2004

Financial Information

Note: In the financial statements, the names given to our business segments are abbreviated as follows:
Housing: Residential   Commercial construction: Commercial   Resort hotels: Resort   Home center business: Home Center   Other businesses: Other

Consolidated Seven-year Summary

Daiwa House Industry Co., Ltd. and Subsidiaries
Years ended March 31, 1998 to 2004

	Millions of yen						
	2004	2003	2002	2001	2000	1999	1998
Net sales	¥1,224,648	¥1,184,544	¥1,197,925	¥1,016,237	¥ 951,073	¥ 896,006	¥1,069,789
Cost of sales	963,457	936,861	945,474	794,170	736,310	691,318	834,407
Selling, general and administrative expenses	201,530	202,411	206,420	177,777	167,266	164,473	186,932
Operating income	59,661	45,272	46,031	44,290	47,497	40,215	48,450
Income (loss) before income taxes and minority interests	67,897	(155,157)	9,538	12,796	32,123	21,414	48,685
Net income (loss)	37,257	(91,388)	5,217	6,256	17,450	16,699	20,373
Per share of common stock (in yen):							
Basic net income (loss)	68.16	(167.06)	9.55	12.05	33.52	31.88	38.89
Diluted net income					33.50		37.91
Shareholders' equity	902.32	884.55	1,066.63	1,182.01	1,188.63	1,151.12	1,136.55
Property, plant and equipment, less accumulated depreciation	344,268	349,646	426,630	383,853	376,489	365,502	346,543
Total assets	1,087,658	1,094,441	1,187,127	1,066,457	981,893	950,701	1,013,072
Shareholders' equity	493,050	483,684	582,438	613,867	617,421	603,060	595,429
Return on equity (%)	7.63	(17.14)	0.85	1.02	2.86	2.79	3.42

Management's Discussion and Analysis (On a Consolidated Basis)

Year Ended March 31, 2004

Operating Environment and Financial Strategy

In the fiscal year ended March 31, 2004, the Japanese economy began showing some positive signs such as a recovery in private capital investment, rising exports and higher stock prices. Despite this, consumer spending remained relatively weak, primarily because of a difficult employment and income situation, although even here a slight improvement was registered.

In the housing industry, new housing starts improved from the previous year for the first time in four years, supported by temporary growth in demand based on bright signs in the economy and the anticipation of higher interest rates. In general construction, demand remained a stop-start affair, failing to stage a full recovery because of the prolonged weakness in public investment, which offset a recovery in private capital spending.

In response to this operating environment, the Daiwa House group endeavored to strengthen its financial position. In the previous period, we took steps to bolster financial health, for example through the accelerated depreciation of property, plant and equipment, and the lump-sum amortization of transition obligations on retirement benefits. Thanks to a stronger financial foundation, we realized a V-shaped recovery in our earnings during the period. It will, however, still be necessary to increase our focus on improving operational efficiency, taking into consideration the balance between capital investment to strengthen our foundations and develop future businesses on the one hand, and profit distribution to shareholders to promote long-term development and ongoing growth on the other. We therefore adopted a basic policy of raising return on equity (ROE) as a criterion to judge the progress in asset efficiency.

To achieve higher ROE, it is necessary to boost each of its basic components, namely, the ratio of net income to sales, total asset turnover and financial leverage. ROE, at 7.6%, reached its highest level for the past five years, because of improvements in both the ratio of net income to sales and total asset turnover. The ratio of net income to sales was 3.0% for the period, compared to the ratio of net loss to sales of 7.7% for the previous year. On the operating income level, the ratio was 4.9% for this fiscal year, against 3.8% in the previous year. Total capital turnover also improved, from 1.12 for the period compared to 1.04 for the previous year. However, financial leverage, another component of ROE, came to 2.2 times as we adopted a policy of reducing interest-bearing debt. Although it will be necessary to raise the financial leverage to enable a higher ROE, debt capital such as borrowings and corporate bonds could negatively impact asset health, as they impose an interest burden as a fixed cost. Our cash flows are sufficient to provide the investment capital we need internally. We therefore believe that we will be able to achieve future development without having to rely on external sources of capital.

Results of Operations

Net Sales

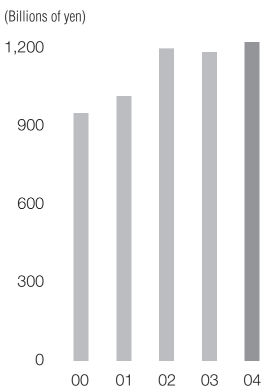
Net sales for the fiscal year ended March 31, 2004 increased 3.4% from the previous year, to ¥1,224.6 billion (US$11,553.2 million). The major supporting factor was new housing starts, which rose on a year-on-year basis for the first time in four years, mainly thanks to the signs of recovery in the Japanese economy and the front-loading of housing demand before the revision of the housing investment tax reduction.

Sales by segment (including inter-segment transactions) were as follows: ¥800.6 billion (US$7,553.1 million, up 1.1% from the previous year) in Housing, ¥276.9 billion (US$2,613.0 million, up 11.7%) in Commercial construction, ¥53.6 billion (US$505.7 million, up 3.3%) in Resort hotels, ¥57.2 billion (US$539.8 million, up 9.7%) in Home centers, and ¥97.7 billion (US$922.3 million, up 0.7%) in Other businesses. While all segments achieved year-on-year sales growth, the mainstay housing and commercial construction businesses in particular remained firm, which contributed to the overall improvement in sales.

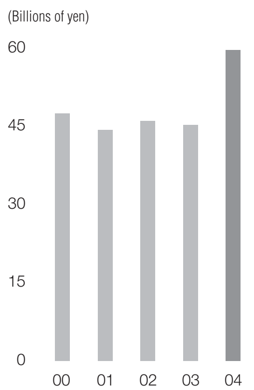
Cost of Sales, and Selling, General and Administrative Expenses

While the cost of sales increased ¥26.5 billion from the previous year, to ¥963.4 billion (US$9,089.2 million), the sales cost ratio was lowered 0.4 percentage points to 78.7%, primarily because of the decrease in cost of sales in the real estate business.

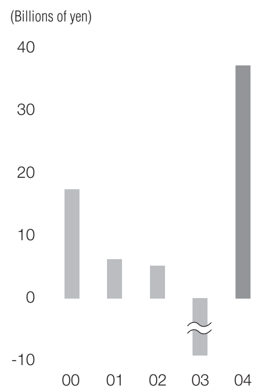
Net sales



Operating income



Net income (loss)



Selling, general and administrative expenses (SG&A) decreased ¥0.8 billion from the previous year, to ¥201.5 billion (US$1,901.2 million). While personnel and advertisement expenses increased, depreciation and retirement benefit expenses fell because of the accelerated depreciation of property, plant and equipment in the previous year. As a result, the ratio of SG&A to sales declined 0.7 percentage point from the previous year, to 16.4%.

Operating Income

Operating income increased 31.8% from the previous year, to ¥59.6 billion (US$562.8 million), chiefly because of the sales increase and the reduction in expenses. Operating income in the home center business posted a year-on-year decline, but the unprofitable resort hotel business returned to the black. The ratio of operating income to sales was 4.9%, up 1.1 percentage point from the previous year.

Business Overview by Segment

The analysis of sales by segment below incorporates inter-segment transactions.

Housing Business

The single-family house division bases its operations on the construction concept of providing "security, safety and confidence" to our customers. We provided new products that responded to the needs of our customers for improved home security. For example, we preinstalled security double glass in all windows on the first floor of all single-family houses and offered a quake-absorbing system as an option on all two-story steel frame houses. We also provided new products tailored to each generation of customers. These efforts were materialized in our new products, such as a lifestyle home based on the concept of a "slow life," a two-story house for the children of the baby boomers, and an urban-type three-story house. As a result, sales (non-consolidated basis) of single-family houses increased 3.7% from the previous year, to ¥288.2 billion (US$2,719.1 million), while unit sales were down 0.7%, to 10,378 units.

In the rental apartment buildings division, unit sales increased 8.3% from the previous year, to 26,411 units, and sales revenue (non-consolidated basis) was also higher, rising 7.6% to ¥223.8 billion (US$2,111.3 million). This growth came in response to the rising demand of landowners for efficient use of their assets, as financial assets remained relatively unattractive. Meanwhile, we launched products to respond to the shift in demand to a maisonette-type of rental housing.

