikin's operations as a means of benefiting shareholders, customers, local communities, employees, and other

FUSION 05 Targets and Performance



Daikin's Solid Corporate Base



stakeholders, we also recognize that responding to environmental issues is an important management task and have therefore striven to be an outstanding corporate citizen by keeping on the leading edge of progress with respect to environmental management.

By keeping all these targets and emphases in mind, the Daikin Group has made great strides toward realizing the objective of becoming a “dynamically excellent and global company that attracts people, capital, and information.”

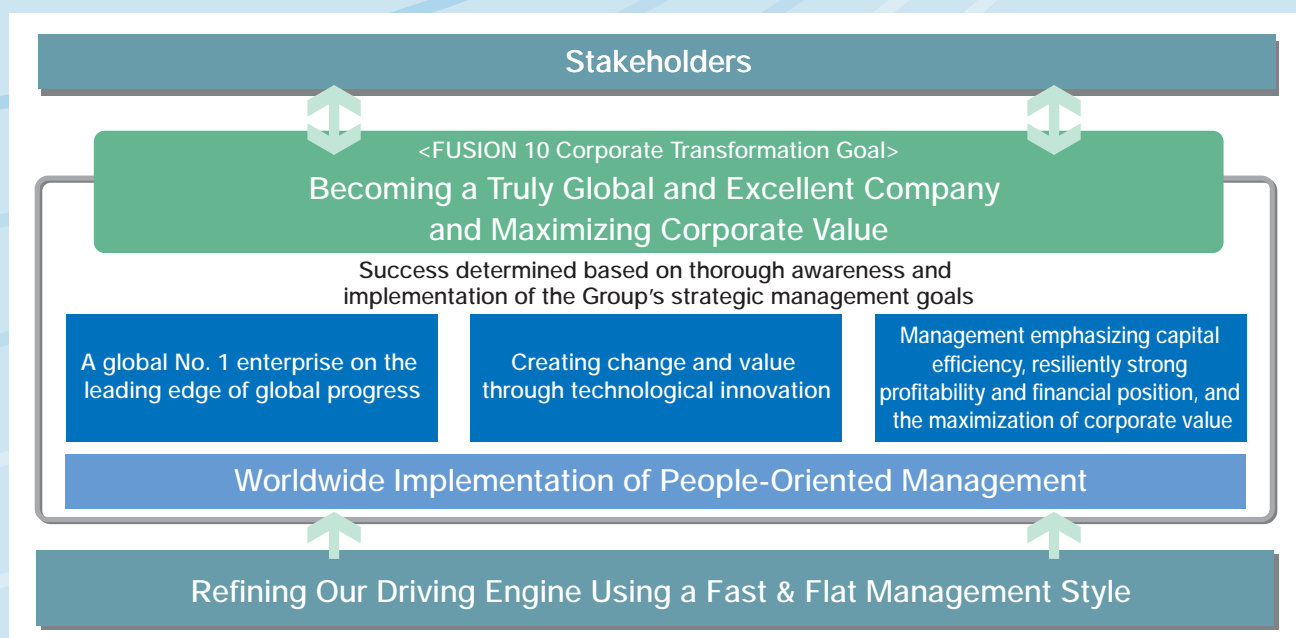
The Drafting of the FUSION 10 Strategic Management Plan

In the current era of megacompetition, we are seeing a trend of intensifying competition among companies that have all successfully overcome the daunting challenges presented by a protracted economic slump and now boast resiliently powerful corporate structures as well as special strengths. The broadening scope of global competition in numerous promising growth fields is being affected by diverse, complex, and interacting factors, and this competition is expected to become even more intense in the future.

In this kind of operating environment, measures to maximize the contributions of each Daikin employee while also promoting teamwork have enabled the Company to realize a great surge of corporate development, as manifested in our accelerated global expansion, our rising shares of strategically emphasized markets in Japan and overseas, and our steadily improving indicators of profitability and financial soundness. Currently, by building on this solid foundation, I am confident that the Daikin Group will be able to continue relentlessly undertaking reforms and directly addressing important challenges in a manner that further sustains its dynamic development, increases its corporate value, and enables it to enjoy an ever more-promising future.

We have drafted a new strategic management plan—FUSION 10—that covers the five years from fiscal 2007 through fiscal 2011. This plan specifies concrete measures designed to comprehensively magnify the Daikin Group’s business scale and strengths as well as sets clear-cut guidelines to ensure the Group advances steadily along a well-marked path toward an illustrious future. Based on

Aiming to Be a Truly Global and Excellent Company



through consideration of current and prospective market trends, FUSION 10 indicates the direction of our strategy for selecting and concentrating our operations in the highly promising business fields in a way that enables the maximization of the Group's corporate value. In line with the plan, we are focusing our resources on efforts to reinforce our core operations while creating additional new businesses on the periphery of those operations.

We are also maintaining and intensifying our long-standing tradition of emphasizing people-oriented management and global management perspectives. In other words, we are accelerating the expansion of our business operations in various countries and regions throughout the world while taking the steps needed to provide workplaces appropriate for multinational workforces and promote a steady increase in the Daikin Group's diversity. In this way, we are inexorably advancing toward our goal of becoming a truly global and excellent company.

Management Plan for Fiscal 2007

The Daikin Group's management plan for fiscal 2007 has the theme of "boldly taking on the challenging new projects that must be undertaken to realize a brilliant corporate future." As we are entering a period of major changes in market structures, everyone in the Group has been assigned the task of concertedly working to maintain forward-looking perspectives so that we can make the most of the highly promising opportunities presented by the ongoing market structure changes. We are doing our utmost to proactively seek out new challenges and take the measures needed to effectively leverage the benefits of our past reform measures with respect to those new challenges.

The fiscal 2007 management plan has four main objectives.

- 1) Effectively expanding sales amid improvement in domestic and overseas economic environments to accelerate the realization of returns on the investments we have made in advance of competitors
- 2) Continuing to progressively attain large-scale cost reductions despite challenges presented by such factors as rising raw materials prices and the introduction

of RoHS regulations and other increasingly stringent environmental protection regulations

- 3) Increasing the sophistication of our global supply chain management (SCM) systems to create supply systems capable of flexibly adjusting to demand fluctuations while also promoting comprehensive inventory reductions
- 4) Emphasizing the high-product quality that has given Japanese manufacturers strong capabilities for overcoming the challenges of global competition while strengthening and developing human resources and otherwise boosting technological, product, and service power to levels that enable Daikin to outcompete the world's top manufacturers

Our principal strategies for our core businesses are as follows:

1) Domestic Air-Conditioning Business

We are endeavoring to comprehensively augment our strengths, expand our market share, and increase profitability. To do this, we are stepping up our regional marketing strategies for marketing promotion measures and other measures that lead to increasingly dominant market positions in our top priority market of the Tokyo metropolitan area as well as in other major metropolitan regions. Regarding residential room air conditioners, we are further strengthening our capabilities for the mass-merchandise marketing route, which is the locus of progressive industrial restructuring. In response to the trend toward all-electric houses, we are upgrading our systems for marketing such products as the Eco Cute CO₂-refrigerant hot water supply system to the construction industry. Moreover, we are moving ahead with comprehensive cost-reduction programs.

2) Global Air-Conditioning Business

Regarding Europe, we are aiming to attain an overwhelmingly dominant No. 1 position in the commercial-use air-conditioning field. With respect to such fields as the freezing and refrigeration field, we will extend our operations into additional markets and move forward with the pioneering of marketing routes in such countries and regions as Russia, the Middle East, and Africa.

In China, we are striving to further reinforce our dominance as the top foreign-affiliated company in terms of sales. We are proactively implementing such measures as those to use sales engineers to develop promising new markets and those to make the effective use of our Solution Plaza Shanghai showroom facility.

In the United States, we are also working to increase sales. In November 2005, we established a marketing company in Texas to begin creating the U.S. market for ductless air-conditioning products. In fiscal 2007, we will be undertaking a large-scale expansion of our U.S. marketing systems and emphasizing measures to increase recognition of the Daikin brand.

3) Fluorochemicals Business

Besides efforts to expand demand for our products on a global scale, we are emphasizing such moves to support sales expansion

as those to resume operations at the Kashima Factory and begin full-scale operations at our Changshu Plant in China. In these ways, we are seeking to create a strong foundation for highly profitable operations. Moreover, we are taking thorough measures to ensure safe operations through the strengthening of on-site capabilities.

In view of these strategies, we have set the following targets for our fiscal 2007 consolidated performance—¥880.0 billion in net sales (up 11.0% from the previous fiscal year), ¥76.0 billion in operating income (up 13.3%), and ¥43.5 billion in net income (up 6.9%).

A Major Step Ahead towards New Surge of Corporate Development

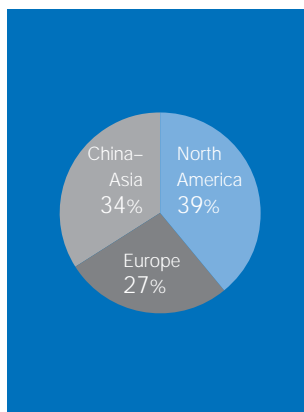
On May 18, 2006, we resolved to acquire Malaysia-based O.Y.L. Industries Bhd (OYL) and signed a stock transfer agreement that

Overview of OYL

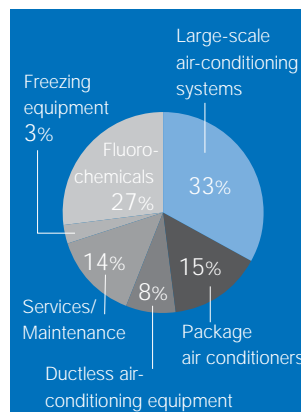
Net sales: ¥18.0 billion Number of employees: 10,000

- A global company developing its operations in North America, China and the other countries of Asia, and Europe
- Group companies include Adler Makay, Inc., the world's fourth-largest manufacturer of large-scale air-conditioning systems, and American Air Filter, Inc., the third-largest manufacturer of industrial filters.

Sales by Region



Sales by Product



OYL performance in the fiscal year ended June 2005

has made us a major shareholder in that company, with ownership of 45.2% of OYL's outstanding shares. All procedures necessary for purchasing 100% of the shares of this company were completed on January 18, 2007.

For Daikin, the acquisition of OYL is part of a proactive strategy for keeping half a step ahead of its competitors. We view the acquisition as a crucial means of building the strengths required for survival in the era of megacompetition. Because Daikin and OYL have highly complementary operations with regard to products and technologies as well as to regional market strengths, it is expected that the companies will be ideal partners for a merger of operations that creates abundant synergistic benefits. The conversion of OYL into a consolidated subsidiary and the subsequent integration of the two companies' operations will create a powerful corporate group with a strong presence throughout diverse sectors of the global air-conditioning market ranging from Europe to the BRICs (Brazil, Russia, India, and China) and other Asian countries. The integration will also increase the comprehensiveness of the Daikin Group's product lineup, enabling the Group to undertake new air-conditioning business strategies more quickly and on a larger scale.

Daikin's emphasis will be on maximizing the synergies generated by the operational integration and effectively wielding its expanded capabilities to attain the No. 1 position in the global air-conditioning market. The integration will immediately expand the Daikin Group's presence in the North American market, and we expect it to considerably accelerate the Group's business development in emerging markets. By giving due deference to the respective strengths of Daikin and OYL and working to deepen mutual understanding between the companies, we intend to arrange a kind of integration that encourages the two companies to improve themselves and develop their special strengths through friendly rivalry, thereby maximizing the benefits of our global alliance.

