

# INTERVIEW

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- ● ● **Q: Please sum up Komatsu's efforts and continuing good business results against the backdrop of dynamic change in the market environment for construction and mining equipment.**

**Sakane:** Thanks to the hard work of all employees of the Komatsu Group and our suppliers, we were able to promptly capitalize on the upturned market conditions for construction and mining equipment and other businesses and thus recorded successful growth in both sales and profits. Sales of construction and mining equipment topped the one trillion yen mark for the first time, supported by excellent overseas results. The Chinese market entered an adjustment phase following overheated growth up until two years ago, but our sales in all other markets expanded. Countries with rich natural resources have been building social infrastructures against the backdrop of price increases for their crude oil and minerals. To excavate those minerals, demand for our mining equipment has also grown around the world. In North America, the world's largest market, demand surged some 30%. Our sales in the Americas surpassed Japanese sales for the first time.

Operating profit and net income for the year renewed their record-high figures after 22 and 23 years, respectively. Record-high profits also reflect our dedicated Groupwide undertakings of the Reform of Business Structure project since 2001. We have made steady progress in the reduction of fixed costs and improvement of our electronics business. We have also ensured Groupwide internal competition based on the business performance and have provided bonuses accordingly.

Meanwhile, we also incurred higher costs for production and logistics, because demand accelerated far more than we had anticipated. The year taught us two lessons in light of cyclical demand for construction and mining equipment: the importance of predicting demand early and accurately; and the need for having a capability to flexibly respond to change. It's very urgent for us to further improve the accuracy of our sales and production plans. We are promoting Groupwide reforms so that we will be able to directly and promptly grasp the market conditions around the world by capitalizing on our KOMTRAX and other IT advantages and incorporate such information to our sales and production management.

It was also a great year outside of our business arena. Ayumi Tanimoto, a member of our women's judo club, won the Gold Medal at the Athens Olympics. I proposed the creation of Komatsu Women's Judo Club in commemoration of our 70th anniversary and it was established 15 years ago. The supporters' association was formed at Komatsu last year. I am very glad to see that many employees and other stakeholders are backing up the club.

- ● ● **Q: Komatsu has just attained the goals of the "Move The World. KOMATSU 5-800" mid-range management plan one year ahead of the original plan. Can you share your thoughts concerning the next goals with us?**

**Management Goals of "Move The World. KOMATSU 5-800" and Results for the Year**

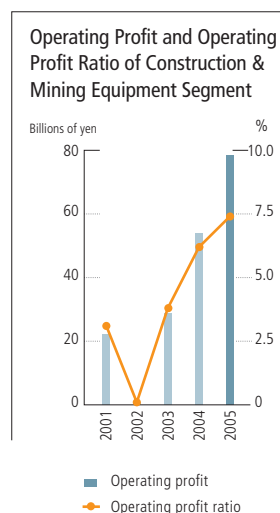
	Results for the Year	Goals for March 31, 2006
Sales	1,434.7 billion yen	1,250 billion yen
Operating profit* <sup>1</sup>	101.9 billion yen	80 billion yen
Return on assets (ROA)	7.1%	5%
Net debt-to-equity ratio* <sup>2</sup>	0.70	1 or under

\*1 Operating profit is the sum of segment profit (net sales less cost of sales and selling, general and administrative expenses). It conforms to Japanese accounting principles, and does not represent consolidated operating profit under U.S.GAAP.

\*2 Net debt-to-equity ratio = (interest-bearing debt - cash and cash equivalents - time deposits) / shareholders' equity

**Sakane:** In November 2003, we announced our mid-range management plan for the fiscal year ending March 2006. And we have outperformed the plan.

Although we attained all four goals, our operating profit ratio is still unsatisfactory at a 7% level on average for all business segments as well as the construction and mining equipment segment by itself. To further focus Groupwide efforts on profitability, we have set a 10% or higher



operating profit ratio as our new goal. Our mainstay business segment of construction and mining equipment is first working to attain the goal. To minimize adverse effects on our production costs, such as boosted price for steel materials, we will strive to further reduce our production costs and increase our sales prices as much as possible. Starting in North America and Europe, Tier III emission standards will be in effect in January 2006, and I assume other players of our industry will also rush to launch new and renewed models on the market, a year of testing the real strength of all players. As I have said before, we are going to replace a large number of current models with DANTOTSU (Unique and Unrivaled) products by capitalizing on this opportunity to achieve an operating profit ratio of 10% or higher.



