

Kubota Corporation

Result Briefing for the FY2019 ended December 31, 2019

Q & A Session (Tokyo, February 19, 2020)

Q. What is your view on future sales growth? While the FY2020's revenue is expected to be the highest level ever, revenue growth rate of 1.6% for the FY2020 seems to be slowed compared with the recent years' growth rates. What is the meaning of the FY2020's revenue in relation to plans for the next year and beyond, and what are drivers for the future growth?

A. Looking at the global market, demand for farm equipment and construction machinery is expected to increase further especially in North America and ASEAN in the future. India is also a large potential market. Furthermore, we have traditionally had competitiveness in the compact and medium-sized tractors, but we have started penetrating into the large-sized tractor market. So, growth can be expected through the development of new markets. Although sales growth rate in the FY2020 is low due to the assumption of exchange rates and the sluggish Chinese market, we are planning to set targets for the next 3 to 5 years as our mid-term plan. In my (the President's) opinion, there is room for growth of about 3~5% per year in the future, but we would like to create specific figures in the mid-term plan.

Q. Compared with the target for the FY2019 announced in February 2017, revenue for the FY2019 was close to the target of 2 trillion yen. However, operating profit margin of 10.5% in the FY2019 was quite different from the target of 14%, and operating profit margin for the FY2020 is expected to be at the same level as the FY2019. I would like to ask you to review the profitability up to the FY2019 and explain your thoughts on maximizing profit and improving profitability in the future.

A. We have grown our profit by expanding our businesses in highly profitable markets such as North America, Japan and Thailand. On the other hand, it has taken some time to improve profitability in ASEAN countries other than Thailand, India, and large-sized farm equipment businesses. In the large-sized farm equipment business, we aim to increase profitability not only by selling products but also by improving after-sales services and setting up dealers precisely. We have made profit by selling products traditionally, but we established the Customer Solutions Division this year. This is because we believe that we can increase profitability by developing businesses that contribute to customers for a long time while using our products.

We understand that operating profit margin has been declining and recognize our efforts to raise margin as important challenge. Currently, in order to compete in markets around the world, we are working on going through the cycle of strengthening our global R&D structure, developing good products that meet local needs, and winning the competition. However, there is a time lag between the up-front investment to improve our structure and realization of return on investment. We consider it is important to shorten the time lag between investment and return, and we try to increase the operating profit margin from the current level as the lowest.

Q. I would like to know what kind of changes you would like to make compared to a former president, Mr. Kimata.

A. Over the past 5 years, I have managed the company with the former president under a system of joint governance, and there have been no major changes in the system. The long-term goal to be achieved is maintained to be Global Major Brand. In addition, we have adopted the slogan "One Kubota" to eliminate barriers between divisions. We also place importance on developing, producing, selling, and servicing products from the customer's perspective in the spirit of "On Your Side". Basically, I would like to follow the spirit of the founder and the basic idea of the former president. On the other hand, since I have a background in technology, I would like to focus on creating new technologies within the company and connecting them to new businesses with considering outsourcing.

Q. There was an explanation about “From hardware to solutions” in the presentation of management policy. What is the background behind the explanation and how do you plan to work on it? Looking at other companies, I feel that there are many cases where a topic about the software side comes out when the hardware side of the business is stagnant. However, Kubota’s business is also profitable on the hardware side. Why does the topic about solution side come up at this time?

A. Kubota is a machinery manufacturer, and our products are the core of our business. However, I believe that selling products alone can meet only a part of a customer’s needs from my past experience. So, I would like to go even further to the point where customers are having trouble in their daily work and think about what we can provide from now on. Our business is based on products, while we also think more deeply about solutions and how we should change and evolve our business to solve customer’s problems. I consider IT and the Internet of Things (IoT) are the weapons for providing solutions. As we continue to supply products in the areas of food, water, and environment, we would like to discover various issues and propose solutions for them.

Q. Will M&A become a means of achieving further growth by accelerating the overseas expansion of businesses and providing solutions in Water & Environment business?

A. In Water & Environment business, some works will move from the public to private sector and our business field is expected to include DBO, O&M, etc. due to the shortage of personnel in local governments in Japan. As for M&A, there may not be many opportunities because we do business with the government in Japan. On the other hand, there will be a variety of business opportunities overseas, particularly in the ASEAN market, in the areas of water pipes, water supply, sewerage, and the environment. So, we consider there are opportunities to cooperate with local companies when we develop new technologies. Considering the future growth of the business including Farm & Industrial Machinery business, it is difficult to work on many tasks only with in-house resources, so alliances with other companies and M&A can be an option. However, since M&A is not the only option, we need to consider which option we should take to achieve our growth strategy. In the case of Water & Environment business in Japan, existing social infrastructures developed in the past is aging, and the challenge is how to renew and maintain them. The government used to do everything from creating specifications to placing orders, but the private sector will have to do them from now on, because the budget and personnel resources of the government are limited. Under these circumstances, we believe there will be more opportunities to develop business by changing our traditional scope, and they will lead to solution businesses in Water & Environment.

Including Farm & Machinery business, while the value which we can deliver to customers after sales was limited in the past, it has become possible to provide different value than in the past by the development of digital technology. Considering the evolution of digital technology as a new business opportunity, we would like to pursue new business opportunities by making full use of digital technology, which doesn’t mean that we will ignore hardware. In the area of Water & Environment, I mentioned that infrastructure has already been developed in Japan and maintenance will be the main focus. However, since ASEAN and other countries will face the same situation as Japan in the future, I believe that we can develop similar businesses in ASEAN and other regions by building solution businesses in Japan. Since it is difficult to build solution businesses only with in-house resources, I would like to consider M&A and alliances with external partners.