The Daikin Group's Concerted Efforts to Maximize Corporate Value

As another key basis for surviving and prospering in global markets, we are working to build corporate governance systems and

management systems that anticipate future requirements. In this and other ways, we are doing our utmost to maximize the corporate value we provide to the entire range of our stakeholders. While taking great pride in our achievements during the periods of FUSION 05 and FUSION 21, we will maintain a relentlessly forward-looking posture as we move ahead with efforts to reform the methodologies and augment the ambition of everyone working in the Daikin Group.

A key means of realizing our corporate value maximization mission is our efforts to become the global No. 1 company in all our business fields. This goal is not simply a matter of expanding our business scale; we are also aiming to be the global No. 1 company in terms of quality. In other words, we are intent on ensuring that our customers evaluate the quality of our goods and services as being the best in the world. Moreover, as we expand our business in diverse countries and regions, we are doing our best to consistently operate as good companies and be recognized as local companies. The Daikin Group's dynamic growth is a clear reflection of the powerful contributions made in concert by each of our diligent employees. We are firmly committed to maintaining the people-oriented management methods that we have long used to encourage all our employees to confidently do what it takes to make the most of their individual potential. This is a central pillar of the "Best Practices, Daikin Way," and it is a primary source of the confident dynamism with which we will attain and surpass our short-, medium-, and long-term business targets.

I hope for the continued understanding and support of all of Daikin's stakeholders.

June 29, 2006



Noriyuki Inoue
Chairman of the Board and CEO

FUSION10

Realizing an Additional Surge of
Corporate Development through FUSION 10



Yuki Yoshi Okano
President and COO,
Member of the Board

Looking 10 Years Ahead toward Creating a “Truly Global and Excellent Company”

The Daikin Group has inaugurated its new strategic management plan, FUSION 10, which covers the five years through fiscal 2011.

During the five years through fiscal 2001, the Group implemented FUSION 21—designed to create a “global company” and a “truly top-tier company”—by means of a growing array of management adjustments aimed at rigorously harmonizing short- and long-term objectives; better integrating manufacturing, marketing, and R&D; promoting greater information sharing; and effecting other “strategic fusion” initiatives covering the entire spectrum of management operations. During the five years through fiscal 2006, Daikin’s FUSION 05 strategy increased the level of the Group’s “fusion management”—the fusion of “market capitalization and financial ratio (ROA, ROE, etc.) management,” “people-oriented management,” and “flat and speedy management”—through the implementation of numerous initiatives aimed at keeping a half step ahead of other companies in the industries in which Daikin conducts business operations.

In the terms of these two strategic management plans, the Daikin Group’s attainment of diverse numerical and qualitative targets enabled the Group to realize considerable growth and development, as reflected in 12 consecutive fiscal years of rising profitability. These achievements represent a solid foundation for the implementation of FUSION 10.

FUSION 10 was drafted during a period of more than a year, during which we undertook repeated internal discussions about our aspirations and dreams with respect to the Daikin Group 10 years from now. These discussions enabled the attainment of a consensus regarding such objectives as the acceleration of global business development culminating in the establishment of dominant market positions worldwide, the creation of new demand segments and markets by means of initiatives centered on technological innovation, and the harmonious fusion of transnational value

perspectives. FUSION 10 is a concrete plan designed to guide the Group along the path toward realizing its aspirations and dreams for 10 years in the future. It aims to maximize the Group's corporate value and culminate in "brilliant future creation."

Currently, Daikin is addressing numerous challenging business creation themes aimed at realizing the Group's aspirations and dreams through initiatives in fields on the periphery of its core air-conditioning and chemicals operations. FUSION 10 places top priority on effectively implementing measures in line with these challenging business creation themes. To further increase the speed of implementation measures, it emphasizes "on-site management" methods for delegating appropriate levels of decision-making authority to implementers. At the same time, the plan seeks to promote progressive management reforms that foster the consistent application of Daikin's fundamental "people-oriented management" practices and to accelerate the Group's transformation into a "truly global and excellent company."

FUSION 10's Goal and Basic Views

FUSION 10 is designed to augment Daikin's corporate value to the level at which the Group will clearly be a "truly global and excellent company." To realize this goal, the plan calls for emphasizing the following four objectives.

- 1) Becoming a world-leading, global No. 1 business with respect to both the scale and quality of operations
- 2) Achieving innovation and value creation with unique technologies as a "shift creation leader"
- 3) Having a robust financial constitution and profitability with excellent capital efficiency (management emphasis on market capitalization)
- 4) Ensuring the implementation of "people-oriented management" throughout the global Group, maximizing the mobilization of our collective strengths based on the pride and enthusiasm of each employee

Based on these objectives, FUSION 10 stipulates the following five basic views.

1) "Selection and concentration" to achieve growth

While taking thorough measures to grow its current core businesses, Daikin will not set out toward totally new business fields but will select promising business opportunities on the periphery of core operations and concentrate management resources on generating strong performances from those opportunities.

2) Rapid business creation through intensive use of flexible partnerships and alliances

Beginning with the acquisition of OYL, Daikin will proactively employ M&A transactions, alliances, and collaboration arrangements to pursue synergies.

3) Enhanced management powers to survive the new era

Amid the start of full-scale global megacompetition, Daikin will devise Groupwide financial strategies, strengthen Groupwide risk management systems, create distinctive corporate social responsibility (CSR) management systems, and otherwise undertake ambitious measures that promote the greater breadth and depth of management capabilities and consequently lead to corporate value maximization.

4) Establishment of top-level technological capabilities and infrastructure

While boosting its core technologies to world-leading levels, Daikin will concretely realize its "technology fusion" concept through measures that promote the internal integration of its technologies as well as through alliances that integrate its technologies with technologies from outside sources.

5) Dramatic strengthening of human resource capabilities

To ensure its "people-oriented management" generates positive results worldwide, Daikin will give top priority to the recruitment and training of diverse human resources.

FUSION 10 Missions

FUSION 10 defines concrete missions with regard to each business field, technological development, finance, and other topics.

Air-Conditioning Business Mission

In about 10 years (midway through the 2010s), Daikin intends to be continuing to provide comfortable air environments throughout the world and to have achieved the position of global leader in the fields of air conditioning and refrigeration. To this end, FUSION 10 is designed to realize the following four missions by fiscal 2011.

- 1) Attain the global No. 1 position in the air-conditioning field with consolidated annual net sales of over ¥1 trillion by leveraging its global No. 1 position in ductless air conditioning
- 2) Achieve eight-region global business development by supplementing the established regions of Japan, Europe, China, and the ASEAN countries and Oceania with the addition of four other regions—North America, India, Latin America, and the Middle East and Africa
- 3) Achieve the goal of being a comprehensive air-conditioning and refrigeration equipment manufacturer by broadening the scope of business from the ¥2 trillion ductless air-conditioning market to the ¥8 trillion comprehensive air-conditioning and refrigeration market (including ductless, applied, cold storage, and refrigeration) and by expanding operations in such peripheral fields as heating and hot water supply equipment
- 4) Attain the global No. 1 position in quality by innovatively strengthening product lines, technological capabilities, and marketing and servicing capabilities—(1) anticipating needs and desires, (2) developing world-leading technologies, (3) developing products featuring customer-satisfying features and dependability, (4) realizing cost reductions that enable the continued provision of products and services at reasonable prices, and (5) building global systems that enable the timely provision of products worldwide.

Chemicals Business Mission

In about 10 years, Daikin intends to establish a unique fluorochemicals business by becoming the global No. 1 in fluorinated materials business, creating diverse kinds of demand, and providing diverse solutions employing fluorochemicals. To this end, FUSION 10 is designed to realize the following two missions by fiscal 2011.

- 1) Become the global No. 1 in fluorinated materials business—
(1) developing applications related to automobiles, semiconductors, and coatings; (2) expanding the scale of marketing in the United States and China; and (3) increasing competitiveness with respect to quality and cost
- 2) Create a ¥1 trillion market by expanding the scope of business from the core of fluorochemicals—(1) developing composite materials from fluorochemicals and other elements and otherwise reducing dependence on pure fluorochemicals operations by developing unique functional materials and new markets as well as (2) moving away from simply providing materials by developing additional operations involving materials processing and finished products

Development Business Mission

In the field of oil hydraulics equipment, Daikin is increasing the share of its business associated with power motion control (PMC) products with diverse power- and position-control functions by strengthening its capabilities for developing and marketing such products. Initial efforts are being concentrated on the Chinese molding machinery market, and plans call for establishing a global business base by fiscal 2011. The Company is also expanding its business involving oil hydraulics equipment for construction machinery, with the goal of attaining the No. 1 share of the Asian (including Japan) market.

In the field of special equipment, Daikin is working to achieve steady growth in defense systems business, while spinning off associated technologies to create demand for new types of non-military products, and the Company is seeking to increase con-signed manufacturing demand for such products as air-conditioner Eco Cute tanks.

In the field of electronic systems, Daikin is giving top priority to efforts to pursue additional synergies with air-conditioning operations.

Technology Mission

In about 10 years, Daikin intends to be achieving innovation and value creation with unique technologies as a "shift creation leader."

Specifically, Daikin is seeking to lead in the development of products that promote the creation of a sustainable, safe, healthy, and pleasant 21st century society, and the Group is also striving to create additional core technology platforms to supplement its existing platforms in heat pumping technology, inverter technology, and flu-orochemical technology. The Group is aiming to achieve unique technological innovations by promoting the fusion of its own internal technologies as well as technology creation collaboration with outside entities.

- 1) Increase the sophistication of core technologies in the fields of air conditioning and chemicals
- 2) Leverage "technology fusion" to promote unique innovations within the Group and create next-generation, air-conditioning technologies
- 3) Develop into the global No. 1 technology group and attain the global No. 1 patent registration capability

Profitability and Finance Mission

As another means of transforming the Daikin Group, FUSION 10 sets the mission of creating highly capital-efficient and resilient profitability as well as a solid financial position.

To enable the timely investments needed to support the Group's dynamic growth and development and make the Group's brilliant future a reality, Daikin will implement a comprehensive financial strategy entailing the employment of diverse funding methods on a global scale. This strategy is designed to support a proactive program of investments, while more effectively ensuring the maximization of operating cash flows for additional business development investments as well as the maximization and recycling of investment returns.

Daikin's strategy also calls for the maintenance or further enhancement of a highly streamlined financial position, the expeditious realization of returns on large-scale investments, a further increase in the efficiency of investment selection and working capital application, and the attainment of other objectives that accelerate the cycle of cash flow generation and recycling. At the same time, the Group will take steps to strengthen its systems for such processes as manufacturing cost management and investor relations.

FUSION 10's numerical consolidated performance targets for fiscal 2009 and fiscal 2011 are as follows.

	Fiscal 2005 Actual performance	Fiscal 2009 Target	Fiscal 2011 Target
Net sales	¥792.9 billion	¥1,350.0 billion	¥1,700.0 billion– ¥1,800.0 billion
Operating income	¥67.1 billion	¥120.0 billion	¥170.0 billion
Percentage of			
net sales	8.5%	9.0%	10%
Overseas sales ratio	46%	60%	70%

Daikin has initially projected that its acquisition of OYL and related synergies to have the effect of boosting consolidated net sales by ¥10.0 billion in fiscal 2009 and ¥20.0 billion in fiscal 2011. These figures are scheduled to be recalculated following the completion of the acquisition.

Strengthening Human Resources to Support FUSION 10

FUSION 10 calls for the successful implementation of measures to greatly expand business operations, create diverse innovative technologies, and attain other goals considerably more ambitious than previous objectives. To ensure its ability to execute this successful implementation, the Group must further strengthen its human resources.

Accordingly, by the end of FUSION 10 in fiscal 2011, Daikin intends to take the following four initiatives to strengthen the human resources in its global Group operations.

