Operating and Financial Review

Scope of Consolidation and Number of Employees

In fiscal 2014, the year ended March 31, 2015, nine companies were newly consolidated with the parent company, bringing the total number of consolidated subsidiaries to 61. On a consolidated basis, Daifuku Co., Ltd. and its consolidated subsidiaries had 7,746 employees as of the fiscal year-end.

Analysis of Operating Results

During fiscal 2014, the global economy faced concerns stemming from a slowdown in economic growth in China and many other emerging countries, while European economies showed continued weakness. Meanwhile, the U.S. economy continued its recovery trend, and the Japanese economy maintained a slow recovery from the marginal influence of the consumption tax increase, bolstered by a weakened yen, lower crude oil prices, and other factors.

The material handling and logistics industry is experiencing rising demand from the e-commerce sector worldwide. In addition, the need for automated facilities is growing due to the issue of labor shortages in Japan.

Amid these operating conditions, the operating results of the Daifuku Group ("the Group") have made steady progress, with orders and sales rising to record highs, and increased sales and profits were reported for the fifth consecutive year.

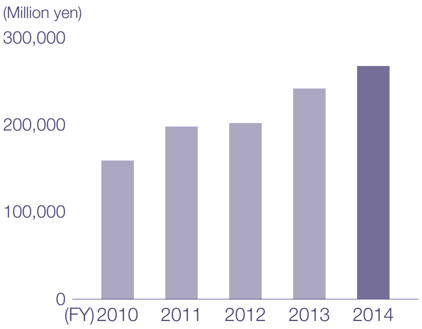
Orders for systems from manufacturers and distributors outside Japan increased. In North America, orders received by Wynright Corporation ("Wynright"), which joined the Group in October 2013, and, in South Korea, large orders from the e-commerce and cosmetics sectors contributed to earnings. In addition, demand from North America's automobile factories was firm, and a series of large orders for systems for semiconductor and flat-panel display (FPD) factories in Taiwan, which were received in the second half of the fiscal year, also contributed to earnings.

Sales were favorable, underpinned by systems for manufacturers, distributors, and automobile factories in North America, as well as systems for FPD factories in China.

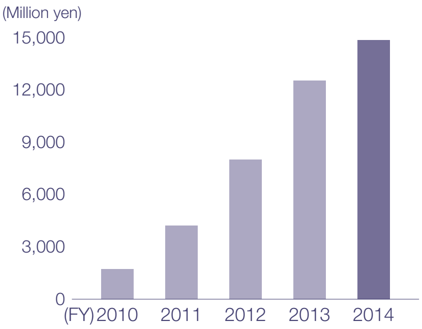
As a result, the Group received orders of 305,567 million yen, a rise of 10.4% from a year earlier, and recorded net sales of 267,284 million yen, an increase of 10.5%.

Turning to profits, the high level of earnings generated by Daifuku Co., Ltd., strong sales posted by Contec Co., Ltd., and positive results recorded by non-Japanese subsidiaries that sell systems for automobile, semiconductor, and FPD factories in North America and Asia contributed to income.

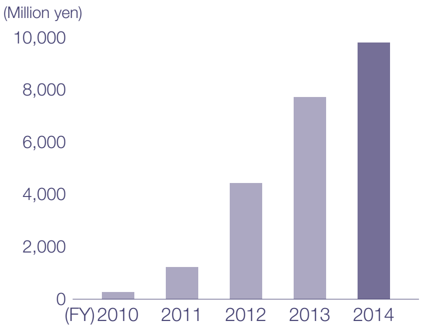
Net Sales



Operating Income



Net Income



Consequently, the Group posted operating income of 14,883 million yen, up 18.5% from a year earlier. Net income was 9,810 million yen, up 26.7% from the previous year, reflecting a favorable operating performance despite some impact from extraordinary losses and an increase in deferred income taxes along with the reduction of corporate tax rates.

Results by reportable segment are as described below. Orders from and sales to outside customers are shown as segment orders and sales, and net income is recorded as segment income.

Operating Results by Segment

(1) Daifuku Co., Ltd.

Orders and sales of Daifuku's mainstay manufacturing and distribution systems for large projects remained firm in the distribution, pharmaceutical, food, e-commerce, supermarket and co-op sectors. In addition, large orders from the e-commerce and cosmetics sectors in South Korea contributed to earnings.

In systems for semiconductor and FPD factories, orders and sales remained steady in the United States and Asian countries, due to trends toward semiconductor miniaturization, large flat-screen TV displays, and high-definition panels used in smartphones and tablet PCs.

Orders and sales of automobile production line systems remained firm in emerging countries, including Russia and Brazil. In Japan, orders and sales of services and other small upgrade projects were also firm. In addition, orders for parts logistics systems started to show positive results.

Sales of car wash machines remained firm, mainly for car service stations.

