

## Interview with Masahiro Sakane, President and CEO

As in the previous fiscal year, Komatsu increased both sales and profits for fiscal 2004 ended March 31, 2004. What do you think about the major factors behind these good results?

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**Sakane:** First of all, the market environment for construction and mining equipment has improved around the world, and I feel demand has entered a cycle of recovery. The Chinese market has maintained a high growth rate which I think is over-heating. It is also significant that North American demand, the largest in the world, has recovered. Furthermore, in the region which I call "Greater Asia," consisting of Asia including Japan and China, Russia and the Middle East, Komatsu has established the Number One market position. In this region, except for Japan, demand for construction equipment has been growing in infrastructure developments. This has helped us achieve good results. I feel that



the recovery of all these markets coupled with the GALEO-series equipment, which we have introduced in recent years, is generating synergy effects. It is also very encouraging that our other businesses have been enhancing their product competitiveness, such as the AC servo-drive H1F and H2F press series of Komatsu Industries, the LEO-NXT series of Komatsu Forklift, and agricultural and forestry equipment of Komatsu Zenoah.

Concerning improved operating profit, the increase in sales counts a lot. At the same time, our fixed cost reduction activities, which generated substantial results for fiscal 2002 and 2003, have continued to become an integral part of routine improvement efforts, like production cost reduction. This is also very significant and I would like to thank Komatsu Group people for their efforts. In addition, with our electronics business having turned to the black for fiscal 2004, all our business segments are now operating in the black. As a result, our operating profit margin is steadily improving. A year ago, I mentioned that we had made a firm footing towards achieving a V-shaped recovery in our performance, and today I am glad that we have made our V-shaped recovery certain with the business performance for the year ended this March.

In November last year, Komatsu announced the "Move The World. KOMATSU 5-800" mid-range management plan. Tell us about the goals and what you are emphasizing to accomplish them.

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**Sakane:** In Japanese, "Move The World" in the title of this management plan expresses our firm determination to "move" the hearts of our customers around the world with our products and services.

Under the plan, we are working to further enhance our business performance by riding the tail wind of improved market conditions through proactive actions, as we uphold our commitment

in the Reform of Business Structure project, which has generated steady results. The numbers of 5 and 800 represent our numerical targets of 5 percent for ROA and 800 Oku\* yen or 80 billion yen. With operating profit of 80 billion yen, we are working to replace our record-high figure of 78.7 billion yen for the year ended December 31, 1982. Recovery in demand for construction and mining equipment has become more evident since last fall when we devised this management plan. Therefore, we are focusing our efforts on achieving those numerical targets one year ahead of the plan, which is the current fiscal year, ending March 31, 2005.

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The objective of this management plan is to conduct speed-emphasized management and to establish a corporate structure of high profitability. The Komatsu Group will work to enhance technology-driven product development capabilities as a manufacturer of industrial-use machinery. We are also doing business thanks to the support of our shareholders and all other stakeholders, so the most significant goal is to become a company which enjoys the trust of every stakeholder. To this end, we are going to strengthen corporate governance.

\* Oku is the Japanese denomination for 100 million.

### Management Goals of "Move The World. KOMATSU 5-800"

	Fiscal 2006
Consolidated sales	1,250 billion yen
Operating profit	80 billion yen
Return on assets (ROA)	5.0%
Net D/E ratio*	1 or under

Foreign exchange preconditions: 1USD=¥110 1EUR=¥125  
\*Net debt-to-equity ratio=(interest bearing debt - cash and cash equivalents)/shareholders' equity

Last year Komatsu acquired Partek Forest, a Swedish manufacturer of forestry equipment, and changed the name to Komatsu Forest. Please describe the current conditions of the forestry equipment market and Komatsu Forest's positioning.

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**Sakane:** It's not well known in Japan that Komatsu has been producing and selling forestry machinery based on construction equipment, such as hydraulic excavators and bulldozers. We generate annual sales of about 10 billion yen, mainly in Southeast Asia and North America, and these sales are included in the construction and mining equipment business segment. Meanwhile, Komatsu Forest is a specialized manufacturer of forestry equipment with annual sales of approximately 30 billion yen.

Over the years, we have wanted to make a full-scale entry into the forestry equipment market as a means to expand the construction equipment-related business. So we have finally materialized this objective.

Komatsu has sales and service networks in Asia, North, Central and South Americas, and Oceania, while Komatsu Forest enjoys a strong market presence in Europe. Thus we believe these two companies are positioned to supplement each other in building stronger sales and service networks in the forestry equipment market. Furthermore, some Komatsu distributors in the Americas have experience in handling Partek Forest-made equipment. In this light, I believe their joint efforts to develop and strengthen networks will go smoothly. It is also a big advantage for them that key components, such as engines and hydraulic systems, can be compatible. By generating synergy in all these aspects, they are working to post annual sales of about 50 billion yen in the future. In addition to expanding sales, they can improve costs through joint procurements of parts and so forth in order to enhance profitability.