- 1) Obtain the human resources needed to lead rapid business expansion—(1) promoting the comprehensive strengthening and expansion of human resources, with emphasis on quality rather than simply increasing the number of employees as well as (2) expeditiously identifying, recruiting, and developing human resources on a global scale and taking measures to ensure capabilities for posting employees at the optimal times and locations
- 2) Create a hiring strategy that enables the recruitment of superior personnel
- 3) Hire personnel capable of creating unique Daikin Group technologies and create personnel organization systems that promote sustained innovative productivity
- 4) Further increase the sophistication of "people-oriented management"—(1) ensuring the ubiquity and vitality of Daikin's ideals and corporate culture throughout global Group operations, (2) further strengthening management power and the competitive spirit of individual employees, (3) further promoting Group cohesiveness and employee motivation, (4) enhancing communications capabilities, and (5) emphasizing diversity and establishing a Group culture that maximizes the capabilities and contributions of all kinds of personnel

Strengthening the Management Structure to Become a Truly Global and Excellent Company

In addition, to further augment Daikin's existing strengths, FUSION 10 is designed to build a corporate management structure capable of supporting the Group's ability to rapidly and flexibly adapt to external changes as the Group transforms into a truly global and excellent company. Accordingly, Daikin plans to emphasize the implementation of the following four themes by the end of fiscal 2011.

- 1) Strengthen capabilities for strategic measures a half a step ahead of other companies in a manner that effectively addresses the risks accompanying increasingly rapid and complex changes and transforms those risks into business opportunities
- 2) Strengthen and expand the Group's information resources as a means of increasing the sophistication of efforts to promote business innovation on a global scale
- 3) Pursue CSR management to promote harmony with the natural environment and society and establish strong relationships of trust with outside entities
- 4) Increase the sophistication of global Group management systems that emphasize global strategic planning and local execution processes in a manner that effectively harmonizes overall optimization goals with individual unit optimization goals

June 29, 2006



Yuki Yoshi Okano

President and COO, Member of the Board

REVIEW OF OPERATIONS

Review of Operations



Air Conditioning

The Japanese Market

Favorable Business Conditions Help Boost Unit Sales

In fiscal 2006, ended March 31, 2006, Daikin saw sales of residential air-conditioning systems rise 8% year on year, to 7.6 million units, on the back of strong demand in the domestic air-conditioning industry spurred by a turnaround in consumer spending as well as hot summer and cold winter weather. Commercial air-conditioning systems also fared well, with sales increasing 6%, to 800,000 units, amid growth in corporate investment and demand stemming from customers replacing equipment purchased during Japan's bubble period. Meanwhile, sales of the Eco Cute hot water supply system that uses the natural refrigerant CO₂ surged an amazing 72%, to 6,000 units, buoyed by the trend toward all-electric houses. Nevertheless, offerings across the board continue to face fierce competition both in terms of price and product development.

Daikin's Air-Conditioning Systems Remain Strong

Eyeing demand in the residential market, Daikin actively promoted such high-value-added products as URURU & SALALA air-conditioning systems featuring sophisticated humidity control; however, sales remained at the same level as in the previous fiscal year as popular compact models struggled. We maintained a solid market share of approximately 18%.

The first in the industry to raise its standard prices for commercial air-conditioning systems in response to soaring prices for copper, aluminum, and other raw materials, Daikin worked to expand sales amid growing demand for replacement units. Specifically, the Company focused on the solution-oriented marketing of distinctive products, including the Ve-up Q multiple air conditioner for office buildings, which enables sales outlets and users to rapidly replace units using existing piping, and the Round Flow ZEAS system, which boasts low power use, low noise, and low environmental load and is designed to provide outstanding indoor comfort. Thanks to these initiatives, we achieved year-on-year growth in sales and retained our lead with a high domestic market share of more than 40%.

Sales of the Eco Cute hot water supply system that uses the natural refrigerant CO₂ rose in line with industry averages, supported by the introduction of the 310-liter Slim Eco Cute, which can be installed in condominiums with newer piping layouts that call for compact units, and other enhancements to the lineup.

As a result, sales in the domestic air-conditioning business climbed 7%, to ¥338.4 billion.

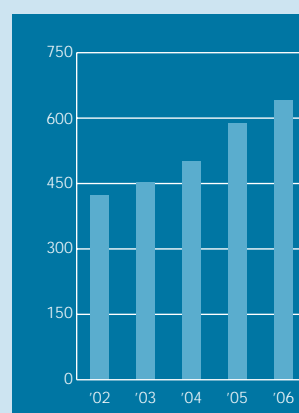
Strategies for New Growth

With no end in sight for skyrocketing raw material and energy prices, we will focus on keeping total costs down via product standardization, global procurement, and other measures as we leverage distinctive, high-value-added products to capture profits.

In addition, we will solidify our position as the undisputed leader in Japan to establish the foundation from which we will work to become the No. 1 comprehensive air-conditioning and refrigeration manufacturer in the world under the Fusion 10 strategic management plan. To accomplish this, we will take steps to further expand our market share in the residential and commercial sectors as well as strengthen our presence in engineering and other related fields to boost sales. In addition, we will put Eco Cute into full play, developing the lineup as our third mainstay offering following residential and commercial air-conditioning systems.

Furthermore, in May 2005, Daikin entered into a business alignment with Aisin Seiki Co., Ltd., in the gas heat pump (GHP) air-conditioning systems field. The tie-up has gotten off to a great start with the October 2006 launch of a Daikin brand GHP air-conditioning system. Armed with conventional electric heat pump (EHP) and GHP models, we provide customers with air-conditioning systems suited to their energy environments. In the future, we aim to develop and provide air-conditioning systems that use an optimal mix of energy as well as further augment our domestic air-conditioning business in a comprehensive manner.

Net Sales
(¥ billion)





Air Conditioning

The Global Market

Performance Strong across the Board

In Europe, Daikin's air-conditioning operations were affected by unseasonable weather for the second year in a row, with unit sales of compact room air-conditioning units losing ground, particularly in such major residential markets as Italy and France. On the other hand, sales of commercial package air conditioners grew, and sales in Russia, Eastern Europe, Greece, and neighboring regions were up. As a result, sales rose 6% from the previous fiscal year. Although there is no denying that demand in Europe, primarily for compact room air conditioners, has temporarily slowed, we expect to see ongoing rising demand over the medium term in view of populations, economic scales, and air-conditioning penetration rates in the region.

In China, sales were up 20% year on year. Although the housing boom, which has been most prominent in Shanghai, is cooling, demand for air conditioning remains robust, due to upcoming major events, including the Beijing Olympics and the Shanghai World Expo. Sales also grew in Southeast Asia and Oceania, rising 16% year on year, due to strong demand in such countries as Thailand.

In fiscal 2005, Daikin established a sales company in the United States; firmly positioned its forte in multiple air conditioners for office buildings and residential, energy-saving air-conditioning systems at the heart of operations; and kicked off full-scale sales efforts. Going forward, we plan to rapidly expand sales.

As a result of these initiatives, sales in the overseas air-conditioning business climbed 11%, to ¥303.2 billion.

The Next Step

Daikin is seeking to bolster its product offerings and sales prowess since it anticipates continued expansion in the global air-conditioning market over the medium term, including growth in the Company's priority markets—Europe and China. In addition, we are aggressively working to enhance our sales networks and strengthen our lineup of popular models in emerging markets,

mainly Brazil, Russia, India, and China (the BRIC nations), and the Middle Eastern market, which is rapidly expanding as a result of high crude oil prices worldwide.

Furthermore, Daikin is looking to leverage the technological and sales capabilities that it has gained over the years in the air-conditioning business to take on challenges in new business areas. Efforts are already under way with regard to applied operations. Specifically, we are working to bolster our air-conditioning business by making the most of our air-purification systems and total heat exchangers, expand our freezing and refrigeration business by taking advantage of the opportunities provided by our Convenience Pack all-in-one freezing, refrigeration, and air-conditioning system, and to enter the hot water and heating field by leveraging the environment-friendly image of the Eco Cute hot water heater that uses the natural refrigerant CO₂. In addition, the organic integration of Daikin's know-how and resources with that of the acquired O.Y.L. Industries Bhd has enabled us to break through barriers pertaining to conventional technologies, sales routes, and more.

Meanwhile, there are more business risks and opportunities than ever before in the global air-conditioning market as a result of environmental issues. Daikin is determined to enhance its presence and avail itself of business opportunities afforded by strict regulations being implemented by environmentally advanced regions, including chlorofluorocarbon (CFC) restrictions as well as the Restriction of the Use of Certain Hazardous Substances (RoHS) and Waste from Electric and Electronic Equipment (WEEE) directives in Europe and energy-saving regulations in Australia, by being quick to respond to such measures. We will continue to boldly embrace new challenges and work to drive home our uniqueness as a global comprehensive manufacturer of air-conditioning and refrigeration systems.

As of the end of fiscal 2006, Daikin had 36 overseas affiliates. Daikin is working to put people-oriented management into practice on a global Group basis and go beyond numerous diverse values by conveying its original, rich practical know-how to the world and using on-the-job training in all countries and regions in which the Company operates to adapt its practices locally as needed.



Chemicals

Operating Environment and Performance in Fiscal 2006

In the Company's chemical business, major accomplishments included increasing supply capacity for plastic products, as the Kashima Factory returned to full-scale operation in February 2005, following an accident that occurred in January 2004, and the start-up of production activities at the Changshu Plant in China. Using this increased supply capacity as a springboard and owing to strong demand stemming from favorable trends in the automobile and semiconductor sectors, sales of the chemical business exceeded ¥100 billion for the first time, climbing 8%, to ¥107.4 billion. In addition, our market share, which declined because of the shortage of capacity following the Kashima Factory accident, recovered and rose above the level prevailing before the accident.

By product, sales of fluoroplastics increased, buoyed by rising demand in the Chinese and other Asian markets as well as expansion in the automobile-related fields and products for use in LAN cables in the United States. In chemical products, sales of high-performance materials, including surface-enhancement products, increased, but sales of water and oil repellents declined because of the adverse impact of weak conditions in the textile industries in Europe and the Americas, which are principal markets for these items. Demand for fluorocarbon gases remained at approximately the same level as in the previous fiscal year, despite the decline in demand for their use in air-conditioning equipment in the European market.

Strategy for New Growth

Under the Company's Fusion 10 next strategic management plan, Daikin will aim to become the No. 1 fluorochemical enterprise in the world and is endeavoring to expand its position in this business by focusing on the development of new uses and the creation of additional markets, which are the keys to growth. Specifically, with fluorochemistry as the core, the Company will accelerate its activities to develop new uses and create new demand, concentrating on the automobile, semiconductor, and certain other industries as well as explore in greater depth additional possibilities in existing product

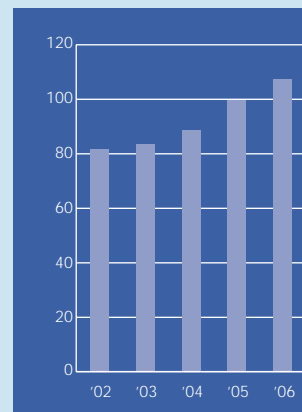
fields. As part of these activities, the Company is making a strong drive to expand sales in the vast markets of the United States and China. At the same time, Daikin is exploring possibilities for compounds with other materials and breaking away from strong dependence on fluorine chemistry. Efforts are also being focused on the creation of new markets through developing original materials to perform certain functions, going beyond offering just materials and entering the semi-finished product and processing fields, and taking other steps to further expand its business domain.