Segment income benefited from the Company's progress overall in cost-cutting efforts in production, the increase in production and profitability during the fourth quarter of fiscal 2014, and other factors.

As a result, Daifuku recorded orders of 137,012 million yen, up 16.7% from the previous fiscal year, net sales of 115,065 million yen, up 4.4%, and segment income of 7,041 million yen, up 22.2%.

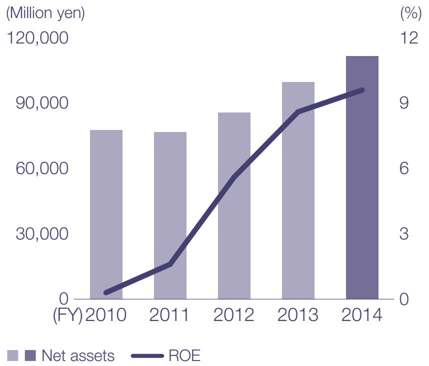
(2) Contec Group

(Contec Co., Ltd., and its subsidiaries)

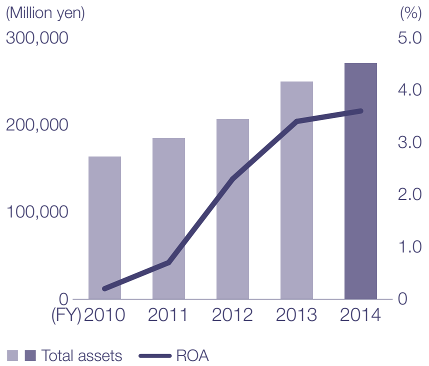
In the industrial computer business in the Japanese market, sales of industrial-use computers and configurable PCs remained favorable, supported by increased capital investment. In addition, in the U.S. market, sales of products for the medical device sector were firm.

Sales of measuring and control boards for automobile production facilities grew along with the increased capital investment of auto-related manufacturers.

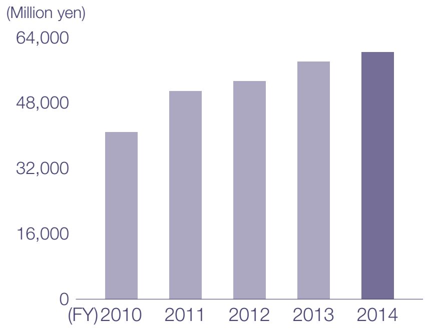
Net Assets and ROE



Total Assets and ROA



Interest-Bearing Liabilities



In the networking product business, the Contec Group strove to identify new markets and introduced new wireless LAN products in the FLEXLAN ZC series for educational institutions.

In the solution products business, despite efforts in marketing activities for hospital bedside information terminals and automobile production management systems, sales of photovoltaic data measuring systems decreased, as an electric company temporarily suspended responses to applications for connecting photovoltaic energy.

As a result of the above developments, the Contec Group reported orders of 15,374 million yen, up 3.7% from the previous fiscal year, net sales of 14,634 million yen, up 9.5%, and segment income of 845 million yen, up 16.2%.

(3) Daifuku Webb Group

(Daifuku Webb Holding Company and its subsidiaries and affiliates)

In systems for manufacturers and distributors, Wynright, which joined the Group in October 2013, significantly contributed to earnings, mainly receiving large orders from the food, apparel and department store sectors. The integration of the production and sales frameworks for these systems into Wynright was completed. The Daifuku Webb Group will pursue further benefits from collaboration within the Group.

In systems for the semiconductor sector, sales of nitrogen purge stockers and other items were favorable.

In automobile production line systems, orders and sales of both new installations and services remained favorable, reflecting brisk capital investment among automakers in North America, including Detroit's Big Three and Japanese automakers.

In airport baggage handling systems, orders are now on a recovery trend. Unprofitable projects are nearing completion.

As a result, the Daifuku Webb Group achieved orders of 75,725 million yen, up 0.7% from the previous fiscal year, net sales of 76,547 million yen, up 45.1%, and segment income of 1,554 million yen, down 7.5%.

In January 2015, Daifuku Webb Holding Company changed its company name to Daifuku North America Holding Company, with the aim of further advancing its businesses activities in North America.

(4) Other

The Other segment includes all other Daifuku Group companies, excluding the aforementioned Contec and Daifuku Webb group companies. The Group has 61 consolidated subsidiaries and affiliates located worldwide.

Outside Japan, major subsidiaries primarily manufacture and sell material handling systems and equipment. These companies have boosted exports to markets in other countries and are playing a global role in the optimal local production and procurement framework of the Group.

In China, orders for systems for FPD factories were brisk. Sales of systems for automobile factories remained firm. In systems for manufacturers and distributors, orders included systems for a large parts center for a non-Chinese automaker, in addition to large orders from pharmaceutical manufacturers and wholesalers as well as the food sector.