In the condominium division, unit sales grew 4.6% from the previous year, to 3,838 units, and sales revenue (non-consolidated basis) also increased 4.7%, to ¥80.1 billion (US$755.8 million). We promoted sales of urban-type compact condominiums to meet the needs of the new market created by the repopulation of city centers. We also marketed the "D series" of condominiums, which come in four types to cater to differing needs depending on specific location as well as region. We also proposed lifestyle and product planning to our customers and improved our quality control system to maintain building asset values.

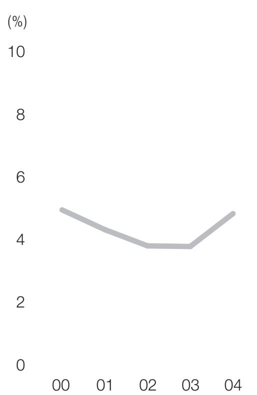
In addition, we established Daiwa House Renew Co., Ltd. in October 2003 to prepare for expansion into the renovation market, which is expected to grow even as the market for new residential housing contracts.

As a result, sales in the housing business reached ¥800.6 billion (US$7,553.1 million), and operating income increased 23.3% from the previous year to ¥48.2 billion (US$455.3 million). The ratio of operating income to sales rose 1.1 percentage point to 6.0%.

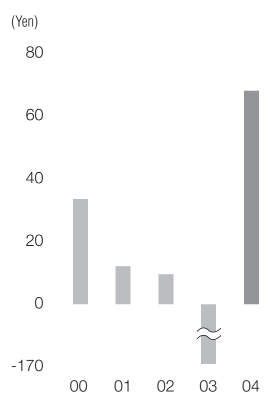
Commercial Construction Business

The subleased area of commercial construction increased 27.8% from the previous year, to 1,099,274 square meters. The number of tenants topped 1,800, reflecting a slight improvement in corporate spending, even as the recovery in consumer spending remains stalled. We also endeavored to expand the construction of medical and nursing care facilities, such as group homes (cohabitation caring facilities for patients suffering from senile dementia) and pay nursery homes, taking advantage of our expertise in this area, which we have developed over many years. In addition, we promoted the construction of corporate logistics facilities geared to meeting distribution strategies and large-scale commercial complexes designed to create trading spheres. All of these

Operating profit margin



Basic net income (loss) per share



efforts contributed to an increasing number of tenants and higher occupancy rates.

As a result, sales in the commercial construction business increased 11.7% from the previous year, to ¥276.9 billion (US$2,613.0 million), and operating income grew 17.2% to ¥20.6 billion (US$194.9 million). The ratio of operating income to sales was 7.5%, up 0.4 percentage point from the previous year.

Resort Hotel Business

In the resort hotel business, we developed new services, such as a new Western-style banquet, a totally fresh style of banquet focusing on higher levels of presentation, service and food. We also endeavored to improve the ability to draw more customers in hotels around the country by providing customer-oriented services based on local specialties, resulting in an increased number of guests and a higher occupancy rate.

As a result, sales in this segment amounted to ¥53.6 billion (US$505.7 million), and operating income came to ¥81 million (US$0.7 million).

Home Center Business

In this segment, unit sales price continued to decline, reflecting the weakness of consumer spending which offsets a rise in customer numbers. We therefore implemented a store scrap-and-build program, with five stores closed and two new stores opened. We also endeavored to better respond to demand for residential renovation, taking advantage of our know-how as a homebuilder.

As a result, sales increased 9.7% from the previous year to ¥57.2 billion (US$539.8 million), while operating income decreased 54.5%, to ¥0.1 billion (US$1.3 million). The operating income ratio was 0.2%, down 0.4 percentage point from the previous year.

Other Businesses

In the construction materials manufacturing and selling business, we made efforts to reduce costs, mainly transportation expenses, by reorganizing and streamlining the production system.

In the distribution business, we made proposals for the improvement of distribution efficiency, focusing on the distribution of raw materials and parts for production, for example through joint distribution and materials procurement. We also provided a total service for fixtures, furniture, and equipment, from delivery, setup and installation to collection, maintenance, storage and re-shipment. In addition, improved operational efficiency by increasing the occupancy rate in Roynet Hotels and cutting costs in other businesses subdivisions.

As a result, sales in other businesses increased 0.7% from the previous year, to ¥97.7 billion (US$922.3 million), and operating income rose 9.7% to ¥2.8 billion (US$26.6 million).

Other Income and Expenses

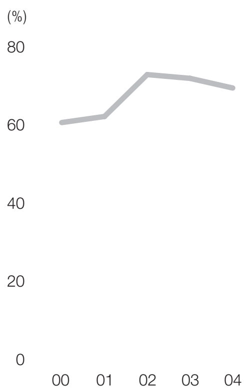
Other income increased ¥2.2 billion from the previous year, to ¥23.5 billion, while other expenses decreased ¥206.3 to ¥15.2 billion.

The increase in other income was the outcome of the fundamental reform of the retirement benefit scheme, which we resolutely carried out over the previous year. As part of this reform, we lowered the expected rate of return from 3.5% to virtually zero, but achieved 7% as a result. We therefore recorded a ¥9.4 billion gain on the amortization of actuarial gains or losses for employees' retirement benefits. We also established an employee pension trust under which our assets were placed directly with a trustee for use as retirement benefits, and we realized an investment return on this account. As a result, we recorded a ¥5.9 billion gain in the amortization of actuarial gains or losses on the employee pension trust during the period, which was a major contribution to the rise in the amortization of actuarial gains or losses on employees' retirement benefits.

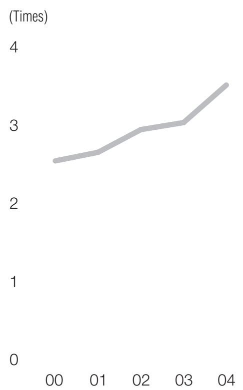
Other expenses, meanwhile, declined sharply as the lump-sum amortization of transition obligations on retirement benefits — which are akin to a hidden loss — ended the previous year, and the depreciation of fixed assets and the evaluation losses of lands and buildings for sale and investment securities decreased significantly.

As a result, the net balance moved significantly upward, to income of ¥8.2 billion (US$77.6 million) for the reporting fiscal year, from a ¥200.4 billion loss in the previous year.

Fixed ratio



Tangible fixed asset turnover ratio



Net Income

Net income reached ¥37.2 billion (US$351.4 million), and the ratio of net income to sales became 3.0%, mainly because other income and expenses moved into the black and operating income increased more than 30% from the previous year. Earnings per share also climbed, to ¥68.16 (US$0.64), the highest level of the last five years.

Liquidity and Capital Resources

Financial Position

Total assets as of the end of March 2004 decreased ¥6.7 billion (0.6%) from the year-ago level, to ¥1,087.6 billion (US$10,260.9 million). While current assets increased ¥27.9 billion, investments and other assets declined by a substantial ¥29.4 billion. The change in property, plant and equipment remained within the scope of changes caused by depreciation.

Among current assets, the significant increase in cash and cash equivalents was particularly noteworthy. The major factor in this rise was the large expansion in income. In contrast, trade receivables were lower, despite the increase in sales, primarily because of the shorter collection period.

The main reason for the large decline in investments and other assets was the reversal of deferred tax assets, which was mainly attributable to a decline in the balance of "liability for employees' retirement benefits" resulting from an extraordinary payment for and a gain on operation of the pension fund. In addition, deferred tax assets corresponding to the valuation loss recognized in the previous year were not recognized for the reporting fiscal year following a change to a more conservative accounting policy. Similarly, the reversal of deferred tax assets related to the land revaluation was derived from the judgment that the sale of land in the future could not be scheduled.

Meanwhile, investment securities increased, mainly because of the gain on valuations that resulted from the recovery of the stock market.

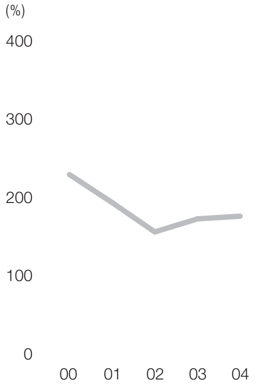
The decrease in liabilities and assets was primarily a reflection of the decline in long-term liabilities after the reversal of the provision for employees' retirement benefits. Within current liabilities, a ¥5.5 billion increase in trade payables from the previous year stood out, and primarily resulted from the increase in sales. The balance of short-term bank loans was ¥0.5 billion, as a result of reducing interest-bearing debt to improve financial health. As a consequence, total debt, including the current portion of long-term debt, was only ¥1.5 billion. This in turn meant that the ratio of interest-bearing debt to total assets was only 0.1%. In total, as the current liabilities increased ¥10.6 billion from the previous year, to ¥279.4 billion (US$2,636.3 million), the current ratio climbed from 174.2%, to 177.6%, which indicates that financial liquidity remains solid.