In product development initiatives, which will make these objectives a reality, Daikin is endeavoring to create differentiated products that draw on the diversity of functions of fluoride materials and expand its position in the automobile, semiconductor, IT, and other fields. In addition, the Company is engaged in a broad range of R&D initiatives, including the development of optical materials, such as coating materials for use in functional chemical product materials; the creation of optical materials, including antireflective films; the development of fluorointermediates for use in LCD materials; and the creation of intermediates for the pharmaceutical field. Moreover, Daikin is moving forward quickly to establish the fluorosilicon business, where it has begun the joint development of fluorocompounds and silicon compounds with Dow Corning Corporation of the United States, with an eye to creating the next major compound products.

To expand operations into the processing field, the Company is working to establish specific development objectives and is formulating plans for realizing synergies with the filter business of Malaysian-based O.Y.L. Industries Bhd, a company it has acquired.

Looking ahead, the Company is aiming to build on its position as the No. 2 fluorochemical company in the United States, which is the world's largest market for these products. To this end, the Company is focusing attention on fusible and other plastics, repellent agents, and fluororubber materials, while working to create a more diverse and extensive lineup of product offerings. In addition, in the rapidly expanding Chinese market, Daikin is looking to integrate production from fluorspar to processed items and is aggressively implementing market expansion policies suited to a leading company in this field.

Net Sales
(¥ billion)

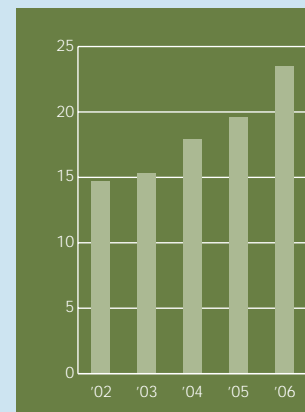


Oil Hydraulics

In the field of hydraulics equipment for industrial machinery, a major change is in progress in core technologies, with oil hydraulics technology being progressively supplemented with motor inverter technologies. This is resulting in a fundamental reform that is shifting the focus from power control to power motion control (PMC), which features a diverse range of functions through the control of power and position. In particular, drawing on the interior permanent magnet (IPM) motor technologies it has created for high-efficiency, air-conditioning motors with embedded rare earth magnets, the Company has become the first in the world to develop IPM motors for oil hydraulics applications and is leveraging the superior characteristics of these motors to develop an expanding business in hybrid energy-saving oil hydraulics package products. Among these products, "High-Pressure Super Units" have developed a strong reputation in the field of industrial machinery and other areas. These units have passed through the basic model stages, and Daikin is moving forward with the development of products aimed at winning a high level of customer satisfaction and the creation of new markets.

In fiscal 2006, demand for oil hydraulics equipment in the combined domestic and overseas markets recovered to the level attained during Japan's bubble economy. The High-Pressure Super Unit line and other hybrid products, such as the Oil Con Series of oil and water cooling systems with high-precision temperature control capabilities, are enabling the Company to differentiate its product offerings and increase sales.

Net Sales
(¥ billion)



In fiscal 2007, Daikin plans to accelerate the transition to PMC, increase the share of hybrid products in total segment sales to 50%, and aim to expand sales in the global market, especially in China. Moreover, by enhancing the depth of its technology through obtaining patents for original developments, the Company will nurture its strong originality and earning power.

In the field of oil hydraulics equipment for construction machinery, demand remained firm in the United States and, thus, sales expanded. In fiscal 2007, the Company will aim for the No. 1 share in oil hydraulics equipment for construction markets in Japan and the rest of Asia.

Daikin withdrew from the hydraulic multilevel car-parking systems business in fiscal 2006. This decision was made under the "selection and concentration" policy of Fusion 10. Going forward, the Company will focus on hydraulics equipment for industrial machinery and construction machinery and seek to expand its activities in these core areas.

Defense

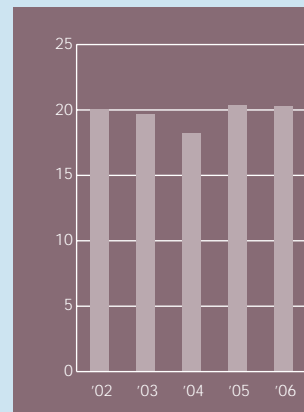
To secure sustainable development and growth into the future in its defense business, Daikin is continuing to press steadily ahead with its conventional defense operations in addition to actively pursuing activities pertaining to products for the civil sector, including home-use oxygen therapy equipment and civil aircraft components.

In fiscal 2006, demand for shells and missile parts for Japan's Defense Agency remained stable, while sales of home-use oxygen therapy equipment declined and those of civil aircraft components rose. As a result, overall sales in this segment were on par with those in the previous fiscal year.

As for the defense business's prospects in fiscal 2007 and beyond, we expect defense products to continue to face a tough environment as a result of cuts in frontline equipment envisioned in the defense planning outline approved by the Japanese Cabinet at the end of 2004. Nevertheless, we will focus on expanding orders for new rifle grenades, tank gun practice ammunition, and other products developed in-house for the short term and conduct R&D that takes into account the Defense Agency's changing needs for the medium term to keep the defense business on a solid development track.

In civil-sector operations, we will concentrate on obtaining even more orders, primarily for civil aircraft components, as well as boosting sales of existing home-use oxygen therapy equipment and developing new models of such equipment with differentiating functions. Furthermore, we aim to take our civil-sector operations even further by leveraging our existing technologies to create new technologies, products, and businesses.

Net Sales
(¥ billion)



Electronics

In the year ended March 31, 2006, the Company's *Visual R&D* knowledge-management system for corporate R&D departments, which is a unique product that combines work flow, database, and accounting ledger functions, was acclaimed in the automobile, electrical machinery, and other industries. As a result, the system is being widely adopted for use in development design, production technology, and quality control departments of corporations. For example, *Visual R&D* is proving effective in addressing such key corporate issues as realizing concurrent engineering and improving QCD (quality, cost, and delivery) because it can provide visual information on progress and results. Going forward, plans call for implementing efforts to substantially raise the awareness and evaluation of this system, with the goal of further expanding sales.

The Company's Network Structure Management System, which makes it possible to manage networks down to the PC level, and its IT Asset Management System, which contributes to ensuring security, are unique, and awareness of these systems among network vendors and IT managers of corporations, schools, and local governments has increased. In addition, Daikin's *FILDER PLUS*, a construction facility CAD system, continued to enjoy a favorable reputation and firm sales.

In the field of digital content, the Company's *SCENARIST* DVD-authoring software has been widely adopted among users. The Company clarified its commitment to this area through a number of measures, including the introduction of a next-generation version for DVD authoring.

In the current term, we plan to move forward with the commercialization of support and consulting services for system creation and operation, while working to enhance the originality and quality of our key product offerings. We will also aim to establish a business base with strong earning power and future potential through offering highly differentiated solutions-provider services.

Five-Year Summary

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

Millions of yen

	2006	2005	2004	2003	2002
Net sales:	¥792,857	¥728,880	¥625,718	¥572,413	¥538,790
Air conditioning	641,657	589,275	501,186	453,850	422,224
Chemicals	107,411	99,612	88,492	83,576	81,705
Others	43,789	39,993	36,040	34,987	34,861
Operating income	67,077	60,897	47,988	44,789	41,968
Income before income taxes and minority interests	67,540	63,802	43,787	36,561	31,598
Net income	40,709	38,747	28,611	21,591	17,937
Per share of common stock (in yen):					
Net income*	¥154.25	¥146.76	¥108.18	¥81.48	¥67.58
Cash dividends applicable to the year	22.00	18.00	14.00	12.00	12.00
Total assets	¥719,382	¥617,874	¥536,379	¥475,760	¥460,549
Total shareholders' equity	343,492	274,122	235,771	205,101	191,196
Net property, plant and equipment	196,485	170,209	149,790	145,579	145,259
Number of employees	21,747	19,310	17,077	15,845	15,247

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

Financial Review

Net Sales

Consolidated net sales amounted to ¥792,857 million, an increase of 8.8% from the previous fiscal year. This reflected the Air Conditioning Division's efforts to promote sales of highly differentiated, value-added products in Japan, and a trend of strong performance in overseas markets, particularly in China and Thailand, that was sustained from the previous fiscal year. Other factors contributing to the rise in consolidated net sales included growth in the Chemicals Division's sales of fluororesins, for which demand expanded in the China/Asia market, and for which sales increased mainly in connection with automotive applications.

The Air Conditioning Division's total sales surged 8.9%, to ¥641,657 million, owing to large increases achieved in both domestic and overseas sales volumes.

Japan

In the Japanese residential air-conditioning system market, the division undertook sales promotional activities focused on demand for living room applications and worked to increase sales of high-value-added products, but sluggish sales of relatively inexpensive compact models restrained overall sales to approximately the same level as in the previous year.

In the Japanese commercial-use air-conditioning system market, against a backdrop of rising private-sector capital investment and growth in industrial demand, the division's sales promotion efforts focused largely on products suitable for equipment model replacement

applications and on proposal-based marketing programs aimed at encouraging purchases of highly differentiated, high-value-added products by retail stores and other users. These activities supported year-on-year growth in both sales volume and net sales.

Europe

The impact of unseasonable weather led to a decrease in residential air conditioner product sales volume centered on Italy and France, but efforts to expand sales of commercial-use products boosted overall net sales.

China

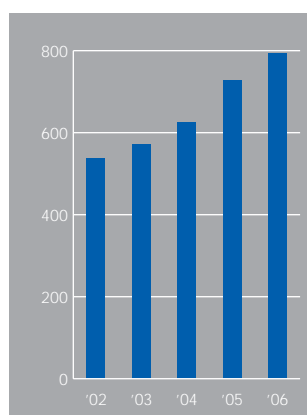
Factors including preparations for the Beijing Olympics and Shanghai World Expo sustained the trend of growing demand for air conditioners seen in the previous fiscal year, and the division increased its sales volume of both residential- and commercial-use products.

Asia and Oceania

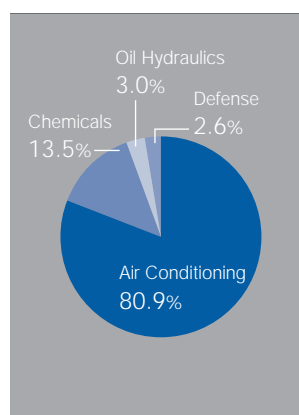
Supported by robust demand in Thailand, Taiwan, and other markets, sales volume rose considerably.

Regarding the Chemicals Division, fluororesin sales increased owing to such situations as expanding demand in China and other Asian countries and growing sales of automobile-related products and products for the U.S. LAN cable market as well as to expanded supply capabilities resulting from the complete recovery of the Kashima Factory's facilities and other factors. Sales of chemical products declined despite higher sales of surface re-forming materials and other high-function materials, as sales of oil- and water-repellant

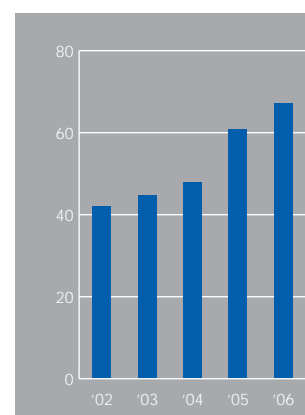
Net Sales
(¥ billion)



Sales Breakdown
(For fiscal 2006)



Operating Income
(¥ billion)



Years Ended March 31.

	2006	2005	2004	2003	2002
Gross profit (net sales less cost of sales) as a % of net sales	34.1%	35.2%	34.1%	33.5%	33.3%
Operating income as a % of net sales	8.5	8.4	7.7	7.8	7.8
Interest coverage (operating income plus interest and dividend income divided by interest expense) (times)	15.0	13.4	12.1	11.1	9.2
Net income as a % of net sales	5.1	5.3	4.6	3.8	3.3

products were impacted by negative trends in the U.S. and European textile markets, which are associated with major applications for those products. Sales of fluorocarbon gas products were approximately unchanged from the previous year, reflecting factors including a decrease in air conditioner-related demand in the United States and Europe. As a result, the Chemicals Division's total sales advanced 7.8%, to ¥107,411 million.