In Taiwan, orders for systems for domestic FPD factories increased, while Taiwan Daifuku Co., Ltd. produced systems for FPD factories in China, where large projects are continuing.

In South Korea, orders from semiconductor manufacturers were favorable. Daifuku Korea Co., Ltd. is steadily receiving orders for systems for automobile factories, and demand for systems for the distribution sector is increasing.

In Thailand, Indonesia, Malaysia, and Singapore, orders grew at a sluggish pace, reflecting unfavorable business sentiment. However, in consideration of Southeast Asia's potential, the Daifuku Group has strengthened its local operating frameworks and its market presence through participation in local trade fairs, seeking orders from automobile factories that need to upgrade or replace their facilities, as well as meeting demand for low-temperature logistics in the food and beverage sectors.

In New Zealand, the acquisition of BCS Group Limited ("BCS"), which sells airport baggage handling systems in Oceania and Asia, was completed at the end of December 2014. Accordingly, only the balance sheets of the 12 BCS group companies were consolidated into the results of fiscal 2014. Looking ahead, the Group will strive to expand this business and increase profitability through further collaboration with other Group companies that operate in North America and Europe.

As a consequence of these developments, the segment received orders of 77,455 million yen, including BCS's order backlogs, up 11.5% from the previous fiscal year, and reported net sales of 64,615 million yen, up 0.7%, and segment income of 4,127 million yen, up 38.8%.

Earnings

During fiscal 2014, as mentioned previously, net sales increased 10.5%, to 267,284 million yen. The gross profit margin decreased 0.1 percentage point, to 19.3%. Although the profitability of Daifuku on a non-consolidated basis was high and sales of Contec were robust, the gross profit margin declined slightly because of low-margin projects in markets outside Japan. The ratio of selling, general and administrative expenses improved 0.4 percentage point, to 13.8%.

As a result, operating income rose 18.5%, to 14,883 million yen. Despite the reporting of extraordinary losses and an increase in income taxes, net income rose a substantial 26.7%, to 9,810 million yen. The effective income tax rate for fiscal 2014 was 35.6%. As a consequence, net income per share rose from 69.96 yen per share in the previous fiscal year to 88.59 yen per share for fiscal 2014.

Financial Position

Assets, liabilities, and net assets

Total assets at the end of fiscal 2014 were 271,011 million yen, an increase of 21,480 million yen year on year. This result principally reflected increases of 2,428 million yen in notes and accounts receivable and unbilled receivables, 4,079 million yen in insufficient charges on uncompleted contracts, and 4,149 million yen in inventories, including costs on uncompleted contracts, as well as an increase of 2,765 million yen in goodwill, mainly related to the acquisition of affiliates.

Total liabilities at the end of fiscal 2014 were 159,490 million yen, an increase of 9,649 million yen year on year. Primary factors included an increase of 2,402 million yen in interest-bearing liabilities, as well as an increase of 3,460 million yen in liabilities for retirement benefits.

Net assets at the end of fiscal 2014 were 111,521 million yen, an increase of 11,831 million yen year on year. This was mainly attributable to an increase of 7,616 million yen in retained earnings, as well as an increase of 3,138 million yen in total other comprehensive income due to changes, etc., in securities owned and foreign currency translation adjustments. The ratio of shareholders' equity to total assets stood at 39.8% at fiscal year-end, and the return on equity (ROE) was 9.6%.

Cash flows

Cash and cash equivalents at the end of fiscal 2014 increased 2,228 million yen from the end of the previous fiscal year, to 54,081 million yen, compared with 51,852 million yen in the same period of the previous fiscal year.

Cash flows from operating activities

Net cash provided by operating activities totaled 6,295 million yen, compared with cash provided of 20,447 million yen in the same period of the previous fiscal year. This primarily reflects 7,021 million yen in income taxes paid and a decrease of 3,657 million yen in notes and accounts payable, offsetting the income before income taxes and minority interests of 15,211 million yen and the depreciation of 4,157 million yen.

Cash flows from investing activities

Net cash used in investing activities was 5,846 million yen, compared with cash used of 7,372 million yen in the same period of the previous fiscal year. Major activities included outlays of 3,666 million yen for the purchase of non-current assets and 3,140 million yen for the acquisition of shares in newly consolidated subsidiaries.

Cash flows from financing activities

Net cash used in financing activities was 509 million yen, compared with cash provided of 1,045 million yen in the same period of the previous fiscal year. Major factors were an increase of 1,754 million yen in interest-bearing liabilities, largely offsetting the dividend payment of 2,218 million yen.

Basic policy regarding dividends for fiscal 2014 and 2015

Daifuku regards the return of profits to shareholders as its most important management task and has adopted a performance-based policy for cash dividends based on consolidated net income, with the aim of achieving additional profit distribution to shareholders. The Company appropriates the remaining surplus to internal reserves for future growth.