Among noncurrent liabilities, the provision for employees' retirement benefits declined significantly. Because of the lump-sum payment of a special premium, the funding shortfall in pension assets corresponding to or retirement benefit obligations declined. As a result, the financial situation of retirement benefits improved. In addition, the balance of corporate bonds as long-term debt became zero. As a result, noncurrent liabilities declined ¥23.4 billion from the previous year, to ¥295.7 billion (US$2,790.2 million).

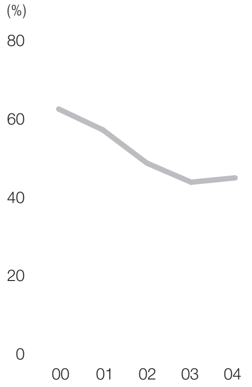
In shareholders' equity, retained earnings expanded because of the significant increase in income and the net unrealized gain on securities available for sale, following the rebound in the stock market. Consequently, total shareholders' equity increased ¥9.3 billion from the previous year to ¥493.0 billion (US$4,651.4 million), despite a decline in unrealized gains on land evaluation resulting from changes in accounting standards.

The shareholders' equity ratio rose 1.1 percentage point from the previous year, to 45.3%, while ROE came to 7.6% and ROA to 3.4%.

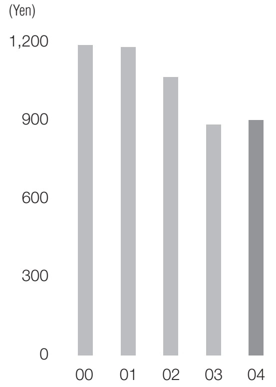
Current ratio



Shareholders' equity to total assets



Shareholders' equity per share



Cash Flows

The balance of cash and cash equivalents increased ¥37.5 billion from the end of the previous year, to ¥141.5 billion (US$1,335.3 million). This is chiefly because of the increase in net cash provided by operating activities, itself attributable to the significant increase in income.

The main factor for the increase in net cash provided by operating activities was the significant year-on-year increase in income before income taxes of ¥223.0 billion, which rose to ¥67.8 billion (US$640.5 million) on the strength of income growth. This offsets the decline in the provision for employees' retirement benefits because of the lump-sum payment of a special premium. Other factors were the decrease in trade receivables and the increase in trade payables. As a result, net cash provided by operating activities increased ¥29.1 billion (72.2%) from the previous year, to ¥69.6 billion (US$657.1 million).

Net cash used in investing activities decreased ¥1.3 billion from the previous year, to ¥25.9 billion (US$244.6 million). This mainly reflected a decrease in negative cash flows for the purchase of property, plant and equipment.

Although the net cash used in financing activities declined by a substantial ¥51.5 billion from the previous year, to ¥6.1 billion (US$57.7 million), this was mainly attributable to the termination of repayment of debt in and before the previous year.

As a result, free cash flows combining the cash flows from operating activities and investing activities increased ¥30.5 billion from the previous year, to ¥43.7 billion (US$412.4 million).

Outlook for the Current Fiscal Year, Ending March 2005

Over the current fiscal year, the Japanese economy should continue to stage a slow recovery, driven by an ongoing improvement in exports and corporate earnings. A strong recovery in private capital spending remains unlikely, however, and the employment and income environment remain uncertain.

In the housing industry, the operating environment is expected to remain unchanged, as stalled consumer spending will be countered by the extension of housing-related tax reductions.

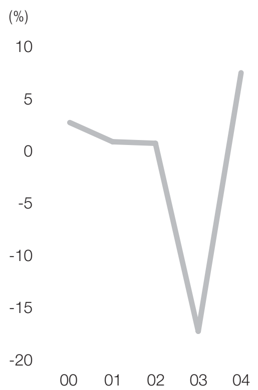
In this environment, all divisions of our company will be united in developing products that deliver high levels of customer satisfaction, to meet needs by strengthening the community-oriented business structure based on the branch system. In addition, to further enhance customer satisfaction (CS), we will initiate CS committees at head office and at each branch office, to better respond to the diverse needs of our customers by using a superior understanding of customer preferences and needs to improve our operations. We will also continue our commitment to expanding and strengthening our business, especially in our core single-family housing division, in a way that promotes the development of operating bases and personnel in the Tokyo metropolitan area. We will develop and bolster our home center business, which we spun off as a separate company in April 2004 to clarify the structure of responsibility and develop a more prompt and efficient operating base.

We recognize that fulfilling corporate social responsibility (CSR) is an important management issue, and will improve our staff's quality in such areas as corporate ethics, compliance and human rights to establish a management structure that responds to requests from different stakeholders.

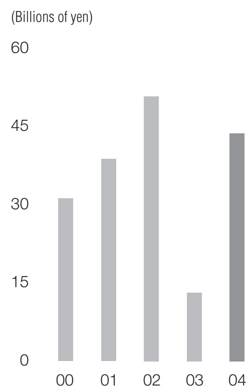
In terms of products and services, we will strengthen our commitment to the environment, a focus of ours for many years, and provide products that ensure "security, safety and confidence." We will also enhance our contribution to society, taking advantage of our unique technologies in such areas as we believe these activities will lead to the enhancement of our enterprise value.

With these initiatives, we expect net sales to reach ¥1,275 billion in the current fiscal year. We also anticipate operating income of ¥62.5 billion and net income ¥36.0 billion.

Return on equity



Free cash flows*



Free cash flows*=
Cash flow from operating activities
+Cash flow from investing activities

Consolidated Balance Sheets

Daiwa House Industry Co., Ltd. and Subsidiaries
March 31, 2004 and 2003

Assets

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Current assets:			
Cash and cash equivalents	¥ 141,546	¥ 103,950	$ 1,335,340
Marketable securities (Note 3)	65	202	613
Short-term investments (Note 2-d)	59	133	557
Receivables:			
Trade notes	5,431	7,238	51,236
Trade accounts	47,299	55,685	446,217
Allowance for doubtful receivables	(1,772)	(1,972)	(16,717)
Inventories (Note 4)	267,920	267,199	2,527,547
Deferred tax assets (Note 11)	22,552	22,106	212,755
Prepaid expenses and other current assets	13,191	13,755	124,443
Total current assets	496,291	468,296	4,681,991
Property, plant and equipment:			
Land (Notes 5 and 6)	210,677	212,312	1,987,519
Buildings and structures (Note 6)	378,761	380,978	3,573,217
Accumulated depreciation	(260,849)	(259,286)	(2,460,840)
Machinery and equipment	50,536	51,264	476,755
Accumulated depreciation	(41,690)	(42,205)	(393,302)
Furniture and fixtures	34,527	36,695	325,726
Accumulated depreciation	(28,738)	(31,116)	(271,113)
Construction in progress	1,044	1,004	9,849
Net property, plant and equipment	344,268	349,646	3,247,811
Investments and other assets:			
Investment securities (Note 3)	45,801	25,988	432,085
Investments in and advances to associated companies	46,921	25,900	442,651
Long-term loans	5,466	5,024	51,566
Deferred tax assets (Note 11)	76,577	100,123	722,425
Deferred tax assets on land revaluation (Note 5)		41,211	
Lease deposits and other assets	81,342	87,589	767,377
Allowance for doubtful accounts	(9,008)	(9,336)	(84,981)
Total investments and other assets	247,099	276,499	2,331,123
Total	¥1,087,658	¥1,094,441	$10,260,925

See notes to consolidated financial statements.