With respect to the market size worldwide, we estimate some 10,000 units or about 300 billion yen annually. Of these estimates, North America generates about half, followed by



Harvester made by Komatsu Forest

Europe with one quarter, and Southeast Asia with over 10 percent. At the beginning of this year, demand for pulp turned upward, so I expect to see a good start for our forestry equipment business.

The ongoing mid-range management plan positions the industrial-use machinery business as the core business of Komatsu. Except for construction and mining equipment, please explain specific business domains of the industrial-use machinery business and the reason why it is positioned as such.

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**Sakane:** Specifically, we imply our conventional business domains of forging machinery, sheet-metal machinery, forklift truck, agricultural and forestry equipment and some other domains where we can fully capitalize on our superior manufacturing expertise. These businesses are undertaken mostly by subsidiaries, and each of them has been improving business performance, by not only strengthening its business structure for higher profitability through reduced fixed costs, but also launching products with unique advantages.



Products we make in these business domains are industrial goods like construction and mining equipment. So many of our customers in all these business domains have extremely high

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standards and expectations concerning the quality, cost and delivery of our machinery and services. We believe that we can also make contributions to our customers by delivering our technology-based solutions for their safety and environmental concerns in addition to meeting their standards.

Unlike our construction and mining equipment business, these businesses are still small in scale or not yet globalized. In this regard, alliances with companies who have global operations or engage in peripheral businesses may be an effective means for their further growth. In fact, Komatsu Industries has formed an alliance with TRUMPF, a leading German manufacturer of industrial machinery, and Komatsu Forklift with Linde, also a leading German manufacturer of forklift trucks, and they have grown their businesses steadily.

Since you became president, you have consistently advocated the "Spirit of Manufacturers" commitment. Komatsu began the launch of Unique and Unrivaled products of the construction and mining equipment segment last year as one of the themes of this initiative. Tell us about your personal evaluations of and future plans for Unique and Unrivaled products.

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**Sakane:** We introduced the MR-2 series mini hydraulic excavators, PC400 and 450 hydraulic excavators, and D475 super large crawler dozers during the year. All these models have helped growth in both sales and market share. In this regard, I believe we have succeeded with these models. However, our commitment in the Spirit of Manufacturers will never end, and thus I am sure that there are still some tasks left for us to work on.

By March 31, 2006, that is the target year of our mid-range management plan, we are planning to replace 25 percent of a total of about 160 models and generate 55 percent of sales of new equipment with those of Unique and Unrivaled products. Mainly in view of the fact that Tier III emission gas regulations will become effective starting in the United States and Europe in January 2006, we plan to concentrate their launches in 2005.

We define Unique and Unrivaled products as those equipped with one or two overwhelming advantages that no competitor can catch up to for a while. At the same time, Unique and Unrivaled products must demonstrate a substantial reduction of production costs when compared with the corresponding, existing models. All in all, it's our customers who evaluate them as such. Even so, I am insisting on the concept Unique and Unrivaled because I hope to see further advancement in our reform by everyone taking on the challenge. Thus far I have clearly separated growth from costs as part of the Reform of Business Structure project and worked to strengthen our business structure rather through cost reductions. I hope that all employees will have self-confidence in regaining our growth through Unique and Unrivaled activities.

Initially, we have focused our main attention on the development of Unique and Unrivaled products in the construction and mining equipment, but today I can see momentum is growing in other divisions and subsidiaries, such as the Industrial Machinery Division and Komatsu Zenoah. Also on our plant floor, self-initiated activities are spreading and making their production lines Unique and Unrivaled in terms of quality and productivity. I am certain that all those Unique and Unrivaled-based activities will transform into a driving force for Komatsu's future growth.

[In response to expanding demand for construction equipment worldwide, how is Komatsu going to enhance production capacity?](#)



**Sakane:** Today we have 34 production facilities for construction and mining equipment around the world, including Japan. Of those facilities, 20 are assembly plants, with four in Japan and 16 offshore.

We are manufacturing components and parts in the remaining fourteen facilities. Key components, such as engines, hydraulic systems and final drives, are produced mainly by plants in Japan and supplied to assembly plants in Japan and overseas. For such components, we started investments to expand production capacity in 2003 to meet growing demand worldwide today and to capture business opportunities, particularly in Greater Asia in the future. Furthermore, the product competitiveness of construction and mining equipment is determined by the systems integration technology for mechatronics-intensive components. In this regard, we are working to sharpen our product competitiveness mainly in Japan, because a collaborative work style has already been established among our development and production divisions, together with suppliers in Japan.

As for assembly plants, we are facilitating equalization of our production load from a global perspective. In Japan we have already reduced our production capacity by some 40 percent by restructuring twice since 1995, in response to the structural change of the market. Therefore, Japanese plants have been running at a very high rate recently. Also, as a result of their cost reduction efforts, they have recovered their earnings level on par with the last peak of fiscal 1997, while their production value for fiscal 2004 represented an 80 percent level of the peak year. In the meantime, our offshore plants have a reserve capacity. So we are going to utilize them more actively and fully to meet expanding global demand for construction equipment. I am sure that our offshore assembly plants will take advantage of the superior manufacturing expertise of Japanese plants accumulated over the years.