With respect to the Oil Hydraulics Division, sales of hydraulic equipment for industrial machinery grew, reflecting robust demand for mainstay machine tool-related products as well as efforts to increase sales of inverter-driven hydraulic units, Oilcon oil cooling units, and other distinctive products in Japan and other Asian countries.

Sales of oil hydraulics equipment for construction machinery also grew, reflecting strong demand from customers in the United States.

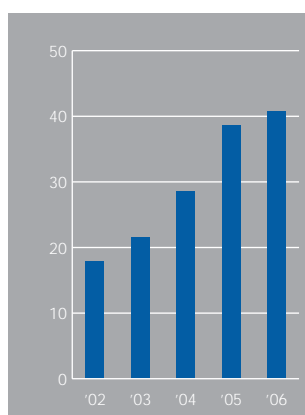
However, a drop in overall Japanese demand for mechanical multi-storied parking systems depressed the Company's sales of such products. Consequently, the Oil Hydraulics Division's total sales rose only 7.8%, to ¥23,466 million.

In the Special Equipment Division, sales in defense-related operations grew due to an increase in the Japanese Defense Agency's orders for ammunition, but a decrease in sales of oxygen-related products for home healthcare restrained overall sales to ¥20,376 million, approximately the same level as in the previous fiscal year.

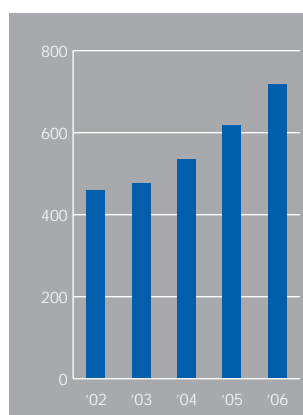
As a result, total sales from other divisions increased 9.5% year on year, to ¥43,789 million. Factors including the decrease in sales of multi-storied parking systems caused an operating loss of ¥773 million.

The operating environment for business in multi-storied parking systems has deteriorated markedly due to such factors as a decrease in selling prices stemming from slack demand and intensifying competition and a rise in raw materials prices. In view of this and projections that demand for such systems will not greatly rise, the Company has decided to withdraw from the multi-storied parking system business in line with its "selection and concentration" strategy. Consequently, during the fiscal year under review, the Company recorded an extraordinary loss of ¥1,952 million on withdrawal from multi-storied parking system business.

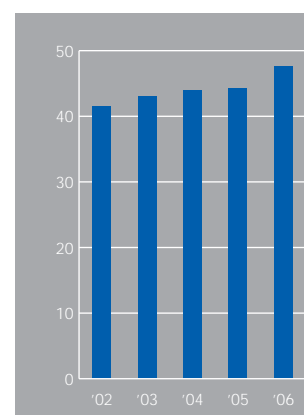
Net Income
(¥ billion)



Total Assets
(¥ billion)



Shareholders' Equity Ratio
(%)



Years Ended March 31.

	2006	2005	2004	2003	2002
Notes and accounts receivable, less allowance for doubtful receivables (¥ billion)	144.9	133.7	116.0	103.1	98.0
Inventories (¥ billion)	149.2	141.9	110.4	101.1	93.8
Interest-bearing debt (not including trade notes discounted) (¥ billion)	173.0	166.4	149.0	142.3	153.5

Costs, Expenses, and Earnings

The cost of sales amounted to ¥522,386 million. As the Company's efforts to reduce manufacturing costs were offset by the impact of higher procurement prices for copper, aluminum, and other raw materials, the cost of sales ratio increased 1.1 percentage points from the previous year, to 65.9%.

Selling, general and administrative (SG&A) expenses increased ¥7,633 million from the previous year, to ¥203,394 million. This rise reflected various steps taken in response to the global growth in demand. These included measures associated with the large rise in sales volume—such as the boosting of advertising, sales promotion, and product shipment—and measures aimed at preparing for further growth in business scale—such as measures to strengthen sales engineering and R&D capabilities, accelerate global expansion

through the acquisition of sales agents in various countries, and achieve other strategic objectives.

Operating income amounted to a record ¥67,077 million, a 10.1% rise from the previous fiscal year and the 12th consecutive year of increase.

Other income (expenses)—net amounted to income of ¥1,605 million, reflecting such factors as rises in dividend income and currency exchange gains.

Extraordinary income (expenses)—net amounted to an expense of ¥1,142 million owing to the special loss on withdrawal from the multi-storied parking system business.

As a result of the above factors, net income totaled ¥40,709 million, up 5.1% from the previous year.

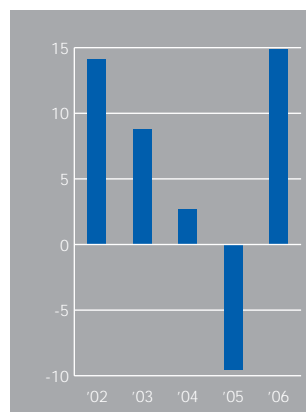
Financial Position

Groupwide efforts were made to reduce notes and accounts receivable and inventories, and the retaining period for receivables was 68 days, approximately the same level as in the previous year. The retaining period

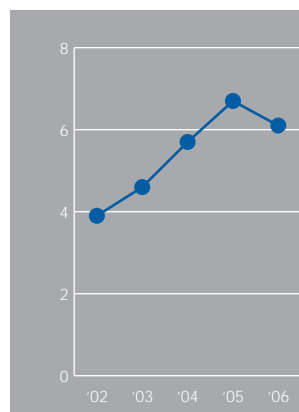
for inventories was 69 days, down 2 days from the previous fiscal year-end's level.

Interest-bearing debt increased ¥6,553 million compared with the previous year-end, to ¥172,995 million;

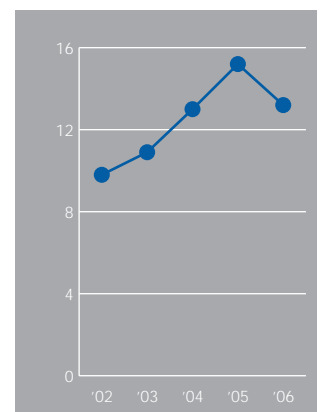
Free Cash Flow (FCF)
(¥ billion)



Return on Assets (ROA)
(%)



Return on Equity (ROE)
(%)



however, the interest-bearing debt ratio decreased 2.9 percentage points, to 24.0%.

Total shareholders' equity increased ¥69,370 million compared with the previous year-end, to ¥343,492

million, chiefly reflecting an increase in internal reserves accompanying a rise in profitability as well as an increase in valuation gains on securities. The shareholders' equity ratio rose 3.3 percentage points, to 47.7%.

Cash Flows

Net cash provided by operating activities amounted to ¥63,511 million, among other factors reflecting a rise in income before income taxes and minority interests.

Net cash used in investing activities totaled ¥63,420 million, and was chiefly associated with purchases of property, plant and equipment.

Net cash used in financing activities was ¥4,284 million, reflecting the redemption of bonds.

As a result, cash and cash equivalents, end of year, totaled ¥54,178 million.

Dividends

Daikin is taking various measures to expand its operations and bolster its operating structure and thereby realize its top-priority objective of maximizing corporate value. For example, the Company is establishing virtual companies and introducing the use of such indicators as FCF, DVA (Daikin Value Added, an in-house-developed metric), ROA, and ROI as management tools. Regarding returns to shareholders, the Company aims

to raise the ratio of cash dividends to shareholders' equity (consolidated basis) to at least 2.0%.

Dividend payments applicable to the fiscal year under review were ¥22.00 per share. This is ¥6.00 per share higher than the level in the previous fiscal year, which included a special ¥2.00 per share dividend to commemorate the 80th anniversary of Daikin's founding.

Capital Investment

Because of the need to increase supply capabilities in light of expanding demand for air conditioners overseas, particularly in Europe and China, Daikin has been investing in the establishment of new manufacturing bases including a new compressor manufacturing base in the Czech Republic. As a result, capital investment

during the fiscal year under review amounted to ¥49,690 million, up ¥4,963 million.

In the current fiscal year, the Company plans to make approximately ¥49.0 billion in capital investment centered mainly on projects designed to boost air-conditioner manufacturing capacity.

Consolidated Balance Sheets

Daikin Industries, Ltd. and Consolidated Subsidiaries
March 31, 2006 and 2005

ASSETS	Millions of yen	
	2006	2005
Current assets:		
Cash and cash equivalents	¥ 54,178	¥ 55,386
Short-term investments	1,284	460
Trade receivables (Notes 7 and 8):		
Notes	10,354	8,006
Accounts	137,326	128,287
Allowance for doubtful receivables	(2,822)	(2,637)
Inventories (Notes 3 and 8)	149,242	141,894
Deferred tax assets (Note 12)	14,845	15,028
Prepaid expenses and other current assets (Note 8)	26,564	21,158
Total current assets	390,971	367,582
Property, plant and equipment (Note 8):		
Land (Note 4)	24,264	23,590
Buildings and structures (Note 4)	137,467	125,858
Machinery and equipment	286,135	254,783
Furniture and fixtures	86,244	80,326
Construction in progress	9,239	11,017
Total	543,349	495,574
Accumulated depreciation	(346,864)	(325,365)
Net property, plant and equipment	196,485	170,209
Investments and other assets:		
Investment securities (Note 5)	103,998	53,072
Investments in and advances to unconsolidated subsidiaries and associated companies	3,733	3,627
Goodwill (Note 6)	6,707	7,739
Deferred tax assets (Note 12)	2,045	1,850
Other assets (Note 4)	15,443	13,795
Total investments and other assets	131,926	80,083
Total	¥719,382	¥617,874

See notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen	
	2006	2005
Current liabilities:		
Short-term borrowings (Note 8)	¥113,687	¥ 95,643
Current portion of long-term debt (Note 8)	3,278	13,838
Trade payables (Note 7):		
Notes	8,494	7,413
Accounts	75,758	70,653
Construction payable	12,859	11,618
Income taxes payable	7,644	9,488
Deferred tax liabilities (Note 12)	32	7
Accrued expenses	29,785	28,635
Other current liabilities	32,917	30,873
Total current liabilities	284,454	268,168
Long-term liabilities:		
Long-term debt (Note 8)	56,030	56,961
Liabilities for retirement benefits (Note 9)	5,072	4,553
Deferred tax liabilities (Note 12)	18,531	4,834
Other long-term liabilities	565	603
Total long-term liabilities	80,198	66,951
Minority interests	11,238	8,633
Commitments and contingent liabilities (Note 16)		
Shareholders' equity (Notes 10, 11 and 18):		
Common stock—authorized, 500,000,000 shares; issued 263,813,973 shares in 2006 and 2005	28,023	28,023
Capital surplus	25,968	25,971
Retained earnings	250,247	215,681
Net unrealized gain on available-for-sale securities	33,054	12,295
Foreign currency translation adjustments	7,750	(6,501)
Total	345,042	275,469
Treasury stock, at cost: 622,947 shares in 2006 and 561,170 shares in 2005	(1,550)	(1,347)
Total shareholders' equity	343,492	274,122
Total	¥719,382	¥617,874

Consolidated Statements of Income

Daikin Industries, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2006 and 2005

