Kubota Corporation

Result Briefing for the FY2018 ended December 31, 2018

Q & A Session　(Tokyo, February 20, 2019)

Q. In the year ended March 31, 2014, revenue was 1.5 trillion yen and operating profit was 200.0 billion yen. And anticipated revenue for the year ending December 31, 2019 (hereinafter, this year) is close to 2.0 trillion yen. However, anticipated operating profit remains unchanged. Compared to the operating profit margin in the year ended March 31, 2014 and the target of the margin for this year announced in February 2017, profitability has declined. Please tell us what expense items were the most different from the forecast at that time.

A. We believe there are three main items. The first is the foreign exchange rate. We assume 108 yen for one U.S. dollar and 122 yen for one Euro. We believe that we would generate more profit in this year's plan if the foreign exchange rate is the same level as our assumption in February 2017. Secondly, we have made upfront investments to strengthen its R&D and sales structure. With regard to R&D expenses, as we have expanded the markets and models, and competition in each market has intensified, we would be appreciated if you understand we needed these investments to introduce superior products. On the other hand, we needed to increase expenses for improving our product support, such as recruitment activities of service personnel and education of dealers, as we have expanded our products lineup for farmers and construction machinery. Thirdly, our incentive costs have increased more than our anticipation, as price competition has intensified amid market expansion mainly in North America. Although these cost increases were anticipated, they increased more than our anticipation due in part to a rise in interest rates. In addition, it takes longer than our anticipation to earn returns in strategic markets, such as large-sized tractor market for upland farming in North America, where the market volume continued to decline and price competition has been intensified, and Indian market, where competition with rival manufacturers has been intensified. These factors also have affected our profitability.

Q. Please tell us which regions experienced the largest decline in operating profit in the prior year. In addition, please tell us which regions are expected to contribute the most to 10.0 billion yen of increase in operating profit in this year.

A. In the prior year, the largest decline in profit was in China, where sales of combine harvesters and rice transplanters fell sharply, while profit in North America increased (by location). In this year, we have expectation of strong revenue growth for North America and Thailand in the forecast for this year, and intend to increase profit in these two regions.

Q. Please explain your idea about profit margin in the future. In the presentation of basic management policy in February 2017, you mentioned you should aim to achieve operating profit margin of 14% as Global Major Brand (hereinafter, GMB). Please tell us what initiatives you will take to achieve operating profit margin of 14% in the future. In addition, please tell us what time you will aim to achieve profit margin of 14% from the current margin of 10%.

A. In the long-term plan to build GMB, we said we are aiming for an operating profit margin of 14%, which is an appropriate level for GMB, to demonstrate its market presence and compete against rival manufacturers. With respect to revenue of farm equipment and construction machinery business, we believe that we will be able to catch up revenue level of the second-largest competitor group in a year, while it depends on the assumption of foreign currency rate. In terms of profit margin, we believe that we have a comparable level to our rivals' margins, while we understand the current operating profit margin of 10.2% is at a level we must halt the deterioration. In the beginning, we thought there was no room for cost reductions in the absence of growth in revenue in order to aim for GMB, and we have generated capital resources by accelerating the development of products with high profitability (products we have competitiveness, such as small- and medium-sized farm equipment) and has made investments in the development of strategic products. However, we have struggled to improve the marginal profit ratios of these strategic products, and we feel that it will take some time to improve profitability of them. We started to introduce products at a price that is acceptable to the market and confirm the market's response to our products. However, the level of discounts has been gradually improving since last year, and we launched drastic cost reduction projects. We believe improvement of profitability in strategic products is expected in a few years through introducing minor changed models and other initiatives. I'd like to report the improvement of profitability or a plan to improve operating profit margin in February of next year. Although we cannot make any assurances as to the figures, we have not changed its target of achieving an operating profit margin of 14% in the medium term.

Q. Please tell us about the current status of Kubota Production System (KPS) initiatives.

A. Currently, we have reduced inventories at domestic and overseas plants significantly, and shortened lead times for orders. However, we haven't seen sufficient spillover effects about reduction of inventories held by our sales subsidiaries and distributors. Currently we haven't prepared the infrastructure, such as unified and integrated supply chain management (SCM) system to manage lead times and inventories. We will pursue the effects of KPS by launching ICT Headquarters from the perspective of SCM. Particularly in farm and industrial machinery division, we reduced inventories of 0.3 months from 2.7 months at the end of 2017 to 2.4 months at the end of 2018. However, we had large amount of inventories which hasn't arrived at dealers or were at sea and couldn't show sufficient result at the end of 2018 due to the negative effect of delayed production resulting from typhoon. Currently, we have launched a global supply chain management project to centralize PSI management, shorten lead time, and restock products which have been sold. We also aim to build a structure to have minimal inventories, such as demonstration machines, for domestic sales subsidiaries.