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[Komatsu's business has continued to expand in China. How are you looking at the Chinese market today ?](#)



**Sakane:** Today's China closely resembles Japan in the 1960's through the 1970's for our construction equipment business. The market for hydraulic excavators has expanded by over 50 percent annually in the last two years. This is clearly over-heating. In an effort to control this bubble economy at an early stage, the Chinese government enforced the credit squeeze measure to cement, aluminum, steel and the real estate industries. Inevitably, our client industry of construction has experienced the adverse effects, and the construction equipment market is in a short-term adjustment phase. However, when you look at the current policies of the Chinese government carefully, they are focused to change China's economy to a sound condition with special attention paid to not only excessive real estate investments, but also other industries with a lack of efficiency, or environmental problems. So I believe their measures are very appropriate. Moreover, by taking the viewpoint of avoiding a hard landing of the economy, I would rather welcome the current adjustment phase in our market.

I am sure that China with its vast land and huge population will transform into an enormous market for construction and mining equipment in the future. It was only mid-1990's when foreign-capitalized companies like Komatsu commenced full-scale production and sales there, and the total amount of construction equipment is still small today. In view of mechanization of construction work in progress, we can expect massive potential demand. In a medium-term prospect, development projects

for roadways and other infrastructure should continue for the Beijing Olympics in 2008 and the Shanghai Expo in 2010. In the long run, there are large-scale government projects such as the Western Region Development Strategy.

So the real ball game is yet to begin in the Chinese market. To prepare for it, we are strengthening our customer support capabilities, including personnel trainings, as the most important task. Customer support capabilities will make a clear difference because it's a vast country. I believe companies having distributors with strong sales and service capabilities and superior support programs will win the game.

Advanced Silicon Materials (ASiMI) recorded an impairment loss on fixed assets for the year. Please describe the current state and outlook of Komatsu's electronics business, including ASiMI.

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**Sakane:** As you might remember, ASiMI recorded an impairment loss on fixed assets of the Butte Plant in 2001 to remove future business risks. However, the market price of polycrystalline silicon dropped lower than we had anticipated then. Demand for solar applications is expected to grow, but ASiMI has concentrated on the production of high-margin products mainly for semiconductors. Therefore, we estimated future market size and competition on a more conservative stance and recorded additional impairment loss on fixed assets during the year.

ASiMI has no more need for substantial capital investments in the foreseeable future, and is expanding sales of monosilane gas for use in LCD (liquid crystal display) panel production. ASiMI produces this monosilane gas in the process of manufacturing polycrystalline silicon. As a result, ASiMI continued to improve business results for the year ended March 31, 2004. Coupled with the impairment loss on fixed assets at this time, we also increased ASiMI's capital, and thus improved their balance sheets considerably. So we can expect that ASiMI will turn to the black for the year ending March 31, 2005.

Concerning the future of our silicon business, we have heard a wide range of comments from investors. While there are a variety of options for these businesses, we have focused our efforts first to remove risks and thus change them to a healthy condition. Komatsu Electronic Metals has secured profits on a



Instructors at Komatsu (China) Training Center in Changzhou

non-consolidated basis even under tough market conditions since their concentration of production of silicon wafers in Japan and Taiwan in 1999. Formosa Komatsu Silicon has generated stable profits since the second half period of fiscal 2003. Both of them are improving profits steadily. They have worked to reduce fixed and manufacturing costs, while promoting their technological differentiation. As a result, they have attained a level of self-support in which they can make necessary investments by using cash generated from their operations. My thoughts about the directions for their further growth in the future include reinforcement of the relationship with their alliance partners.

As the chief executive officer of the Komatsu Group, you have just started the fourth year. Are there any changes concerning your roles as top management?

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**Sakane:** I see no change. I continue to believe that frank and honest communication is what is needed for a CEO to converge the attitudes and actions of employees in the direction that the company should take. This should be true regardless of the size of companies.



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 Since I became president of Komatsu, I have held meetings on every possible occasion soon after our announcement of business results, certainly with shareholders as well as with employees in Japan and abroad, suppliers and sales and service distributors. In these meetings I have explained my own thoughts on the current conditions of the Komatsu Group and future directions that we should take. I explain the same contents in general. In this way, stakeholders will have a mutual understanding, and I believe each and every employee will take an initiative for action. One of my most important roles is accountability to all stakeholders.

Also on such occasions, I have consistently advocated the importance of compliance. I believe that corporate value is a total sum of trust from customers, business partners, local communities and employees in addition to shareholders and investors. To enhance this sum, we are required, of course, to improve our business results and the soundness of management. At the same time I also believe it is becoming more important for all top management and employees of the Komatsu Group working around the world to strictly comply with local laws and the Rules of the Business Community.