	Millions of yen	
	2006	2005
Net sales (Note 7)	¥792,857	¥728,880
Cost of sales (Note 7)	522,386	472,222
Gross profit	270,471	256,658
Selling, general and administrative expenses (Note 7)	203,394	195,761
Operating income	67,077	60,897
Other income (expenses):		
Interest and dividend income	2,051	1,141
Interest expense	(4,615)	(4,618)
Exchange gains	1,050	794
Loss on disposals of property, plant and equipment	(1,045)	(651)
Loss on impairment of long-lived assets (Note 4)	(796)	
Gain on sales of investment securities	1,249	111
Write-down of investment securities	(45)	(62)
Write-down of other assets		(3)
Equity in earnings of unconsolidated subsidiaries and associated companies	505	398
Gain on loss-of-profit insurance from explosion at Kashima plant—net		6,884
Gain on insurance for fire in Spain—net	1,448	
Loss on withdrawal from oil hydraulic multi-tier parking equipment business	(1,952)	
Other—net	2,613	(1,089)
Other income (expenses)—net	463	2,905
Income before income taxes and minority interests	67,540	63,802
Income taxes (Note 12):		
Current	23,936	23,836
Deferred	274	(1,832)
Total	24,210	22,004
Minority interests	(2,621)	(3,051)
Net income	¥ 40,709	¥ 38,747
	Yen	
Amounts per common share (Note 17):		
Basic net income	¥154.25	¥146.76
Diluted net income	154.21	146.74
Cash dividends applicable to the year	22.00	18.00

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Daikin Industries, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2006 and 2005

	Outstanding Number of Common Shares Issued	Millions of yen					
		Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain on Available-for- Sale Securities	Foreign Currency Translation Adjustments	Treasury Stock
Balance, April 1, 2004	263,324,348	¥28,023	¥25,969	¥180,945	¥11,200	¥ (9,256)	¥(1,110)
Cumulative effect of consolidating subsidiaries previously unconsolidated				51			
Effect of change of the fiscal year-end of certain consolidated subsidiaries (Note 2)				7			
Net income				38,747			
Cash dividends, ¥15 per share				(3,949)			
Bonuses to directors and corporate auditors				(120)			
Repurchase of treasury stock	(153,303)						(432)
Disposal of treasury stock	81,758		2				195
Net unrealized gain on available-for-sale securities					1,095		
Foreign currency translation adjustments						2,755	
Balance, March 31, 2005	263,252,803	28,023	25,971	215,681	12,295	(6,501)	(1,347)
Cumulative effect of consolidating subsidiaries previously unconsolidated				23			
Effect of change of the fiscal year-end of certain consolidated subsidiaries (Note 2)				(265)			
Net income				40,709			
Cash dividends, ¥22 per share				(5,791)			
Bonuses to directors and corporate auditors				(110)			
Repurchase of treasury stock	(155,367)						(435)
Disposal of treasury stock	93,590		(3)				232
Net unrealized gain on available-for-sale securities					20,759		
Foreign currency translation adjustments						14,251	
Balance, March 31, 2006	263,191,026	¥28,023	¥25,968	¥250,247	¥33,054	¥ 7,750	¥(1,550)

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Daikin Industries, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2006 and 2005

	Millions of yen	
	2006	2005
Operating activities:		
Income before income taxes and minority interests	¥67,540	¥63,802
Adjustment for:		
Income taxes—paid	(25,281)	(22,796)
Proceeds from loss-of-profit insurance for explosion at Kashima plant—net		7,517
Proceeds from insurance for fire in Spain—net	3,379	
Depreciation and amortization	29,269	23,425
Gain on sales of investment securities	(1,249)	(111)
Write-down of investment securities	45	62
Write-down of other assets		3
Loss on disposals of property, plant and equipment	1,045	651
Loss on impairment of long-lived assets	796	
Gain on loss-of-profit insurance for explosion at Kashima plant—net		(6,884)
Gain on insurance for fire in Spain—net	(1,448)	
Loss on withdrawal from oil hydraulic multi-tier parking equipment business	1,952	
Equity in earnings of unconsolidated subsidiaries and associated companies	(505)	(398)
Changes in assets and liabilities, net of effects of the purchase of subsidiaries and a newly consolidated subsidiary:		
Trade notes and accounts receivable	(8,251)	(1,851)
Inventories	(5,084)	(28,043)
Other current assets	(5,608)	(2,419)
Trade notes and accounts payable	4,945	2,322
Accrued expenses	(26)	2,746
Other current liabilities	1,643	6,001
Other—net	349	(57)
Total adjustments	(4,029)	(19,832)
Net cash provided by operating activities	63,511	43,970
Investing activities:		
Purchases of property, plant and equipment	(46,169)	(37,506)
Increase in investments in unconsolidated subsidiaries and associated companies	(60)	(427)
Payment for purchase of a subsidiary, net of cash acquired		(3,408)
Payment for purchase of minority interest	(115)	(960)
Payments to acquire investment securities	(18,090)	(1,047)
Proceeds from sales of investment securities	3,204	363
Other—net	(2,190)	894
Net cash used in investing activities	(63,420)	(42,091)
Financing activities:		
Net increase in short-term borrowings	15,760	15,025
Increase in long-term debt	1,903	9,759
Repayments of long-term debt	(14,419)	(16,822)
Payments of cash dividends	(5,791)	(3,949)
Other—net	(1,737)	(479)
Net cash provided by (used in) financing activities	(4,284)	3,534
Effect of exchange rate changes on cash and cash equivalents	3,226	129
Net increase (decrease) in cash and cash equivalents	(967)	5,542
Cash and cash equivalents of newly consolidated subsidiaries, beginning of year	347	152
Effect of change of the fiscal year-end of consolidated subsidiaries	(588)	(410)
Cash and cash equivalents, beginning of year	55,386	50,102
Cash and cash equivalents, end of year	¥54,178	¥55,386

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Daikin Industries, Ltd. and Consolidated Subsidiaries Years Ended March 31, 2006 and 2005

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared from the consolidated financial statements issued for domestic reporting purposes in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards. Daikin Industries, Ltd. (the "Company") and its consolidated domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and in conformity with accounting principles and practices generally accepted in Japan,

and its consolidated foreign subsidiaries in conformity with those of their respective countries of their domicile.

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 2005 financial statements to conform to the classification used in 2006.

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 and 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, 2006 and 2005, the Company consolidated the result of a consolidated subsidiary, Daikin Airconditioning UK Ltd., and 6 consolidated subsidiaries including Daikin Airconditioning France S.A.S. for the 15-month period ended March 31, 2006 and 2005, respectively, because such subsidiaries changed their fiscal year-end from December 31 to March 31. The Company included the subsidiaries' results for the 12-month period in the consolidated statements of income, and included their results for the 3-month period in the consolidated statements of shareholders' 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 5 to 10 years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

Cash Equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits, marketable debt securities issued by the Japanese Government and private companies, all of which mature or become due within three months of the date of acquisition.

Marketable debt securities that mature or become due 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 stated at cost, determined by the average method. Inventories of consolidated foreign subsidiaries are principally stated at the lower of cost, determined by the average-cost method, or market.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation of property,

plant and equipment of the Company and its consolidated domestic subsidiaries is computed by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998, at rates based on the estimated useful lives of the assets. Depreciation of property, plant and equipment of consolidated foreign subsidiaries is principally computed by the straight-line method at rates based on the estimated useful lives of the assets.

The range of useful lives is 15 to 50 years for buildings and structures, 5 to 15 years for machinery and equipment, and 2 to 10 years for furniture and fixtures.

Long-Lived Assets

In August 2002, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting for Impairment of Fixed Assets*, and in October 2003 the Accounting Standards Board of Japan (ASBJ) issued ASBJ Guidance No. 6, *Guidance for Accounting Standard for Impairment of Fixed Assets*. These new pronouncements were effective for fiscal years beginning on or after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The Group adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

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.

The effect of adoption of the new accounting standard for impairment of fixed assets was to decrease income before income taxes and minority interests for the year ended March 31, 2006, by ¥796 million.

Leases

All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that are deemed to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for

as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the financial statements.

Investment Securities

Under Japanese accounting standard for financial instruments, all marketable securities held by the Group are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. The cost of securities sold is determined based on the moving-average method.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method.

For other than temporary declines in fair value, available-for-sale securities are reduced to net realizable value by charging such losses to income.

Employees' Retirement Benefits

The Company and its consolidated domestic subsidiaries have a non-contributory funded pension plan covering substantially all of its employees. Effective April 1, 2000, the Company adopted a new accounting standard for employees' retirement benefits and accounted for the liability for retirement benefits based on projected benefit obligations and plan assets at the balance sheet date. The transitional obligation of ¥25,249 million as of April 1, 2000 is being amortized over seven years and the annual amortization is presented as selling, general and administrative expenses in the consolidated statements of income.

Based on an agreement between labor and management in March 2006, the Company and certain consolidated subsidiaries implemented a defined benefit pension plan and a defined contribution pension plan effective June 1, 2006, by which time the former qualified defined benefit pension plan was terminated.

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 shareholders' equity, which is translated at historical rates. Revenue and expense accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the average exchange rates. Differences arising from such translations were shown as "Foreign currency translation adjustments" in a separate component of shareholders' equity.

Income Taxes

The provision for current income taxes is computed based on the income before income taxes and minority interests included in the consolidated statements of income. Deferred income taxes are recorded to reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

Derivative Financial Instruments

The Group uses foreign exchange forward contracts, currency swaps and currency options to hedge foreign exchange risk associated with certain assets and liabilities denominated in foreign currencies, and mainly interest rate swaps and interest rate options to manage its exposures to fluctuations in interest rates. The Group does not enter into derivatives for trading or speculative purposes.

Derivative financial instruments and foreign currency transactions are classified and accounted for as follows: a) all derivatives are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the statements of income and b) for derivatives used for hedging purposes, if such derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses are deferred until maturity of the hedged transactions.

The interest rate swaps that qualify for hedge accounting and meet specific matching criteria are not remeasured at market value but the differential paid or received under the swap agreements is recognized and included in interest expense or income.

Appropriations of Retained Earnings

Appropriations of retained earnings at each year-end are reflected in the financial statements for the following year upon shareholders' approval.

Amounts per Common Share

Basic net income per 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.

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 Combination and Business Separation

In October 2003, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting for Business Combinations*, and on December 27, 2005 the Accounting Standards Board of Japan (ASBJ) issued *Accounting Standard for Business Separations* and ASBJ Guidance No. 10, *Guidance for Accounting Standard for Business Combinations and Business Separations*. These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

- a. the consideration for the business combination consists solely of common shares with voting rights,
- b. the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and
- c. there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

Stock Options

On December 27, 2005, the ASBJ issued *Accounting Standard for Stock Options and Related Guidance*. The new standard and guidance are 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 shareholders' equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-

based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

Bonuses to Directors and Corporate Auditors

Prior to the fiscal year ended March 31, 2005, bonuses to directors and corporate auditors were accounted for as a reduction of retained earnings in the fiscal year following approval at the general shareholders meeting. The ASBJ issued ASBJ Practical Issues Task Force (PITF) No. 13, *Accounting treatment for bonuses to directors and corporate auditors*, which encouraged companies to record bonuses to directors and corporate auditors on the accrual basis with a related charge to income, but still permitted the direct reduction of such bonuses from retained earnings after approval of the appropriation of retained earnings.

The ASBJ replaced the above accounting pronouncement by issuing a new accounting standard for bonuses to directors and corporate auditors on November 29, 2005. Under the new accounting standard, bonuses to directors and corporate auditors must be expensed and are no longer allowed to be directly charged to retained earnings. This accounting standard is effective for fiscal years ending on or after May 1, 2006. The companies must accrue bonuses to directors and corporate auditors at the year-end to which such bonuses are attributable.