Liabilities and shareholders' equity

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Current liabilities:			
Short-term bank loans (Note 6)	¥ 550	¥ 2,800	$ 5,189
Current portion of long-term debt (Note 6)	51		481
Payables:			
Trade notes	20,020	26,012	188,868
Trade accounts	102,421	90,890	966,235
Other accounts	55,400	58,639	522,641
Deposits received from customers	39,719	38,444	374,708
Income taxes payable	14,218	8,419	134,132
Accrued bonuses	12,837	9,769	121,104
Provision for product warranties	4,864	4,181	45,887
Accrued expenses and other current liabilities	29,373	29,657	277,104
Total current liabilities	279,453	268,811	2,636,349
Long-term liabilities:			
Long-term debt (Note 6)	911	3,237	8,594
Liability for employees' retirement benefits (Note 7)	103,237	136,480	973,934
Long-term deposits received from the Company's club members	60,854	64,243	574,095
Lease deposits and other long-term liabilities	130,760	115,229	1,233,585
Total long-term liabilities	295,762	319,189	2,790,208
Minority interests	19,393	22,757	182,953
Shareholders' equity (Notes 2-c, 2-n, 5, 8 and 17):			
Common stock, authorized, 1,900,000,000 shares; issued, 550,664,416 shares in both 2004 and 2003	110,120	110,120	1,038,868
Capital surplus	147,757	147,755	1,393,934
Retained earnings	313,215	289,840	2,954,858
Land revaluation difference	(86,200)	(60,409)	(813,207)
Net unrealized gain on available-for-sale securities	12,958	777	122,245
Foreign currency translation adjustments	(917)	(881)	(8,651)
Treasury stock — at cost, 4,238,236 shares in 2004 and 3,848,065 shares in 2003	(3,883)	(3,518)	(36,632)
Total shareholders' equity	493,050	483,684	4,651,415
Total	¥1,087,658	¥1,094,441	$10,260,925

Consolidated Statements of Operations

Daiwa House Industry Co., Ltd. and Subsidiaries
Years ended March 31, 2004, 2003 and 2002

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2004	2003	2002	2004
Net sales	¥1,224,648	¥1,184,544	¥1,197,925	$11,553,283
Cost of sales	963,457	936,861	945,474	9,089,217
Gross profit	261,191	247,683	252,451	2,464,066
Selling, general and administrative expenses (Note 12)	201,530	202,411	206,420	1,901,226
Operating income	59,661	45,272	46,031	562,840
Other income (expenses):				
Interest income and dividends	651	546	569	6,142
Interest expense	(423)	(723)	(1,348)	(3,991)
Write-down of marketable and investment securities	(61)	(9,773)	(16,956)	(575)
Write-down of inventories	(3,285)	(22,900)	(5,994)	(30,991)
Loss on sales and disposal of property, plant and equipment	(641)	(3,488)	(1,594)	(6,047)
Prior service benefit from changes to employees' retirement benefit plan (Note 7)		6,736	1,583	
Amortization of transitional obligation for employees' retirement benefits (Notes 2-i and 7)		(8,780)	(9,473)	
Amortization of actuarial gain (loss) for employees' retirement benefits (Note 7)	15,460	(4,925)	(3,361)	145,849
Actuarial loss on retirement benefits (Notes 2-i and 7)		(49,888)		
Actuarial loss due to a change of discount rate (Notes 2-i and 7)		(31,733)		
Extraordinary depreciation for property, plant and equipment (Note 2-f)		(75,183)		
Other — net (Note 10)	(3,465)	(318)	81	(32,689)
Other income (expenses) — net	8,236	(200,429)	(36,493)	77,698
Income (loss) before income taxes and minority interests	67,897	(155,157)	9,538	640,538
Income taxes (Note 11):				
Current	10,409	17,792	8,633	98,198
Deferred	19,199	(81,370)	(4,913)	181,123
Total	29,608	(63,578)	3,720	279,321
Minority interests in net (income) loss of subsidiaries	(1,032)	191	(601)	(9,736)
Net income (loss)	¥ 37,257	¥ (91,388)	¥ 5,217	$ 351,481

	Yen			U.S. dollars
Per share of common stock (Note 2-o):				
Basic net income (loss)	¥ 68.16	¥ (167.06)	¥ 9.55	$ 0.64
Cash dividends applicable to the year	15.00	10.00	10.00	0.14

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Daiwa House Industry Co., Ltd. and Subsidiaries
Years ended March 31, 2004, 2003 and 2002

	Thousands	Millions of yen						
	Issued number of shares of common stock	Common stock	Capital surplus	Retained earnings	Land revaluation difference	Net unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
Balance, April 1, 2001	523,893	¥108,781	¥122,041	¥387,594			¥(927)	¥(3,622)
Issuance for merger with Daiwa Danchi Co., Ltd. (Note 16)	26,771	1,339	25,714					
Retained earnings of Daiwa Danchi Co., Ltd. at April 1, 2001				3,663				
Net income				5,217				
Cash dividends, ¥17.0 per share				(8,829)				
Bonuses to directors and corporate auditors				(54)				
Land revaluation difference					¥(59,910)			
Net increase in unrealized gain on available-for-sale securities (Note 2-c)						¥ 1,358		
Foreign currency translation adjustments (Note 2-n)							118	
Net increase in treasury stock								(45)
Balance, March 31, 2002	550,664	110,120	147,755	387,591	(59,910)	1,358	(809)	(3,667)
Net loss				(91,388)				
Cash dividends, ¥10.0 per share				(5,461)				
Bonuses to directors and corporate auditors				(19)				
Effect of change in statutory tax rate and other					(1,382)			
Transfer due to sales of land				(883)	883			
Net decrease in unrealized gain on available-for-sale securities (Note 2-c)						(581)		
Foreign currency translation adjustments (Note 2-n)							(72)	
Net decrease in treasury stock								149
Balance, March 31, 2003	550,664	110,120	147,755	289,840	(60,409)	777	(881)	(3,518)
Net income				37,257				
Cash dividends, ¥10.0 per share				(5,457)				
Transfer due to sales of land				(8,425)	8,425			
Devaluation of deferred tax assets on land revaluation and other					(34,216)			
Net increase in unrealized gain on available-for-sale securities (Note 2-c)						12,181		
Foreign currency translation adjustments (Note 2-n)							(36)	
Net increase in treasury stock			2					(365)
Balance, March 31, 2004	550,664	¥110,120	¥147,757	¥313,215	¥(86,200)	¥12,958	¥(917)	¥(3,883)

	Thousands of U.S. dollars (Note 1)						
	Common stock	Capital surplus	Retained earnings	Land revaluation difference	Net unrealized gain on available-for-sale securities	Foreign currency translation adjustments	Treasury stock
Balance, March 31, 2003	$1,038,868	$1,393,915	$2,734,340	$(569,896)	$ 7,330	$(8,311)	$(33,189)
Net income			351,481				
Cash dividends, $0.09 per share			(51,481)				
Transfer due to sales of land			(79,482)	79,482			
Devaluation of deferred tax assets on land revaluation and other				(322,793)			
Net increase in unrealized gain on available-for-sale securities (Note 2-c)					114,915		
Foreign currency translation adjustments (Note 2-n)						(340)	
Net increase in treasury stock		19					(3,443)
Balance, March 31, 2004	$1,038,868	$1,393,934	$2,954,858	$(813,207)	$122,245	$(8,651)	$(36,632)

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Daiwa House Industry Co., Ltd. and Subsidiaries
Years ended March 31, 2004, 2003 and 2002