- ● ● **Q: To increase the operating profit ratio of the construction and mining equipment segment to 10%, it appears indispensable to improve the profitability of the Japanese operation. What measures are you planning?**

**Sakane:** As the Japanese market size has dropped to one third of the peak of fiscal 1991, our market environment is very tough today. When you look at the balance of the global market size, however, the current Japanese situation is not extraordinary. It was just too large back then. To secure earnings, we have restructured our Japanese sales and service operations in line with the shrinking market, while advancing our businesses in downstream markets such as used and rental equipment, parts and services. I believe the essential problem of Japanese profitability is not related to declined demand but to dropped sales prices. Especially in Japan, the market competition for medium-size hydraulic excavators is intense, which has made Japanese manufacturers technologically very competitive. At the same time, the price of Japanese excavators has slid to the cheapest level in the world. While we have worked to increase Japanese sales prices since last year, from now on we are going to successively launch DANTOTSU products with outstanding features. It will be a great opportunity for us to straighten out sales prices.

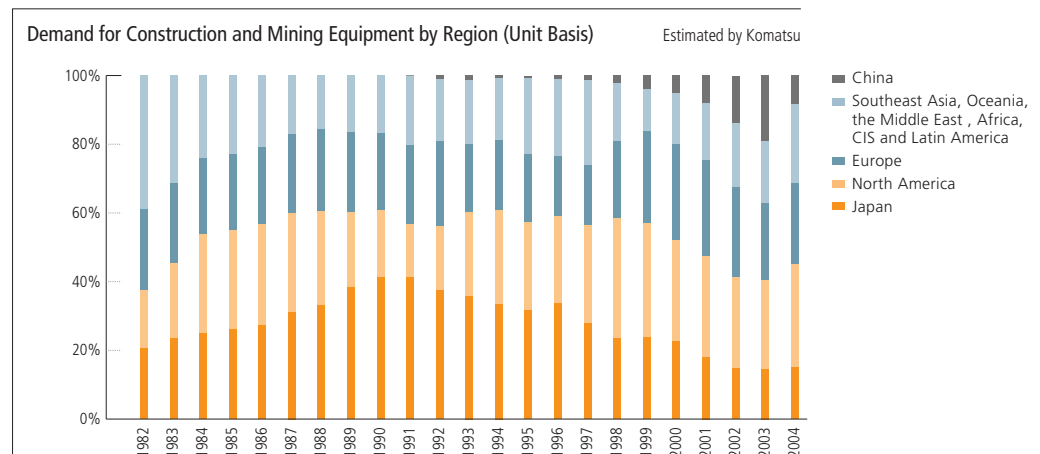
- ● ● **Q: Komatsu continued to improve business performance overseas during the year. What is your view of the global market from now? Which markets are you going to emphasize?**

**Sakane:** In light of global demand for construction equipment, a big surge in market recovery is gaining momentum centering on "Greater Asia" for the first time after 20 years. For about 15

years, since 1985, Japan, the US and Europe accounted for about 80% of global demand. This was abnormal. Reflecting sluggish economies and political instability, cash didn't go to the countries which needed to build infrastructure by using construction equipment.

Around 2000, however, the economies began to expand rapidly in BRICs, resulting in the recent tightening of supply and demand of commodities such as crude oil and minerals. I think the price of crude oil represents those of coal and other mineral resources. When the crude oil price is high, the prices of minerals also become high. Those countries, which suffered a lack of cash inflow, are now exporting their commodities for trade revenues and allocating them to infrastructure development and improvement. They also need our machines to develop resources. So, the price hike of crude oil means a tailwind for Komatsu. It used to just be my gut feeling, but we have confirmed a positive correlation between the Dubai crude price and Komatsu's operating profit in our analysis.