Q. Looking at capital expenditures over the next 2 to 3 years, will they increase from the FY2020 plan of 115 billion yen or will it remain at the same level as the FY2020? What areas are you investing in for the long-term?

A. Capital expenditures are expected to remain at the FY2020 level. On the other hand, a temporary increase may occur when there is a large investment, such as the construction of the new Sakai R&D center. As a reason for the continued high level of capital expenditures, R&D investment should be maintained at a high level, including the establishment of new R&D bases. The reason for that we also need large IT-related investments is that we lag behind other companies in overall use of IT in addition to the necessity of incorporating digital technology into its products. Although we operate globally, we are not able to manage people, goods, and money in a timely manner on a global basis. We are currently integrating core systems in Japan and North America, but we must also do this in Europe, ASEAN, and other regions. Of course, we will pursue return from investments, but we believe IT investment should be conducted at a high level continuously. Investment related to BCPs is also

required under the circumstances, such as an increase in natural disasters affecting our bottom line significantly in recent years. Taking into account the circumstances, we will continue to invest at a high level continuously. However, we must consider how to absorb the increasing depreciation costs. Since some of the capital expenditures are related to molds to manufacture new models, we will adjust the timing of investment depending on the market situation, taking into account the bottom line. Considering the next 5 to 10 years, the investment for the establishment of production system, R&D structure, and IT infrastructure will be the main themes.

Q. I have an impression that it will be difficult to expand the field of after-sales service in 3 to 5 years. Given the high level of fixed costs, what measures will be taken to increase profitability over the next 3 to 5 years? In particular, what areas will generate outcomes?

A. I would like to put after-sales service business on track within the next 5 years in consideration of M&A and so on. Of course, we will continue to promote daily productivity improvements and cost reductions. The Innovation Center has also been active since last year and I hope to generate results within 5 years in terms of creating new businesses with new technologies. In considering future profitability, I would like you to understand that we have been able to manufacture products at factories and deliver them to customers in the midst of significant sales increase, and so on in the past few years, but these operations have been not necessarily efficient. We must consider how to efficiently manufacture products from now on. In addition, as distribution costs remain high, we believe it is necessary to utilize IT in the supply chain management to improve efficiency. I said that we lag behind other companies in terms of IT. For instance, there are some areas where we have to manufacture products without grasping what is happening in the local dealerships in a timely manner. Accordingly, we believe that we can improve our business performance by utilizing IT to grasp the latest situation and respond to it in a timely manner. Accordingly, we can improve our business performance by accumulating these initiatives on some areas. Another challenge is improving office productivity. We want to absorb the increase in fixed costs by improving efficiency and increasing sales of service parts. In the situation where investment amount has gradually increased, we will continue to consider how we can achieve the results from past investments quickly.

Q. You said that depreciation costs will increase in the future. Could you tell me about your thinking on fixed costs in the future?

A. Please look at the changes in depreciation and R&D expenses. Although there is a time lag between R&D expenses and outcomes from them, they are directly linked to the development of attractive products. I would like you to see how they affect the top line. With regard to depreciation costs, we have to expand our production capacity in order to operate a business of 2 trillion yen smoothly because we regretted we had to ship engines by air due to shortage of production capacity. In the situation where depreciation costs are increasing accordingly, we understand that we need to show how depreciation costs will increase and their outcomes clearly.

Q. I understand you intend to create the new business model which provides total digitalized solutions over 5 to 10 years by capital expenditures and R&D investment. If these investments will work successfully, how will Kubota's business results be changed in the future?

A. We aim to become the world's top manufacturer of farm and construction equipment, but Kubota is currently No. 3. Within the company, it is said that we should catch up with and overtake the top, and we would like to build a corporate structure befitting the top in the world through new businesses. To achieve it, I would like to set targets such as ROE and operating profit margin in the mid-term plan from now on. On the other hand, the most important thing is to become a company that can contribute to solving social issues. We would like to be a company that can show not only an increase in revenue and profit but also contribution to ESG and SDGs.

Q. I understand that the impact of the novel coronavirus has not been factored into the FY2020's plan. Could you tell us about the current situation in China? Also, are there any risks that have the potential to affect production in Japan?

A. Each manufacturing base in China has been permitted to resume operations by the government and gradually started operations since February 10th. At present, while production has started, only about 60% of employees

are able to come to work and the level of production is still low. Some of the suppliers are not yet operational and we are currently gathering information on when they can start full production. In addition, some dealers have suspended operations due to administrative guidance, and the movement of people and trucks is also restricted. Since now is a high season of the rice transplanter, shipments of them are prioritized. In case that the impact continues through May or June and it comes to the sales peak season for combine harvesters which are our main products, there will be a certain impact. The situation is improving on a daily basis, but I'm not sure how long this issue will last. Additionally, we use parts from Chinese suppliers at some plants in Japan, so there is a possibility of an impact on production in Japan. Domestic production continues by using inventory at this moment. While suppliers were also stuck right after Chinese New Year, the situation is gradually getting better. There is no problem if suppliers go back to normal before we run out of stock, but if not, there will be some impacts.

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 February 19, 2020 (result briefing for the FY2019 ended December 31, 2019). These statements do not constitute a guarantee 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.