3. Inventories

Inventories at March 31, 2006 and 2005 consisted of the following:

	Millions of yen	
	2006	2005
Finished products and merchandise	¥ 85,103	¥ 84,099
Semi-finished products and work-in-process	43,180	41,570
Raw materials and supplies	20,959	16,225
Total	<u>¥149,242</u>	<u>¥141,894</u>

4. Long-Lived Assets

The Group reviewed its long-lived assets for impairment for the year ended March 31, 2006 and, as a result, recognized an impairment loss of ¥796 million as other expense for certain land, buildings and leaseholds, which were deemed to be idle assets with no future plan for utilization and of which the carrying amount

exceeded the fair value. The carrying amount of the relevant assets was written down to the recoverable amount. The recoverable amount of these assets was measured by the net selling price at disposition, which was primarily determined by independent real estate appraisals of land and buildings.

5. Investment Securities

The acquisition costs and aggregate fair values of marketable available-for-sale securities included in investment securities at March 31, 2006 and 2005 were as follows:

	Millions of yen			
	2006			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥44,909	¥55,219	¥(21)	¥100,107
Other	504	444		948
Total	¥45,413	¥55,663	¥(21)	¥101,055

	Millions of yen			
	2005			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities classified as available-for-sale:				
Equity securities	¥27,973	¥21,249	¥(690)	¥48,532
Other	503	107		610
Total	¥28,476	¥21,356	¥(690)	¥49,142

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2006 and 2005 were as follows:

	Millions of yen	
	Carrying Amount	
	2006	2005
Available-for-sale:		
Equity securities	¥1,910	¥1,790
Other	1,033	2,140
Total	¥2,943	¥3,930

Proceeds from sales of available-for-sale securities for the years ended March 31, 2006 and 2005 were ¥3,204 million and ¥363 million, respectively. Gross realized gains on these sales computed on the moving average cost basis were ¥1,249 million and ¥111 million

for the years ended March 31, 2006 and 2005, respectively.

The Company did not have investments in debt securities at March 31, 2006 and 2005.

6. Goodwill

Goodwill at March 31, 2006 and 2005 consisted of the following:

	Millions of yen	
	2006	2005
	Consolidation goodwill	¥5,427
Others	1,280	1,534
Total	¥6,707	¥7,739

7. Related Party Transactions

Receivables and payables, with respect to transactions with unconsolidated subsidiaries and associated companies, at March 31, 2006 and 2005 were as follows:

	Millions of yen	
	2006	2005
Trade notes and accounts receivable	¥2,172	¥2,745
Trade notes and accounts payable	695	727

Sales to and purchases from unconsolidated subsidiaries and associated companies for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen	
	2006	2005
Sales	¥16,340	¥17,317
Purchases	8,102	8,986

Material transactions and balances with related individuals, including shareholders and directors, for the years ended March 31, 2006 and 2005 were as follows:

Name	Description of Post	Ownership of the Company (%)	Description of Transaction	Millions of yen	
				Resulting Account Balances	
				2006	2006
Noriyuki Inoue	Chairman of the Board and CEO/Director general of Daikin Foundation for Contemporary Arts	0.02	Donation to Daikin Foundation for Contemporary Arts	¥7	

Name	Description of Post	Ownership of the Company (%)	Description of Transaction	Millions of yen	
				Resulting Account Balances	
				2005	2005
Noriyuki Inoue	Chairman of the Board and CEO/Director general of Daikin Foundation for Contemporary Arts	0.02	Donation to Daikin Foundation for Contemporary Arts	¥105	

8. Short-Term Borrowings and Long-Term Debt

Short-term borrowings of the Group at March 31, 2006 and 2005 consisted of the following:

	Millions of yen	
	2006	2005
Bank overdrafts and notes to banks	¥ 53,044	¥57,643
Commercial paper	60,643	38,000
Total	¥113,687	¥95,643

Unused short-term bank credit lines were ¥25,000 million at March 31, 2006. Weighted average interest rates of bank overdrafts and notes to banks at March 31, 2006 and 2005 were 2.73% and 2.16%, respectively.

Weighted average interest rates of commercial paper at March 31, 2006 and 2005 were 0.18% and 0.02%, respectively.

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen	
	2006	2005
2.70% unsecured bonds, due 2006		¥10,000
0.82% unsecured bonds, due 2009	¥20,000	20,000
Collateralized loans from government sponsored banks, with interest 1.75%, due through 2012	1,200	1,200
Unsecured loans from government sponsored banks, with interest 1.40% (2006), and interest ranging from 1.40% to 6.53% (2005), due through 2012	3,000	3,674
Collateralized loans from banks with: Floating interest ranging from 0.44% to 0.59% (2006), and from 0.44% to 0.58% (2005), due through 2010	8,250	8,250
Unsecured loans from banks and others, payable in foreign currencies, with interest ranging from 1.59% to 5.42% (2006), and from 2.30% to 11.36% (2005), due through 2009	13,909	14,701
Unsecured loans from banks with interest ranging from 0.45% to 6.10% (2006), and from 0.44% to 6.10% (2005), due through 2027	12,949	12,974
Total	59,308	70,799
Less current portion	(3,278)	(13,838)
Long-term debt, less current portion	¥56,030	¥56,961

Annual maturities of long-term debt outstanding at March 31, 2006 were as follows:

Years ending March 31,	Millions of yen
2007	¥ 3,278
2008	7,822
2009	27,338
2010	5,808
2011 and thereafter	15,062
Total	¥59,308

At March 31, 2006, property, plant and equipment, trade accounts receivables, inventories and prepaid expense and other current assets with a net book value of ¥48,183 million, ¥6,203 million, ¥4,611 million and ¥713 million, respectively, were pledged as collateral for short-term borrowings and long-term debt, and short-term investments with a value of ¥1,284 million were pledged as collateral for a supplier's borrowings of ¥1,246 million.

Certain loan agreements provide that the lender may require the Group to submit proposals for paying dividends, issuing additional long-term debt and certain other matters for prior approval. As is customary in Japan, security must be given if requested by a lending bank. Banks have the right to offset cash deposited with them against any debt or obligation that becomes due, or, in case of default and certain other specified events, against all other debt payable to them. To date, none of the lenders has ever exercised this right with respect to debt of the Group.

9. 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 March 2006, the Company and certain consolidated subsidiaries implemented a defined benefit pension plan and a defined contribution pension plan effective June 1, 2006, by which the former qualified defined benefit pension plan was terminated.

The liabilities for employees' retirement benefits at March 31, 2006 and 2005 consisted of the following:

	Millions of yen	
	2006	2005
Projected benefit obligation	¥69,681	¥68,458
Fair value of plan assets	(67,852)	(50,285)
Unrecognized prior service cost	400	97
Unrecognized actuarial loss	6,450	(6,503)
Unrecognized transitional obligation	(3,607)	(7,214)
Net liability	¥ 5,072	¥ 4,553

The components of net periodic benefit costs for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen	
	2006	2005
Service cost	¥3,498	¥3,487
Interest cost	1,706	1,698
Expected return on plan assets	(1,257)	(1,105)
Amortization of prior service cost	(13)	(13)
Amortization of transitional obligation	3,607	3,607
Recognized actuarial loss	1,171	1,283
Net periodic benefit costs	¥8,712	¥8,957

Assumptions used for the years ended March 31, 2006 and 2005 were set forth as follows:

	2006	2005
Discount rate	2.5%	2.5%
Expected rate of return on plan assets	2.5%	2.5%
Amortization period of prior service cost	10 years	10 years
Recognition period of actuarial gain/loss	10 years	10 years
Amortization period of transitional obligation	7 years	7 years

10. Shareholders' Equity

Through May 1, 2006, Japanese companies are subject to the Commercial Code of Japan (the "Code").

The Code requires that all shares of common stock are issued with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds are required to be presented as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing shareholders without consideration by way of a stock split. Such issuance of shares generally does not give rise to changes within the shareholders' accounts.

The Code also provides that an amount of 10% or more of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period (such as bonuses to directors) shall be appropriated as a legal reserve (a component of retained earnings) until the total of such reserve and additional paid-in capital equals 25% of common stock. The amount of the total legal reserve and additional paid-in capital that exceeds 25% of the common stock may be available for dividends by resolution of the shareholders after transferring such excess in accordance with the Code. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to the common stock by resolution of the Board of Directors.

The Code allows Japanese companies to purchase treasury stock and dispose of such treasury stock upon resolution of the Board of Directors. The aggregate purchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve that could be transferred to retained earnings or other capital surplus other than additional paid-in capital upon approval of such transfer at the annual general meeting of shareholders.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash outlays, the Code also imposes certain limitations on the amount of capital surplus and retained earnings available for dividends. The amount of capital surplus and retained earnings available for dividends under the Code was ¥155,116 million as of March 31, 2006, based on the amount recorded in the Company's general books of account.

Dividends are approved by the shareholders at a meeting held subsequent to the end of the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

On May 1, 2006, a new corporate law (the "Corporate Law") became effective, which reformed and replaced the Code with various revisions that would, for the most part, be applicable to events or transactions which occur on or after May 1, 2006 and for the fiscal years ending on or after May 1, 2006. The significant changes in the Corporate Law that affect financial and accounting matters are summarized below:

(1) Dividends

Under the Corporate Law, 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 a Board of Directors, (2) having independent auditors, (3) having a 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) if the Company has prescribed so in its articles of incorporation.

The Corporate Law 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. Under the Code, certain limitations were imposed on the amount of capital surplus and retained earnings available for dividends. The Corporate Law also 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.

(2) Increases/decreases and transfer of common stock, reserve and surplus

The Corporate Law 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 Code, the aggregate amount of additional paid-in capital and the legal reserve that exceeds 25% of the common stock may be made available for dividends by resolution of the shareholders. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law 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.

(3) Treasury stock and treasury stock acquisition rights

The Corporate Law 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 Corporate Law, stock acquisition rights, which were previously presented as a liability, are now presented as a separate component of shareholders' equity.

The Corporate Law 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 shareholders' equity or deducted directly from stock acquisition rights.

On December 9, 2005, the Accounting Standards Board of Japan (ASBJ) published a new accounting

standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interests, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006.

11. Stock Option Plan

On June 29, 2000, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 93 thousand shares of the Company's common stock in the period from July 1, 2002 to June 30, 2006. On July 25, 2000, the options were granted at an exercise price of ¥2,471 per share.

On June 28, 2001, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 92 thousand shares of the Company's common stock in the period from July 1, 2003 to June 30, 2007. On July 30, 2001, the options were granted at an exercise price of ¥2,541 per share.

On June 27, 2002, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 118 thousand shares of the Company's common stock in the period from July 1, 2004 to June 30, 2008. On July 30, 2002, the options were granted at an exercise price of ¥2,330 per share.

On June 27, 2003, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 118 thousand shares of the Company's common stock in the period from July 1, 2005 to June 30, 2009. On July 30, 2003, the options were granted at an exercise price of ¥2,405 per share.

On June 29, 2004, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 144 thousand shares of the Company's common stock in the period from July 1, 2006 to June 30, 2010. On July 30, 2004, the options were granted at an exercise price of ¥2,957 per share.

On June 29, 2005, the Company's shareholders approved a stock option plan for the Company's directors and key employees that will enable them to purchase up to 153 thousand shares of the Company's common stock in the period from July 1, 2007 to June 30, 2011. On July 29, 2005, the options were granted at an exercise price of ¥2,852 per share.