Komatsu is ranked second, still far behind the top international player in the scale of business, but we enjoy a strong market position in Greater Asia, and I believe this market will drive our future market expansion. In the course of our globalization drive, we have gotten our product range and production network in place today. In addition, we have been reinforcing our customer support capabilities intensively in Greater Asia, becoming well prepared for a new era of our growth.



Note: Demand is based on 7 major products (excluding mini equipment), i.e., 1) crawler-type hydraulic excavator, 2) wheel-type hydraulic excavator, 3) bulldozer, 4) wheel loader, 5) rigid-type dump truck, 6) articulated dump truck, and 7) motor grader.

● ● ● **Q: Please tell us the current condition and future outlook of the Chinese market where demand fell sharply.**

**Sakane:** In China, demand for construction equipment surges after the Chinese New Year. In 2005, it was February 9th and demand shows the same level as it was in 2002. The adjustment phase has continued since May last year, pushing demand down to the 2001 level, but since the Chinese New Year, the rate of monthly decline this year has become smaller compared to the corresponding month a year ago. We can also see an increase in operating hours of our customers' machines according to the data we get from the KOMTRAX system. So it is very likely that the market bottomed out at the end of 2004.

It's hard to predict the future outlook. The Chinese government's macro controls to curtail



KOMTRAX Monitoring Center  
at Komatsu (China)

economic overheating are still in place, but I believe the economy as a whole will enter a stable growth phase with reasonable financial measures. I also believe the government will continue its efforts to correct the regional economic differences, respond to environmental problems and develop competitive industries. In this light, the market recovery will differ in speed and scale, depending on the region and industry. In 2003 the eastern region generated more than half of all demand in China from industrial park development projects and general construction works. So the market recovery will take some time.

On the contrary, in the northeastern and western regions, infrastructure development is buoyant, reflecting the government's efforts to solve regional economic differences. The demand decline in 2004 was relatively small in these regions, and we can expect some growth in 2005. By industry, aggressive investments should continue in the energy sector, such as oil and coal, as well as in the port and railway industries which transport those raw materials. We can also expect demand to expand in the mining industry which emphasizes more speed through mechanization for larger production capacities. In urban areas, demand for compact machines should also increase for work such as city water pipe installation. The Chinese market has also begun to accommodate growing demand for equipment other than 20-ton class hydraulic excavators which have almost exclusively accounted for demand. In this light, as a full-line manufacturer, we will have great opportunities.

While the Chinese market has definitely become larger, the percentage of Chinese sales in our total sales of construction and mining equipment stands at a mere 3.8% for fiscal 2005. Furthermore, our combined sales in BRICS\* account for only about 10%, which encourages me to have a bright future for us.

Note: \*With the capital letter S, Komatsu includes South Africa in the common usage of BRICs, i.e., Brazil, Russia, India and China.

● ● ● **Q: You have just described further growth in demand for your machines, supported by active infrastructure developments in emerging markets. Can you now tell us about Komatsu's production capabilities in Japan and overseas?**

**Sakane:** Komatsu reduced domestic production capacity by 40% from 1995 through 2000 in response to the market shrinkage in Japan. When we balanced our supply capacity with market demand, demand recovered, especially overseas. Today, demand for our machines for export, large models for mining in particular, is accelerating. So we are expanding our production capacity by investing in bottleneck areas of production and changing the models for production flexibly among our plants worldwide. When demand increases in BRICS, our production capacity will be even tighter. We will expand the production capacity of existing assembly plants by making full use of 28 overseas plants. I don't think we should build new plants right away.

As for major components such as engines, transmissions and hydraulic units, we are investing in additional production capacity, because the production of hydraulic units and transmissions is concentrated in Japan. Moreover, we are planning to increase our production capacity to a slightly excessive level, as we must be prepared for the Chinese market recovery. The combination of these components is extremely important because it determines machine performance and fuel efficiency. Product competitiveness is derived from it. In view of differentiation from competitors, therefore, we will ensure in-house production and accumulate and refine our technologies.