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2004	2003	2002	2004
Operating activities:				
Income (loss) before income taxes and minority interests	¥ 67,897	¥(155,157)	¥ 9,538	$ 640,538
Adjustments to reconcile income (loss) before income taxes and minority interests to net cash provided by operating activities:				
Income taxes — paid	(4,671)	(6,230)	(24,236)	(44,066)
Depreciation	15,165	21,386	20,883	143,066
Write-down of golf club membership	62	147	411	585
Write-down of marketable and investment securities	61	9,773	16,956	575
Loss on sales and disposal of property, plant and equipment	641	3,488	1,594	6,047
Extraordinary depreciation for property, plant and equipment		75,183		
Impairment loss on property, plant and equipment	370			3,491
Equity in earnings of associated companies	(2,384)	(278)	(1,052)	(22,491)
Provision for (reversal of) employees' retirement benefits, net of payments	(30,067)	85,002	17,053	(283,651)
Changes in certain assets and liabilities, net of consolidation:				
Decrease in receivables	9,568	3,571	3,942	90,264
Decrease (increase) in inventories	(13,447)	32,872	48,909	(126,858)
Increase (decrease) in payables — trade	9,618	(31,453)	(3,797)	90,736
Increase (decrease) in deposits received from customers	3,639	4,260	(508)	34,330
Other — net	13,207	(2,105)	(2,672)	124,595
Total adjustments	1,762	195,616	77,483	16,623
Net cash provided by operating activities	69,659	40,459	87,021	657,161
Investing activities:				
Purchases of property, plant and equipment	(21,647)	(26,464)	(30,405)	(204,217)
Purchases of marketable and investment securities	(514)	(4,269)	(3,873)	(4,849)
Increase in investments in and advances to associated companies	(2,549)	(1,275)	(1,881)	(24,047)
Proceeds from sales of marketable and investment securities	220	2,814	422	2,075
Proceeds from sales of property, plant and equipment	2,207	1,244	379	20,821
Purchase of investments in subsidiaries	(559)			(5,274)
Net decrease from sales of shares of the former consolidated subsidiaries	(640)			(6,038)
Net proceeds from purchases of shares of the newly consolidated subsidiary		1,489		
Increase in lease deposits	(4,028)	(5,415)	(2,768)	(38,000)
Net decrease in other assets	1,573	4,560	1,897	14,840
Net cash used in investing activities	(25,937)	(27,316)	(36,229)	(244,689)
Financing activities:				
Net decrease in short-term bank loans	(250)	(52,005)	(80,060)	(2,359)
Proceeds from long-term debt		1,237		
Repayments of long-term debt	(38)	(1,000)	(58)	(358)
Proceeds from issuance of bonds			2,000	
Repayments of convertible bonds			(2,005)	
Net of purchases and proceeds from sales of treasury stock	(109)	(200)	(43)	(1,028)
Dividends paid	(5,729)	(5,745)	(9,101)	(54,047)
Cash paid related to merger with Daiwa Danchi Co., Ltd.			(268)	
Net cash used in financing activities	(6,126)	(57,713)	(89,535)	(57,792)
Cash and cash equivalents increased by merger			14,062	
Net increase (decrease) in cash and cash equivalents	37,596	(44,570)	(24,681)	354,680
Cash and cash equivalents, beginning of year	103,950	148,520	173,201	980,660
Cash and cash equivalents, end of year	¥141,546	¥ 103,950	¥148,520	$1,335,340

See notes to consolidated financial statements.

Non-cash investing and financing activities:	Millions of yen 2004	Thousands of U.S. dollars 2004
Assets and liabilities decreased by sales of shares of the former consolidated subsidiaries and associated proceeds and gain:		
Current assets	¥19,139	$180,557
Long-term assets	6,598	62,245
Current liabilities	(13,000)	(122,642)
Long-term liabilities	(6,851)	(64,632)
Minority interests	(3,337)	(31,481)
Company's interest prior to acquisition	(1,252)	(11,811)
Gain on sales of securities	77	726
Proceeds from sales of securities	1,374	12,962
Cash and cash equivalents of the subsidiaries	(2,014)	(19,000)
Net decrease in cash from sales of shares of the former consolidated subsidiaries	¥ (640)	$ (6,038)

	Millions of yen 2003
Assets and liabilities increased by purchases of shares of the associated company and associated proceeds:	
Current assets	¥3,621
Long-term assets	5,642
Consolidation difference	98
Current liabilities	(2,418)
Long-term liabilities	(4,844)
Minority interests	(973)
Company's interest prior to acquisition	(1,094)
Acquisition cost	32
Cash and cash equivalents of the consolidated subsidiary	(1,521)
Net proceeds from purchases of shares of the newly consolidated subsidiary	¥1,489

	Millions of yen 2002
Assets acquired and liabilities assumed in merger (Note 16):	
Current assets	¥143,756
Long-term assets	132,201
Total	¥275,957
Current liabilities	¥176,694
Long-term liabilities	54,595
Total	¥231,289

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Daiwa House Industry Co., Ltd. and Subsidiaries

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 accordance with the provisions set forth in the Japanese Securities and Exchange Law. Daiwa House Industry Co., Ltd. (the "Company") and its domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code (the "Code") and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards, and its foreign subsidiaries in conformity with those of their countries of domicile.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Company is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥106 to $1, the approximate rate of exchange at March 31, 2004. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. Summary of significant accounting policies

a. Consolidation

The consolidated financial statements include the accounts of the Company and all subsidiaries (together the "Group") based on the control or influence concept. Under the control or influence concept, those companies over whose operations the Parent, 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 differences between the cost and underlying net equity of investments in subsidiaries and associated companies at acquisition, are amortized over five 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.

During the year ended March 31, 2003 Nihon Jyutaku Ryutu Co., Ltd., formerly an associated company, has been included in consolidation as a result of the additional acquisition of its shares.

During year ended March 31, 2004 Daiwa System Co., Ltd. and three subsidiaries, have been excluded from consolidation as a result of sales of its shares.

b. Cash and cash equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value. Cash equivalents include time deposits and certificate of deposits, all of which mature or become due within three months of the date of acquisition.

c. Marketable and investment securities

Marketable and investment securities are classified and accounted for, depending on management's intent, as follows: i) held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity are reported at amortized cost and ii) available-for-sale securities, which are not classified as held-to-maturity. Effective April 1, 2001, in accordance with the new accounting standard for financial instruments, available-for-sale securities were reported at fair value, with unrealized gains and losses, net of applicable taxes, reported as a separate component of shareholders' equity, which were reported at cost, prior to April 1, 2001.

Non-marketable available-for-sale securities are stated at cost, determined by the moving-average method. For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

d. Short-term investments

Short-term investments are time deposits and certificates of deposit, all of which mature or become due later than three months after the date of acquisition. Time deposits pledged as collateral as substitutes of deposits for certain construction and advertisement contracts were both ¥29 million ($274 thousand) as of March 31, 2004 and 2003.

e. Inventories

Inventories are stated at cost. Inventories of land, residential homes and condominiums, and construction projects in progress include all costs of land, land development and construction. The cost of construction materials and supplies is determined by the average method. However, appropriate write-downs are recorded for inventories with values considered to have been permanently or substantially impaired.

f. Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation is computed substantially by the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998. The range of useful lives is principally from 15 to 39 years for buildings and structures, from 10 to 13 years for machinery and equipment and from 5 to 15 years for furniture and fixtures.

Extraordinary depreciation for property, plant and equipment is charged to income for the year ended March 31, 2003, for depreciable assets in which utilization declined significantly, these assets consist of resort hotels, club-houses on golf courses and commercial buildings for rent. The extraordinary depreciation recorded was ¥73,369 million, ¥856 million, and ¥958 million, for buildings and structures, machinery and equipment, and furniture and fixtures, respectively.

g. Long-lived assets

In August 2002, the Business Accounting Council issued a Statement of Opinion, *Accounting for Impairment of Fixed Assets,* and in October 2003 the Accounting Standards Board of Japan (ASB) issued ASB Guidance No. 6, *Guidance for Accounting Standard for Impairment of Fixed Assets.* These new pronouncements are 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 from the year ended March 31, 2004. 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, 2004 by ¥370 million ($3,491 thousand).

h. Leases

All leases are accounted for as operating leases. Under Japanese accounting standard 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 lessee's financial statements.

i. Retirement and pension plans

The Company and its domestic subsidiaries have unfunded retirement benefit plans and a contributory funded pension plan.

Effective April 1, 2000, the Company and its domestic consolidated subsidiaries adopted a new accounting standard for employees' retirement benefits and account for the liability for retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date.

The transitional obligation of ¥43,221 million, determined as of April 1, 2000, was reduced by an immediate charge to income in the amount of the fair value of the contribution of available-for-sale securities in August 2000. The remaining transitional obligation of ¥28,489 million (including ¥896 million assumed in a merger with Daiwa Danchi Co., Ltd.) is principally being amortized over three years.