Under its four-year business plan Value Innovation 2017, Daifuku aims to achieve sustainable growth in dividend per share and a medium- to long-term dividend payout ratio of 30%.

For fiscal 2014, Daifuku paid an interim dividend of 7 yen per share and a year-end dividend of 15 yen per share, making the annual dividend 22 yen per share.

With respect to dividends for fiscal 2015, the year ending March 31, 2016, the Company plans to pay an annual dividend of 25 yen per share (an interim dividend of 10 yen per share and a year-end dividend of 15 yen), taking into consideration the earnings forecast for fiscal 2015 and the basic policy described above.

Management Policy

Basic management policy for the Group

Daifuku has grown to become a manufacturer and systems integrator vying for the No. 1 and No. 2 positions within the material handling field, as a result of consistently seeking to achieve sustainable growth based on its medium-term business plans. For fiscal 2014, the Company was ranked first in sales in the material handling industry in the world for the first time in three years, according to the U.S. magazine, *Modern Materials Handling - April 2015.*

Under the four-year business plan Value Innovation 2017, which started with fiscal 2013, the year ended March 31, 2014, the Group aims to evolve into a top-class Value Innovator that provides the best solutions for customers worldwide by capitalizing on the experience and technologies it has accumulated as a comprehensive manufacturer and integrator of material handling systems.

In the plan Value Innovation 2017, the Group set management targets to achieve net sales of 280 billion yen and an operating income ratio of 7% for fiscal 2016, the year ending March 31, 2017. However, net sales of 320 billion yen are now projected for fiscal 2015, which will be a year earlier than the initial target. Accordingly, the Group has revised the management targets to net sales of 340 billion yen and operating income of 21 billion yen for the plan’s final fiscal year. In addition, the Group has added a target

ROE and will strengthen its earning power and financial position to maintain a stable ROE of 10%. Furthermore, other key Group objectives will include aiming for sustainable growth in dividends per share, a medium- to long-term dividend payout ratio of 30%, an increase in shareholders' equity through the conversion of outstanding convertible bonds, an improved R&I rating, and an increase in net income per share.

For additional information on the Group's medium- to long-term strategy, please refer to the Message from the CEO section of this report.

Business-Related Risks

The main items that the Daifuku Group recognizes as risks and responds to as such are as follows. Some of the content of this section constitutes forward-looking statements. Accordingly, please note that these statements have been made based on judgments of the Group as of the date of submission of its Securities Report to Japan's Ministry of Finance.

Risks covered by the Chief Financial Officer and Chief Risk Officer

(1) Major disruptions in production (damage to facilities, etc.)
(2) Impact of natural disasters and intentional threats, war, acts of terrorism, strikes, disease, etc.
(3) Environmental problems
(4) Labor relations issues (deterioration in the employee-management relationship, outbreak of industrial disputes, etc.)
(5) Joint ventures (deterioration in management policy at joint venture partner(s), deterioration in management environment, etc.)
(6) Risk related to intellectual property (IP) rights (failure to obtain the license for use of the third-party IP rights/royalty demands; third-party allegations of IP right infringement(s); lack of protection of Daifuku IP rights in certain countries and regions outside of Japan, etc.)
(7) Securing of personnel (recruitment and retention of competent personnel; difficulties in training human resources, etc.)
(8) Customer/Supplier credit risk (customer/supplier doubtful accounts/bad debts, etc.)
(9) Information management (leak of important and/or personal information to outside the Company; use for purposes other than that intended, etc.)
(10) Risk related to global business development (changes to each country's laws and regulations; changes in the social, political and economic situation; deterioration in public safety, disruption to transportation/electric power infrastructure; currency exchange restrictions and fluctuations; tax system changes; taxation by transfer price; trade protection regulations; customer credit risk from different commercial practices; different employment/social insurance systems; changes in labor environment; difficulties in recruiting/retaining personnel; outbreaks of disease, etc.)

Risks covered by the Chief Operating Officer

(1) Impacts of conditions in the markets related to semiconductors and flat-panel displays, as well as automobiles (changes in demand/capital investment trends, etc.)
(2) Price competition (pressure on profits due to fierce price competition, etc.)
(3) Product quality issues (product defects/failures, quality claims/complaints, etc.)
(4) Risk related to the development of new products/technologies (mismatch between new products/technologies and market needs; rival developments from competitors; absence of IP right protection; breach of another company's IP rights; emergence of new alternative technology products from other companies, etc.)
(5) Increase in raw material prices (sharp increase in prices for raw materials and components, product shortages, supply instability, etc.)

Risks covered by the Compliance Committee

Compliance-related risks (trouble or losses caused by director/employee failure to observe laws, regulations, standards, internal regulations, policies, etc.)