Many people used to think exports from Japan were not profitable due to the constant appreciation trend of the Japanese yen from the Plaza Accord of 1985 to the mid 90s. Through fact-finding efforts, on the contrary, we have discovered that fixed costs, such as administrative

expenses, are high but our production costs are very competitive when compared to U.S. and European makers. This is why I promoted the Reform of Business Structure project centering on the reduction of fixed costs, while consistently encouraging employees to have confidence in the competitiveness of Japanese ways of manufacturing. Of course, I have also emphasized that our overseas plants have many areas to further enhance their competitiveness.

- ● ● **Q: Automakers have made aggressive investments especially in Asia. Please tell us about the current condition and future outlook of Komatsu's industrial machinery business, which is one of the core operations.**

**Sakane:** Fiscal 2005 sales of the industrial machinery, vehicles and others segment totaled 266.4 billion yen. Of this amount, the forklift business accounted for about 40% and the industrial machinery business including large presses, about 20%. The rest comes mainly from products for Japan's Defense Agency, Komatsu Zenoah's agricultural and forestry machines as well as Komatsu Logistics' transport business. While all these operations have improved their results, the industrial machinery operation recorded excellent orders from automakers for large presses which incorporate new technologies, and we expect further growth in the future.

Needless to say, the industrial machinery market also accommodates big changes in demand. Recently, demand has been expanding against the backdrop of aggressive investments of automakers around the world. We have successfully capitalized on this market environment by introducing new products with unique features. Komatsu Industries led the industry by introducing the H1F and H2F Hybrid AC Servo Press series in 2002. Through CNC controls, these presses achieve outstanding, high-precision forging compared to conventional mechanical presses. The series has also captured growing environmental concerns over noise with a super-low level. With such advantages, the series has become a breakthrough product, recording cumulative sales of over 700 units since its introduction three years ago. Concerning large presses, we developed jointly with our customer, Daihatsu Motor, a new type of large press line. It features a unique pendular mechanism for the feeder which incorporates a linear motor system for the first time in the world. Coupled with advanced synchronization controls of the line, it boasts the world's highest level of productivity and flexibility. Also, with Toyota Motor Corporation, we have applied our accumulated AC Servo technology for small and medium-size presses to the domain of large presses and developed the world's first AC Servo press. We are going to deliver this new press to Toyota's plants around the world. I thought about the title of DANTOTSU products originally for differentiated construction equipment, but these industrial machines also deserve the DANTOTSU title.

- ● ● **Q: Komatsu is negotiating the sale of Advanced Silicon Materials. Has Komatsu changed the policy concerning its electronics business?**

**Sakane:** My stance on the electronics business remains consistent. Specifically, we remove all critical risk factors and transform the business structure into one capable of generating cash by itself so that the operation can make investments while reducing debt. We also help our electronics companies find partners for their further business growth.

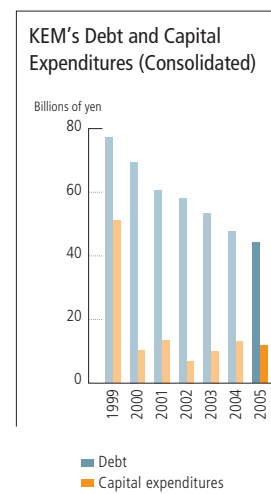
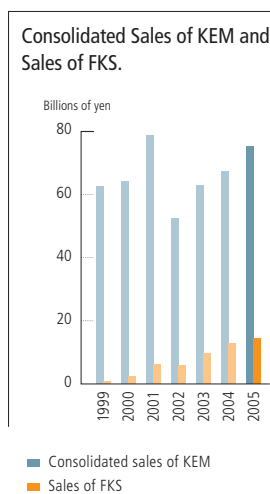
First, concerning the silicon wafer business, all manufacturers have started full-scale investments in 300mm wafers. Komatsu Electronic Metals (KEM) already has a line in operation for monthly production of 45,000 pieces in Japan and is investing in facilities to raise the capacity

to 75,000 pieces. In addition, they have already decided to build an integrated line capable of monthly production of about 50,000 pieces at their joint ownership company, Formosa Komatsu Silicon (FKS), in Taiwan. The new line is scheduled to start production in 2006.