12. 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, 2006 and 2005.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen	
	2006	2005
Deferred tax assets:		
Inventories	¥ 7,716	¥ 8,803
Retirement benefits	1,983	1,750
Foreign tax credit	1,626	1,572
Tax loss carryforwards	391	386
Accrued bonus	2,929	2,641
Warranty reserve	2,932	3,121
Software and other assets	4,161	3,680
Business tax payable	769	555
Property and equipment	469	284
Investment securities	190	112
Other	3,544	2,652
Less valuation allowance		(53)
Total deferred tax assets	¥26,710	¥25,503
Deferred tax liabilities:		
Deferred gains on sales of property	¥ 2,168	¥ 2,168
Unrealized gain on available-for-sale securities	22,598	8,406
Other	3,617	2,892
Total deferred tax liabilities	¥28,383	¥13,466
Net deferred tax assets (liabilities)	¥ (1,673)	¥12,037

A reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2006 and 2005 is as follows:

	2006	2005
Normal statutory income tax rate	40.6%	40.6%
Permanent non-deductible expenses	3.4	1.7
Difference in foreign subsidiaries' tax rates	(6.1)	(6.2)
Tax credit for research and development costs	(2.8)	(2.8)
Losses of consolidated subsidiaries	1.0	0.6
Other—net	(0.3)	0.6
Actual effective income tax rate	35.8%	34.5%

13. Research and Development Costs

Research and development costs were ¥26,648 million and ¥24,583 million for the years ended March 31, 2006 and 2005, respectively.

14. Leases

The Group leases certain computer equipment and other assets.

Lease payments under finance leases were ¥2,283 million and ¥2,141 million for the years ended March 31, 2006 and 2005, respectively.

Pro forma information of leased property under finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005, was as follows:

	Millions of yen		
	Furniture and Fixtures	Others	Total
For the year ended March 31, 2006			
Acquisition cost	¥6,282	¥2,413	¥8,695
Accumulated depreciation	2,798	981	3,779
Net leased property	<u>¥3,484</u>	<u>¥1,432</u>	<u>¥4,916</u>
For the year ended March 31, 2005			
Acquisition cost	¥5,983	¥1,909	¥7,892
Accumulated depreciation	3,044	812	3,856
Net leased property	<u>¥2,939</u>	<u>¥1,097</u>	<u>¥4,036</u>

Obligations under finance leases:

	Millions of yen	
	2006	2005
Due within one year	¥2,061	¥1,780
Due after one year	2,855	2,256
Total	<u>¥4,916</u>	<u>¥4,036</u>

The amount of acquisition cost and obligations under finance leases includes the imputed interest expense portion.

Depreciation expense under finance leases:

	Millions of yen	
	2006	2005
Depreciation expense	¥2,283	¥2,141

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

15. Derivatives

The Group enters into mainly various interest rate swap agreements and interest rate options covering certain portions of long-term debt as a means of managing interest rate exposure. The impact on interest expense from these agreements is recognized over the lives of the respective agreements, which are the same as the terms of the related loans.

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

All derivative transactions are entered into to hedge interest and foreign currency exposures incorporated

within the Group's business. Accordingly, market risk in these derivatives is basically offset by opposite movements in the value of hedged assets or liabilities. The Group does not hold or issue derivatives for trading purposes.

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

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

Fair Value of Derivative Financial Instruments

The fair values of the Group's derivative financial instruments at March 31, 2006 and 2005 were as follows:

	Millions of yen					
	2006			2005		
	Contract Amount	Fair Value	Unrealized Gain (Loss)	Contract Amount	Fair Value	Unrealized Gain (Loss)
Forward exchange contracts:						
Selling: GBP	¥ 3,797	¥ 3,795	¥ 2	¥ 3,015	¥ 3,050	¥(35)
EUR	2,856	2,863	(7)	11,421	11,409	12
US\$	1,880	1,860	20	3,125	3,168	(43)
AU\$				2,418	2,454	(36)
ZAR	1,844	1,846	(2)	600	595	5
CZK	1,830	1,829	1	69	69	
HUF				38	37	1
PLN	60	60		107	105	2
SKK				24	24	
Currency swaps contracts:						
Receive JPY/Pay HK\$	647	106	106			
Total	¥12,914	¥12,359	¥120	¥20,817	¥20,911	¥(94)

	Millions of yen					
	2006			2005		
	Contract Amount	Fair Value	Unrealized Gain (Loss)	Contract Amount	Fair Value	Unrealized Gain (Loss)
Interest rate swaps contracts:						
Pay fixed/receive floating	¥7,854	¥205	¥205	¥ 2,775	¥(63)	¥(63)
Interest rate option contracts:						
Buying	1,542			5,661	(1)	(1)
Forward rate agreement contracts:						
Buying				2,081		
Total	¥9,396	¥205	¥205	¥10,517	¥(64)	¥(64)

Information related to derivative contracts that qualify for hedge accounting and forward contracts that are assigned to associated assets and liabilities and recorded on the balance sheets at March 31, 2006 and 2005 are excluded from the disclosure of market value information.

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

16. Commitments and Contingent Liabilities

Commitments for capital expenditures outstanding at March 31, 2006 totaled approximately ¥5,037 million.

Guarantees of bank loans and items of a similar nature at March 31, 2006 were ¥1,083 million.

17. Net Income Per Share

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the year ended March 31, 2006 and 2005 were as follows:

	Millions of yen	Thousands of shares	Yen
For the year ended March 31, 2006	Net Income	Weighted Average Shares	EPS
Basic EPS			
Net income available to common shareholders	¥40,599	263,198	¥154.25
Effect of dilutive securities			
Stock options		71	
Diluted EPS			
Net income for computation	¥40,599	263,269	¥154.21
	Millions of yen	Thousands of shares	Yen
For the year ended March 31, 2005	Net Income	Weighted Average Shares	EPS
Basic EPS			
Net income available to common shareholders	¥38,637	263,267	¥146.76
Effect of dilutive securities			
Stock options		42	
Diluted EPS			
Net income for computation	¥38,637	263,309	¥146.74

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, 2006 and 2005 was as follows:

(1) Industry Segments

a. Sales and Operating Income

	Millions of yen				
For the year ended March 31, 2006	Air Conditioning	Chemicals	Others	Eliminations and Corporate	Consolidated
Sales to customers	¥641,657	¥107,411	¥43,789		¥792,857
Intersegment sales	488	3,376	19	¥(3,883)	
Total sales	642,145	110,787	43,808	(3,883)	792,857
Operating expenses	585,035	100,034	44,582	(3,871)	725,780
Operating income (loss)	¥ 57,110	¥ 10,753	¥ (774)	¥ (12)	¥ 67,077

b. Assets, Depreciation and Capital Expenditures

	Millions of yen				
For the year ended March 31, 2006	Air Conditioning	Chemicals	Others	Eliminations and Corporate	Consolidated
Assets	¥440,199	¥129,919	¥29,258	¥120,006	¥719,382
Depreciation	16,842	10,273	1,246		28,361
Capital expenditures	33,737	14,402	1,551		49,690

a. Sales and Operating Income

For the year ended March 31, 2005	Millions of yen				Consolidated
	Air Conditioning	Chemicals	Others	Eliminations and Corporate	
Sales to customers	¥589,275	¥99,612	¥39,993		¥728,880
Intersegment sales	385	2,770		¥(3,155)	
Total sales	589,660	102,382	39,993	(3,155)	728,880
Operating expenses	538,428	93,423	39,274	(3,142)	667,983
Operating income	¥ 51,232	¥ 8,959	¥ 719	¥ (13)	¥ 60,897

b. Assets, Depreciation and Capital Expenditures

For the year ended March 31, 2005	Millions of yen				Consolidated
	Air Conditioning	Chemicals	Others	Eliminations and Corporate	
Assets	¥398,065	¥111,192	¥30,847	¥77,770	¥617,874
Depreciation	13,141	7,850	1,174		22,165
Capital expenditures	30,093	12,926	1,439		44,458

Corporate assets consist principally of the Company's cash, time deposits, short-term investments and investment securities.

The effect of the adoption of the new accounting standard for impairment of fixed assets in Note 2 was to decrease corporate assets at March 31, 2006, by ¥796 million.

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, 2006 and 2005 were summarized below:

For the year ended March 31, 2006	Millions of yen						Consolidated
	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	
Sales to outside customers	¥465,540	¥116,277	¥174,811	¥33,443	¥2,786		¥792,857
Interarea transfers	96,162	67,279	3,270	3,572		¥(170,283)	
Total sales	561,702	183,556	178,081	37,015	2,786	(170,283)	792,857
Operating expenses	531,342	163,345	165,636	36,704	2,640	(173,887)	725,780
Operating income	¥ 30,360	¥ 20,211	¥ 12,445	¥ 311	¥ 146	¥ 3,604	¥ 67,077
Assets	¥416,261	¥159,943	¥114,812	¥38,703	¥2,491	¥ (12,828)	¥719,382

For the year ended March 31, 2005	Millions of yen						Consolidated
	Japan	Asia and Oceania	Europe	Americas	Other	Eliminations and Corporate	
Sales to outside customers	¥440,222	¥ 98,066	¥160,757	¥27,326	¥2,509		¥728,880
Interarea transfers	110,434	67,594	913	5,447		¥(184,388)	
Total sales	550,656	165,660	161,670	32,773	2,509	(184,388)	728,880
Operating expenses	528,581	142,390	147,315	28,513	2,306	(181,122)	667,983
Operating income	¥ 22,075	¥ 23,270	¥ 14,355	¥ 4,260	¥ 203	¥ (3,266)	¥ 60,897
Assets	¥391,698	¥131,247	¥122,213	¥25,449	¥1,268	¥ (54,001)	¥617,874

The above amounts are summarized by geographic area based on the countries where subsidiaries are located.

The effect of the adoption of the new accounting standard for impairment of fixed assets in Note 2 was to decrease assets of Japan at March 31, 2006, by ¥796 million.

(3) Sales to Foreign Customers

Sales to foreign customers for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen	
	2006	2005
Asia and Oceania	¥143,310	¥123,920
Europe	178,822	168,806
Americas	36,403	31,808
Other	8,966	6,745
Total sales to foreign customers	¥367,501	¥331,279

19. Subsequent Events

(1) Acquisition of O.Y.L. Industries Bhd

On May 18, 2006, the Company's Board of Directors authorized the proposed acquisition of O.Y.L. Industries Bhd ("OYL"), a Malaysian listed company. On the same date, the Company entered into separate share transfer agreements with two major shareholders to acquire a total of 600,526 thousand shares representing 45.2% ownership of OYL for RM3,441 million. These share transfers will take place in early July 2006. Public tender offer procedures for the remaining shares of OYL are scheduled to commence in early July 2006, with settlement scheduled for late September 2006.

This acquisition remains subject to certain conditions including approvals by relevant regulatory authorities and compliance with antitrust laws. The above schedule may change depending on various factors.

OYL is a holding company with subsidiaries engaged in the manufacturing and sales of air-conditioning and refrigeration equipment and industrial air filter products. Consolidated total assets as of June 30, 2005 and consolidated total sales for the year then ended were RM3,665 million and RM5,516 million, respectively.

(2) Resolutions Approved by the Company's Shareholders at the General Shareholders' Meeting Held on June 29, 2006

a. Appropriations of Retained Earnings

The shareholders approved payment of a year-end cash dividend of ¥11 per share to holders of record at March 31, 2006, totaling ¥2,895 million and bonuses to directors and corporate auditors totaling ¥110 million.

b. Purchase of Treasury Stock

The Company is authorized to repurchase up to 400 thousand shares of the Company's common stock (aggregate amount of ¥2,200 million) as treasury stock until the next general shareholders' meeting.

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, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards 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, 2006 and 2005, 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.

As discussed in Note 2 to the consolidated financial statements, the Group adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

As discussed in Note 19 to the consolidated financial statements, on May 18, 2006, the Company's Board of Directors authorized the proposed acquisition of O.Y.L. Industries Bhd, a Malaysian listed company, through separate share transfer agreements and public tender offer procedures commencing in early July 2006.

June 29, 2006

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