Due to the deterioration of the stock market and the revision of the discount rate from 3.5% to 2.5%, the amount of unrecognized actuarial losses accumulated to 40% of the projected benefit obligation during 2003. With the government's approval of the Group's application for the exemption from future obligations related to the substitutional portion of the pension program (Note 7), the revision of the retirement benefit plans, and the reexamination of investment policy, the actuarial loss, which was amortized evenly over principally 10 years under the Group's previous method, was changed to be recognized when incurred in order to disclose information about retirement and pension plans more timely. As a result, the loss before income taxes and minority interests for the year ended March 31, 2003 increased by ¥81,621 million, compared with what would have been recorded under the previous method.

j. Revenue and profit recognition

Sales and related profits are generally recorded when sales contracts are completed and customers have satisfied the down payment and other requirements stipulated by the contracts. Land and land development costs are allocated to units sold based upon relative area.

k. Income taxes

The provision for income taxes is computed based on the pretax income included in the consolidated statements of operations. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

l. Appropriations of retained earnings

Appropriations of retained earnings at each year end are reflected in the financial statements of the following year after shareholders' approval has been obtained.

m. Foreign currency transactions

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the current exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the statements of operations.

n. Foreign currency financial statements

The balance sheet accounts of the consolidated foreign subsidiary and associated companies are translated into Japanese yen at the current exchange rate as of the balance sheet date except for shareholders' equity, which is translated at historical exchange rates. Revenue and expense accounts of the consolidated foreign subsidiaries and associated companies are translated into yen at the current exchange rate.

Differences arising from such translation are shown as "Foreign currency translation adjustments" as a separate component of shareholders' equity.

o. Per share information

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 year.
The weighted-average number of common shares outstanding for the years ended March 31, 2004, 2003 and 2002 were 546,625 thousand, 547,045 thousand and 546,079 thousand, respectively.

Diluted net income per share of common stock for the years ended March 31, 2004 and 2002 are not disclosed because it is anti-dilutive. Diluted net income per share of common stock for the year ended March 31, 2003 is not disclosed because the Company incurred a net loss.

Cash dividends per share presented in the accompanying consolidated statements of operations are dividends applicable to the respective years including dividends to be paid after the end of the year.

p. Treasury stock

Effective April 1, 2002, the Company adopted a new accounting standard for treasury stock issued by the Accounting Standards Board of Japan. Under the new standard, the stock of the Company, which is held by its subsidiaries and associated companies, is stated as treasury stock according to the percentage of ownership.

3. Marketable and investment securities

Marketable and investment securities as of March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Current:			
Government and corporate bonds	¥ 65	¥ 202	$ 613
Non-current:			
Marketable equity securities	45,767	25,926	431,764
Government and corporate bonds	34	62	321
Total	¥45,801	¥25,988	$432,085

The carrying amounts and aggregate fair values of marketable and investment securities at March 31, 2004 and 2003 were as follows:

	Millions of yen			
	2004			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥18,523	¥21,610	¥100	¥40,033
Held-to-maturity	99			99

	Millions of yen			
	2003			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	¥18,096	¥2,895	¥1,119	¥19,872
Held-to-maturity	264	1		265

	Thousands of U.S. dollars			
	2004			
	Cost	Unrealized gains	Unrealized losses	Fair value
Securities classified as:				
Available-for-sale:				
Equity securities	$174,745	$203,868	$943	$377,670
Held-to-maturity	934			934

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2004 and 2003 were as follows:

	Carrying amount		
	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Available-for-sale:			
Equity securities	¥5,734	¥5,854	$54,094
Debt securities		200	
Total	¥5,734	¥6,054	$54,094

The carrying values of debt securities by contractual maturities for securities classified as held-to-maturity at March 31, 2004 are as follows:

	Held to maturity	
	Millions of yen	Thousands of U.S. dollars
Due in one year or less	¥65	$613
Due in one to five years	25	236
Due in five to ten years	9	85
Total	¥99	$934

4. Inventories

Inventories at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Finished residential homes and condominiums	¥ 29,378	¥ 27,771	$ 277,151
Construction projects in progress	31,593	28,745	298,047
Residential homes and condominiums in process	26,496	20,383	249,962
Land held:			
For resale	123,863	134,130	1,168,519
Under development	34,291	33,110	323,500
Undeveloped	11,687	11,687	110,255
Construction materials and supplies	10,612	11,373	100,113
Total	¥267,920	¥267,199	$2,527,547

The Group engages in two principal business activities. They manufacture and construct prefabricated houses and structures and also engage in various contracted construction projects, primarily for the construction of large-scale commercial and residential buildings. To further such business, the Group purchases land for development and resale.

5. Land revaluation

Under the "Law of Land Revaluation," the Company and certain subsidiaries elected a one-time revaluation of their own-use land to a value based on real estate appraisal information as of March 31, 2002.

The resulting land revaluation difference represents unrealized depreciation of land and is stated, net of income taxes, as a component of shareholders' equity. There was no effect on the statement of operations. Continuous readjustment is not permitted unless the land value subsequently declines significantly such that the amount of the decline in value should be removed from the land revaluation difference account and related deferred tax liabilities. The details of the one-time revaluation as of March 31, 2002 were as follows:

	Millions of yen
Land before revaluation	¥311,703
Land after revaluation	208,811
Land revaluation difference	102,892
Deferred tax assets on land revaluation	43,135
Minority interests, net	(153)
Net land revaluation difference	¥ 59,910

As to significant change in the land revaluation difference see the consolidated statements of shareholders' equity.

6. Short-term bank loans and long-term debt

Short-term bank loans at March 31, 2004 and 2003 consisted of bank loans. The annual interest rates for the short-term bank loans were 1.4% and ranged from 0.6% to 1.4% at March 31, 2004 and 2003, respectively.

Long-term debt at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Unsecured bank loans, 1.50%, due serially to July 2005		¥ 237	
Unsecured 0.5% bonds due December 2004		2,000	
Collateralized loans from bank, 1.26%, due serially to March 2007	¥962	1,000	$9,075
Total	962	3,237	9,075
Less current portion	51		481
Long-term debt, net of current portion	¥911	¥3,237	$8,594

Annual maturities of long-term debt at March 31, 2004, were as follows:

Year ending March 31:	Millions of yen	Thousands of U.S. dollars
2005	¥ 51	$ 481
2006	52	490
2007	859	8,104
Total	¥962	$9,075

At March 31, 2004, assets pledged as collateral for secured long-term debt were as follows:

	Millions of yen	Thousands of U.S. dollars
Land	¥ 502	$ 4,736
Buildings and structures	1,379	13,009
Total	¥1,881	$17,745

As is customary in Japan, the Company maintains deposit balances with banks with which it has bank loans. Such deposit balances are not legally or contractually restricted as to withdrawal. In addition, collateral must be provided if requested by the lending banks and certain banks have the right to offset cash deposited with them against any bank loan or obligation that becomes due and, in case of default and certain other specified events, against all other debt payable to the bank concerned. The Company has never received any such request.

7. Retirement and pension plans

Under the unfunded employees' retirement benefit plan, employees of the Company and certain subsidiaries terminating their employment are entitled, in most circumstances, to lump-sum severance payments determined by reference to wage rates at the time of termination and years of service. In addition, the Company, together with certain subsidiaries and associated companies, has adopted a contributory funded defined benefit pension plan covering most of their employees.

The liability for employees' retirement benefits at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Projected benefit obligation	¥207,238	¥199,597	$1,955,076
Fair value of plan assets	(104,078)	(63,185)	(981,868)
Net liability	103,160	136,412	973,208
Prepaid benefit costs	77	68	726
Liability for employees' retirement benefits	¥103,237	¥136,480	$ 973,934

The components of net periodic benefit costs are as follows:

	Millions of yen			Thousands of U.S. dollars
	2004	2003	2002	2004
Service cost	¥11,647	¥ 10,845	¥11,967	$109,877
Interest cost	4,856	7,182	7,535	45,811
Expected return on plan assets	(4)	(3,181)	(4,219)	(37)
Prior service benefit		(6,736)	(1,583)	
Recognized actuarial loss (gain)	(15,460)	86,546	3,361	(145,849)
Amortization of transitional obligation		8,780	9,473	
Net periodic benefit costs	¥ 1,039	¥103,436	¥26,534	$ (9,802)

Prior service benefit for the year ended March 31, 2002 represents the net effect of (1) a decrease in the benefit obligation of ¥5,964 million from raising the eligibility age for payments regarding the basic part of the welfare pension plan for employees of the Company and certain subsidiaries, which is similar to the national pension plan, in accordance with a revision in the Welfare Pension Insurance Law in March, 2000 and (2) an increase in the benefit obligation of ¥4,381 million from changing the Daiwa Danchi pension plan from a qualified pension plan to a welfare pension plan and unfunded retirement benefit plan. These changes were effective March 2002 and November 2001, respectively, and the full effect on the benefit obligation as of those dates was charged to income in the year ended March 31, 2002.