Their investments are about 11 billion yen in Japan in 2004 and 2005 and about 23 billion yen in Taiwan in 2006 and 2007. They are using their own cash generated from their business, not from our construction and mining equipment business. Moreover, they are making these investments while not increasing borrowings. In fact, their debt totaled 77.1 billion yen on a consolidated basis as of March 31, 1999 and decreased to 44.1 billion yen at March 31, 2005. FKS began production in 1999, and the percentage of their sales in consolidated sales of KEM has been gradually increasing. Business growth of this Taiwan operation should further strengthen KEM's relationship with the Taiwanese partner. In this regard, I feel certain that the silicon wafer business will grow larger.



Concerning the polycrystalline silicon business, Advanced Silicon Materials (ASiMI) made impressive improvement for fiscal 2005, reflecting buoyant demand for monosilane gas and polycrystalline silicon. We determined that it was most appropriate for the Komatsu Group to sell ASiMI when its value is increasing at this time. We are negotiating the sale of the Butte Plant with Renewable Energy Corporation (REC). In 2002, ASiMI contributed its Moses Lake Plant to establish a joint-venture manufacturer of polycrystalline silicon for solar applications with REC. To ensure stable supply of polycrystalline silicon to KEM and FKS, the Komatsu Group will keep 25% of its equity ownership in ASiMI, but ASiMI will be managed by this joint venture partner.



- ● ● **Q: Komatsu has been known over the years as a company with superior quality control. Please tell us about the objective of the NQ-5 Promotion Department which was established recently. What do you think of as important to promote Kaizen (improvement) activities and enhance corporate strength?**

**Sakane:** N stands for new and Q for quality, and 5 represents 1) jobsite, 2) reality, 3) actual case, 4) origin, and 5) bringing to light. By taking a leadership role of getting all employees involved, the new department is in charge of promoting activities designed not only to enhance

our Quality and Reliability commitment but also to strengthen jobsite capabilities of production and development and reform administrative processes.

A variety of methods for Kaizen are available, such as quality control which is our stronghold and the U.S. style Six Sigma. As we stress the power of manufacturing, it is essential for us to diligently turn the cycle of the basic concepts of quality control, which are Plan, Do, Check and Act and continuously advance our Kaizen efforts.

When engaging in these activities to enhance our jobsite capabilities and corporate strength, I always emphasize the importance of fact finding. There are things which you might take for granted or think as a common sense. But when you take a closer look at them and try to find the facts, you will be able to see them from a different angle and come up with new ideas for Kaizen.

Another important matter is what I call Show and Share. Bring to light or show the facts you found and share them with others. Because when you move on without finding the facts, you will be carrying problems with you. This concept of Show and Share is not limited to quality control but is also related to corporate strength. Development of an open corporate culture in which problems are communicated to top management and disclosed to all stakeholders is extremely important for compliance.



**Q: Corporate social responsibility is becoming more and more important today. Concerning accountability to stakeholders and compliance, what do you always emphasize?**

**Sakane:** Since I became president, I have consistently continued direct communications with not only shareholders but also employees, suppliers, sales and service distributors on all possible occasions such as the announcement of our business results. I believe corporate value is the total sum of trust given to us by society and all stakeholders and that direct communications are an important means to build up this trust. By talking with stakeholders and disclosing appropriate information as often as possible, we can not only minimize the so-to-speak “surprises” but also share the direction and issues of the Komatsu Group with them.

Of all trust, social trust is so fragile that it can become zero even with one problem. I believe it is virtually impossible to prevent all problems at any company. While preventive efforts are of course important, I advocate the importance of disclosing problems as soon as possible and responding to them promptly.

Like other management tasks, compliance cannot be achieved by Komatsu Ltd. alone. There are many instances in which one problem caused by one company of a corporate group has brought about critical damage to the entire group, including the parent company. Thus, compliance can be achieved only when it is promoted Groupwide as one dedicated team under the leadership of a core company. Compliance is a very critical matter which can affect customers, shareholders, employees, suppliers and even their families. For this reason, each and every management officer must tackle compliance by transcending his or her area of responsibility.



Internal meeting held at Head Office in Tokyo, where he explained the business results for fiscal 2005 and discussed the current management issues and policies, followed by questions and answers.