Q. Please tell us what situation your company is facing about price increase in North America compared with your major competitors.

A. Competitiveness varies by product and price increase depends on how new products are launched, but we plan to raise prices roughly by 2 to 3%. And competitors raised prices roughly at the same level as us.

Q. In your explanation, you expect demand for large-sized farm equipment would recover. However, your competitors mentioned large-sized farm equipment market will be flat as the prior year given the impact of the trade friction between the United States and China in the comments at the time of the announcement of financial results. Please tell us what you think about the current and future conditions of large- and medium-sized farm equipment.

A. Our classification of medium- and large-sized products is different from our competitors'. Our medium-sized products (40-120 horsepower) are mainly used for livestock farming, and we expect this market to recover gradually as demand bottomed out in the prior year. Our large sized products (120-160 horsepower) are used rather for dairy operation or livestock farming, and the impact of trade friction between the United States and China is not so large. I think the trade friction is likely to have diverse impact for our competitors, as large-sized farm equipment of our competitors is used for production of wheat, soy, corn, etc. I think the market, which has been stagnant for the past few years, will eventually begin to recover in a renewal cycle, so I think the difference in market views between us and our competitors is a difference in whether recovery will be delayed or not. I don't feel that the current status is so stagnant even if I hear the opinions of farmers. Looking ahead, we believe that there are many opportunities to increase market share in the future, as our market share for large-sized products is still low.

Q. Regarding the priorities of management issues and the allocation of management resources, you mentioned you plan to make a course correction about them to maximize profit. Please tell us what specific corrections will be made between last year and this year.

A. I tried to say we plan to accelerate ongoing efforts to improve profitability. For example, we began to focus on market expansion and see market responses, while the profitability of strategic businesses was extremely severe at the time of market launch. However, I have ordered improvement in profitability of each strategic product, such as cost reduction through introducing minor changed products, since last year, and we are carrying out these efforts as projects. In particular, we expect cost reductions for multi-purpose tractors in India through a drastic decision to produce locally. Including these efforts, we will put more effort into individual profitability of strategic products. With respect to KPS, we have been working on eliminating needless works and cost reduction in cooperation with suppliers since two years ago. But we started more meticulous cost reductions since the prior year.

Q. Fixed costs have been increasing for the past few years, and even in this year's plan, capital expenditures are expected to be 100.0 billion yen, which is the high level as your budget. Please tell us whether you are not putting a brake on the pace of increase in fixed costs.

A. Capital expenditure of 100.0 billion yen for this year is the maximum amount, including the acquisition of land for R&D center in Sakai City, taking into account requests from each division. We haven't changed our approach about capital investment, such as thoroughly incorporating alternative plans and cost reduction plans and examining each plan thoroughly before our implementation. We will reconsider cost down plan for each request and whether we should implement this request in this year before our implementation. In addition, we also keep an eye on the balance between capital expenditures and depreciation and amortization, and manage capital expenditures in order not to differ from the amount of depreciation and amortization. Situation of each business varies with type of business and location. The amount of capital expenditures in this year is the figure in which we included all of required expenditures after considering whether which business we should expand and what type of investment we need. However, we must reexamine each investment and make decision on them. There are concerns that R&D investments will not immediately lead to new products. However, we would like to increase profitability in the current strong product lineup and earn profit to invest in R&D with appropriate balance.

Q. Please tell us it is likely that expense in your forecasts decrease in actuality.

A. The plan was prepared by factoring in various cost increases that could be assumed at present. We intend to respond flexibly to investments throughout the year while looking at circumstances. However, we believe that our forecast include all of the negative factors that are currently anticipated.

Q. Please tell us a breakdown of 22.0 billion yen in *Others* in the analysis of changes in operating profit.

A. R&D, depreciation and amortization, and personnel expenses account for the majority of the total increase. The increase includes substantial amount of investments for improving our sales operations, such as staffing for customer support and related costs required to grow our business. There are also some small amounts of increased expenses, and total of various items amount to 22.0 billion yen.

Q. Please tell us your specific measures included in the investment for customer support and sales operations.

A. For example, in North America, the investment includes some expenses to hire personnel to provide customer support on agricultural and construction sites and increase the number of personnel to provide related training.

Cautionary Statements with Respect to Forward-Looking Statements

This document may contain forward-looking statements that are based on management's expectations, estimates, projections and assumptions as of August 8, 2018 (result briefing for the 1st half of FY2018 ending December 31, 2018). These statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Therefore, actual future results may differ materially from what is forecast in forward-looking statements due to a variety of factors.