Prior service benefit for the year ended March 31, 2003 represents the effect of a decrease in the benefit obligation from the adoption of the revised retirement benefit plan concerning the lump-sum severance payments.

Assumptions used for the years ended March 31, 2004 and 2003 are set forth as follows:

	2004	2003
Discount rate	2.5%	2.5%
Expected rate of return on plan assets	Principally 0%	3.5%
Recognition period of actuarial gain / loss	1 year	1 year
Amortization period of transitional obligation		Principally 3 years (completed)

The contributory funded defined benefit pension plan, which is established under the Japanese Welfare Pension Insurance Law, covers a substitutional portion of the governmental pension program managed by the Company on behalf of the government and a corporate portion established at the discretion of the company. According to the enactment of the Defined Benefit Pension Plan Law in April 2002, the Company applied for an exemption from obligation to pay benefits for future employee services related to the substitutional portion which would result in the transfer of the pension obligations and related assets to the government by another subsequent application. The Company obtained an approval of exemption from future obligation by the Ministry of Health, Labor and Welfare on October 28, 2002. As a result of this exemption, the Company and certain subsidiaries recognized a gain on exemption from future pension obligation of the governmental program in the amount of ¥8,575 million in accordance with a transitional measurement of the accounting standard for employees' retirement benefits for the year ended March 31, 2003.

The substitutional portion of the plan assets which will be transferred to the government in the subsequent year is measured to be approximately ¥38,040 million as of March 31, 2003.

8. Shareholders' equity

Japanese companies are subject to the Japanese Commercial Code (the "Code") to which various amendments have became effective since October 1, 2001.

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

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

The revised Code eliminated restrictions on the repurchase and use of treasury stock allowing Japanese companies to repurchase treasury stock by a resolution of the shareholders at the general shareholders meeting and dispose of such treasury stock by resolution of the Board of Directors beginning April 1, 2002. The repurchased amount of treasury stock cannot exceed the amount available for future dividend plus amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general shareholders meeting.

The amount of retained earnings available for dividends under the Code was ¥177,359 million ($1,693,196 thousand) as of March 31, 2004, based on the amount recorded in the parent company's general books of account. In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends.

Dividends are approved by the shareholders at a meeting held subsequent to the fiscal year in 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.

9. Segment information

Information about operations in different industry segments of the Group for the years ended March 31, 2004, 2003 and 2002 is as follows:

Sales and operating income (loss)

	Millions of yen						
	2004						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Sales to customers	¥797,627	¥270,002	¥53,612	¥56,069	¥47,338		¥1,224,648
Intersegment sales	3,004	6,986		1,158	50,428	¥(61,576)	
Total sales	800,631	276,988	53,612	57,227	97,766	(61,576)	1,224,648
Operating expenses	752,365	256,319	53,531	57,088	94,943	(49,259)	1,164,987
Operating income	¥ 48,266	¥ 20,669	¥ 81	¥ 139	¥ 2,823	¥(12,317)	¥ 59,661

	Thousands of U.S. dollars						
	2004						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Sales to customers	$7,524,783	$2,547,188	$505,774	$528,953	$446,585		$11,553,283
Intersegment sales	28,340	65,906		10,924	475,736	$(580,906)	
Total sales	7,553,123	2,613,094	505,774	539,877	922,321	(580,906)	11,553,283
Operating expenses	7,097,783	2,418,103	505,010	538,566	895,689	(464,708)	10,990,443
Operating income	$ 455,340	$ 194,991	$ 764	$ 1,311	$ 26,632	$(116,198)	$ 562,840

	Millions of yen						
	2003						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Sales to customers	¥789,325	¥245,999	¥51,903	¥51,219	¥46,098		¥1,184,544
Intersegment sales	2,656	2,015		940	51,019	¥(56,630)	
Total sales	791,981	248,014	51,903	52,159	97,117	(56,630)	1,184,544
Operating expenses	752,846	230,383	55,872	51,854	94,544	(46,227)	1,139,272
Operating income (loss)	¥ 39,135	¥ 17,631	¥ (3,969)	¥ 305	¥ 2,573	¥(10,403)	¥ 45,272

	Millions of yen						
	2002						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Sales to customers	¥805,022	¥257,733	¥48,499	¥44,349	¥42,322		¥1,197,925
Intersegment sales	981	3,052		1,114	46,906	¥(52,053)	
Total sales	806,003	260,785	48,499	45,463	89,228	(52,053)	1,197,925
Operating expenses	763,070	242,434	52,854	45,162	86,708	(38,334)	1,151,894
Operating income (loss)	¥ 42,933	¥ 18,351	¥ (4,355)	¥ 301	¥ 2,520	¥(13,719)	¥ 46,031

Total assets, depreciation and capital investments

	Millions of yen						
	2004						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Total assets	¥396,552	¥212,235	¥102,740	¥36,779	¥72,961	¥266,391	¥1,087,658
Depreciation	4,822	2,771	1,530	647	3,628	1,767	15,165
Capital investments	6,688	4,465	2,272	2,098	4,916	(331)	20,108

	Thousands of U.S. dollars						
	2004						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Total assets	$3,741,057	$2,002,217	$969,245	$346,972	$688,311	$2,513,123	$10,260,925
Depreciation	45,491	26,141	14,434	6,104	34,226	16,670	143,066
Capital investments	63,094	42,123	21,434	19,793	46,377	(3,123)	189,698

	Millions of yen						
	2003						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Total assets	¥394,119	¥211,168	¥98,803	¥35,196	¥78,976	¥276,179	¥1,094,441
Depreciation	5,288	2,604	6,334	592	4,774	1,794	21,386
Capital investments	6,984	8,114	2,164	2,317	3,778	1,354	24,711

	Millions of yen						
	2002						
	Residential	Commercial	Resort	Distribution "Home Center"	Other	Eliminations/ Corporate	Consolidated
Total assets	¥436,521	¥192,101	¥152,280	¥30,728	¥85,251	¥290,246	¥1,187,127
Depreciation	5,378	2,122	6,610	538	4,444	1,791	20,883
Capital investments	20,753	11,935	2,514	1,841	3,996	23,393	64,432

The effect of adoption of the new accounting standard for impairment of fixed assets described in Note 2-g was to decrease total assets of the Commercial segment as of March 31, 2004, by ¥181 million ($1,708 thousand), compared with the prior year.

The industry segments consisted of the following:

	Industry segment				
Components of net sales in the consolidated statements of operations	Residential	Commercial	Resort	Distribution "Home Center"	Other
Construction	Construction of single/ multi-family houses and condominiums	Construction of commercial buildings			
Real estate	Sales of real estate for residential use	Sales and rental of real estate for commercial use			
	Real estate commissions				
	Rental of residential complexes				
Other	Care of condominiums	Care of commercial buildings	Operation of resort type hotels and golf courses	Operation of "do-it-yourself" hardware centers	Manufacture and sales of building materials Physical distribution Operation of city type hotels

Eliminations/Corporate include unallocated operating expenses, principally consisting of general corporate expenses incurred by the administration headquarters of the Company.

Corporate assets are principally cash and cash equivalents, marketable securities and investment securities.

10. Other income (expenses): Other — net

"Other income (expenses): Other — net" for the years ended March 31, 2004, 2003 and 2002 consisted of the following:

	Millions of yen			Thousands of U.S. dollars
	2004	2003	2002	2004
Exchange loss	¥ (2)	¥ (7)	¥ (2)	$ (19)
Real estate acquisition tax and other taxes	(369)	(277)	(257)	(3,481)
Retirement benefits for directors	(214)	(120)	(643)	(2,019)
Gain (loss) on sales of marketable and investment securities	99	123	(544)	934
Impairment loss on property, plant and equipment	370			3,491
Allowance for doubtful accounts	(386)	(4,157)	(873)	(3,642)
Gain on exemption from future pension obligation		8,575		
Equity in earnings of associated companies	2,384	278	1,052	22,491
Write-down of golf club membership	(62)	(147)	(411)	(585)
Loss on sales of membership	3	(79)	(170)	28
Gain (loss) on liquidation of associated company		(2,145)		
Bad debt expenses for long-term loans		(4,082)		
Loss on closure of "do-it-yourself" hardware centers	(2,637)			(24,877)
Loss on sublease agreements	(3,503)			(33,047)
Other — net	852	1,720	1,929	8,037
Total	¥ (3,465)	¥ (318)	¥ 81	$ (32,689)

11. Income taxes

The Company and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 42.0% for the years ended March 31, 2004, 2003 and 2002.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2004 and 2003 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Current:			
Deferred tax assets:			
Write-down of land held for resale	¥ 12,162	¥ 15,257	$114,736
Accrued bonuses	5,669	3,404	53,481
Accrued enterprise tax	1,328	769	12,528
Other	3,393	2,676	32,010
Deferred tax assets	¥ 22,552	¥ 22,106	$ 212,755
Non-current:			
Deferred tax assets:			
Employees' retirement benefits	¥ 41,316	¥ 55,498	$ 389,774
Unrealized gains on sales of property, plant and equipment	6,781	7,503	63,972
Extraordinary depreciation for property, plant and equipment	28,808	30,299	271,773
Other	11,239	9,703	106,028
Less valuation allowance	(763)		(7,198)
Deferred tax assets	¥ 87,381	¥103,003	$ 824,349
Deferred tax liabilities:			
Retained earnings appropriated for tax allowable reserves	¥ (2,004)	¥ (2,038)	$ (18,906)
Net unrealized gain on available-for-sale securities	(8,730)	(723)	(82,358)
Other	(70)	(119)	(660)
Deferred tax liabilities	¥(10,804)	¥ (2,880)	$(101,924)
Net deferred tax assets	¥ 76,577	¥100,123	$ 722,425

A reconciliation between the normal effective statutory tax rate and the actual effective tax rates reflected in the accompanying consolidated statements of operations for the years ended March 31, 2004, 2003 and 2002 is as follows:

	2004	2003	2002
Normal effective statutory tax rate	42.0%	42.0%	42.0%
Increase (decrease) in tax rates due to:			
Permanently non-deductible expenses	1.3	(0.6)	9.2
Non-taxable dividend income	(0.0)	0.0	(0.2)
Equity in earnings of associated companies	(0.9)	0.1	(4.6)
Write-down of investments in and advances to associated companies	(0.1)	0.4	(0.7)
Per capita levy	0.8	(0.3)	5.4
Increase (decrease) in valuation allowance for deferred tax assets	0.1	1.2	(11.8)
Decrease in deferred tax assets by change of tax rate		(2.0)	
Other — net	0.4	0.2	(0.3)
Actual effective tax rates	43.6%	41.0%	39.0%

On March 31, 2003, Cabinet Order No. 9 entitled "Reform of a Portion of Local Tax Law" was issued and this reform will apply to fiscal years beginning after April 1, 2004. As a result of this reform, the statutory income tax rate to be used for the calculation of deferred income taxes concerning temporary differences which are expected to be realized or settled after April 1, 2004 will be changed from 42.0% to 40.6%.

The effect of this change was to decrease deferred tax assets and deferred tax assets on land revaluation by ¥3,145 million and ¥1,417 million, respectively, and to increase income taxes — deferred, net unrealized gain on available-for-sale securities and land revaluation difference by ¥3,170 million, ¥18 million and ¥1,417 million, respectively, as of March 31, 2003 and for the year ended March 31, 2003.

12. Research and development costs

Research and development costs charged to income were ¥5,667 million ($53,462 thousand), ¥5,609 million and ¥5,474 million for the years ended March 31, 2004, 2003 and 2002, respectively.

13. Leases

Total lease payments under finance leases that are not deemed to transfer ownership of the leased property to the lessee were ¥5,331 million ($50,292 thousand), ¥4,815 million, and ¥4,510 million for the years ended March 31, 2004, 2003 and 2002, respectively.

Pro forma information of leased property under finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2004 and 2003 were as follows:

(Lessee)

	Millions of yen			
	2004			
	Buildings and structures	Machinery and equipment	Furniture and fixtures	Total
Acquisition cost	¥10,055	¥1,768	¥10,289	¥22,112
Accumulated depreciation	5,647	526	5,440	11,613
Accumulated impairment loss		184		184
Net leased property	¥ 4,408	¥1,058	¥ 4,849	¥10,315

	Thousands of U.S. dollars			
	2004			
	Buildings and structures	Machinery and equipment	Furniture and fixtures	Total
Acquisition cost	$94,859	$16,679	$97,066	$208,604
Accumulated depreciation	53,274	4,962	51,321	109,557
Accumulated impairment loss		1,736		1,736
Net leased property	$41,585	$ 9,981	$45,745	$ 97,311

	Millions of yen			
	2003			
	Buildings and structures	Machinery and equipment	Furniture and fixtures	Total
Acquisition cost	¥10,006	¥1,307	¥9,311	¥20,624
Accumulated depreciation	4,193	480	4,874	9,547
Net leased property	¥ 5,813	¥ 827	¥4,437	¥11,077

Obligations under such finance leases as of March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Due within one year	¥ 4,607	¥ 4,561	$43,462
Due after one year	5,708	6,516	53,849
Total	¥10,315	¥11,077	$97,311
Impairment of leased property	¥ 184		$ 1,736

The amount of acquisition cost and obligations under finance leases includes the imputed interest expense portion.
Depreciation expenses, which are not reflected in the accompanying statements of operations, computed by the straight-line method, respectively.

Obligations and future rental income under non-cancellable operating leases as of March 31, 2004 and 2003 were as follows:

(Lessee)

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Due within one year	¥ 29,142	¥ 25,456	$ 274,924
Due after one year	355,726	313,820	3,355,906
Total	¥384,868	¥339,276	$3,630,830

(Lessor)

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Due within one year	¥ 24,009	¥ 19,290	$ 226,500
Due after one year	334,616	269,724	3,156,755
Total	¥358,625	¥289,014	$3,383,255

14. Derivatives

The Group enters into foreign exchange forward contracts and interest rate swaps to hedge foreign exchange or interest rate risks.
It is the Group's policy to use derivatives only for the purpose of reducing market risks associated with liabilities.
Derivatives are subject to market risk and credit risk. Because the counterparties to those derivatives are limited to major international financial institutions, the Company does not anticipate any losses arising from such credit risk.

The Company implemented a risk control system for derivatives primarily to control the purpose, limitation and selection of the counterparties. The system's primary function is to avoid excess risks associated with derivatives. Each derivative transaction, which is based on these internal policies, is reported to the Director of the Financing Department, and the execution and control of derivatives are managed by the Finance Section of the Company.

As of March 31, 2004 and 2003, the Group did not have any derivative contracts outstanding.

15. Contingencies

At March 31, 2004, contingent liabilities for notes endorsed with recourse and loans guaranteed in the ordinary course of business amounted to ¥1,057 million ($9,972 thousand) and ¥70,785 million ($667,783 thousand), respectively. Included in loans guaranteed were customers' housing loans from banks in the amount of ¥68,729 million ($648,387 thousand).

16. Merger with Daiwa Danchi Co., Ltd.

Effective April 1, 2001, the Company merged with Daiwa Danchi, which was an associated company. Under the terms of the merger, the Company issued 0.3 shares of its common stock for each Daiwa Danchi common share, which resulted in the issuance of 26,771,371 shares and increases in common stock of ¥1,339 million and capital surplus of ¥25,714 million.

17. Subsequent event

The following appropriations of retained earnings at March 31, 2004 were approved at the Company's shareholders' meeting held on June 29, 2004:

	Millions of yen	Thousands of U.S. dollars
Year-end cash dividends, ¥15.0 ($0.14) per share	¥8,253	$77,858

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Independent Auditors' Report

Daiwa House Industry Co., Ltd. and Subsidiaries

To the Board of Directors of
Daiwa House Industry Co., Ltd.:

We have audited the accompanying consolidated balance sheets of Daiwa House Industry Co., Ltd. and subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended March 31, 2004, all expressed in Japanese yen. 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 Daiwa House Industry Co., Ltd. and subsidiaries as of March 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2004, in conformity with accounting principles generally accepted in Japan.

As discussed in Note 2-c, effective April 1, 2001, in accordance with the new accounting standard for financial instruments, available-for-sale securities are reported at fair value. As discussed in Note 2-i, the Company and certain subsidiaries changed its method of accounting for its liability for employees' retirement benefits as of March 31, 2003, and the actuarial loss, which previously was amortized evenly over principally 10 years, was changed to be amortized when incurred.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

June 29, 2004

Member of
Deloitte Touche Tohmatsu