

Face to Face



Q: Komatsu has achieved the fourth consecutive year of growth in both sales and profits by capitalizing mainly on expanded demand worldwide for construction and mining equipment. Please outline the results for fiscal 2006, ended March 31, 2006.

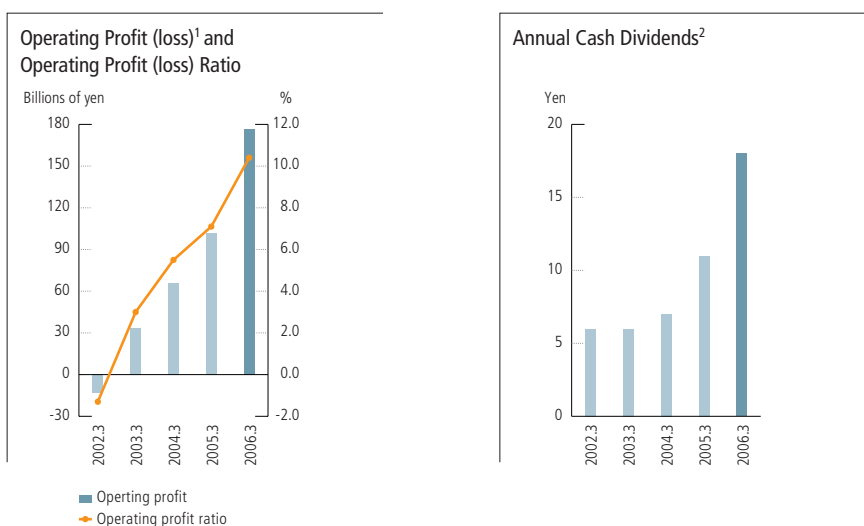
Sakane: I am very pleased to report to our shareholders and investors that we continued to outperform our last results, enabling us to improve the corporate value of the Komatsu Group. I would also like to thank our distributors and suppliers in addition to Komatsu Group employees around the world for their efforts.

For fiscal 2006, we not only continued to renew record highs in sales and profits but also further improved our profitability, achieving our goal of a double digit operating profit ratio. As we had set the goal of 10% or higher for the operating profit ratio of all combined segments for fiscal 2007 ending March 31, 2007, in addition to the Construction and Mining Equipment segment, we accomplished this goal a year earlier. In the meetings with investors, I kept telling them that I hadn't given up the chance of achieving the goal in fiscal 2006.

About our improved performance, what I feel more confident and proud of ourselves are, first, all business segments achieved growth in both sales and profits, thus improving their operating profit ratios, and second, each company of the Industrial Machinery, Vehicles and Others segment, which consists of different subsidiaries, increased profits.

Demand continued to expand for construction and mining equipment. The North American market, fueled mainly by steady housing starts, remained strong as before, and the Chinese market, which had been uncertain of recovery, made a remarkable comeback. The mining equipment market was also thriving. Powered by this tailwind, we accelerated sales in all regions, worked to increase our selling prices and reinforce our product support capability, and launched, in the last half period, models compliant to Tier III emission standards in Japanese, North American and European markets. Furthermore, by anticipating the continued expansion of demand, we made aggressive investments in production facilities. All in all, it was a year for us to shift our gear from defense to offense.

We set ¥18 for annual dividends for fiscal 2006, the third consecutive year of increases. We also expressed, for the first time, our goal for 20% or higher payout ratio in the business results news release. We will maintain our basic policy of redistributing profits by considering consolidated business results. We would like to pay stable dividends to shareholders in the payout ratio of 20% to 40% after excluding extraordinary gain or loss. However, we cannot guarantee it, because our business performance can be adversely affected by unpredictable events in the future.



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) Based on the resolution of annual shareholders' meetings

Q: In the previous annual report, you mentioned that you would emphasize profits more thoroughly and set 10% or higher as the goal of operating profit ratio. Now that Komatsu has improved it to 10.4%, up 3.3 percentage points from the previous year, please tell us your next management goals.

Sakane: I have included two new goals in my management policy for fiscal 2007. First, we are going to maintain top levels of profitability and financial conditions in our industry, and enhance our position in the global marketplace, especially in "Greater Asia." Second, we will continue our management by always keeping in mind the market value which reflects the amount of trust given to us by society and shareholders.

Our "Move The World. KOMATSU 5-800" mid-range management plan was set for fiscal year ended March 31, 2006, and included four management goals for sales, operating profit, ROA, and net debt-to-equity ratio. After achieving all four goals a year ahead of schedule, we set our new management goal of 10% or higher for operating profit ratio, and we have achieved this goal in fiscal 2006 ended last March. Now I believe that our profitability and financial position



have become on par with our foreign competitor. As we continue to compare these management indices with our competitor, we will continue our activities to refine our strengths and revamp our weaknesses and maintain industry's top-level profitability and financial conditions. This stance will remain unchanged. While I know that it's easier for everyone to understand with specific figures for goals, such figures would change their values depending on the preconditions made in the dynamic changes of the business environment today. Therefore, I have decided that we must sustain relative advantages over our competitor. To this end, as our basic strategies, we are going to enhance our market position in Greater Asia and other regions of the world with high-growth potential. We will discuss goals with specific figures as we move ahead.

● ● **Q : The other goal is managing Komatsu by keeping market value in mind. Tell us about your message for this goal.**

Sakane: It's extremely important for any company to improve its profitability and financial position and sustain them at a desired level. Nevertheless, that's not all there is to do. I personally believe corporate value is the total sum of trust given to us by society and all stakeholders, and have advocated this concept to Komatsu Group people by making use of all possible opportunities. I believe market value is an index for the total sum of trust.

Market value reflects a variety of efforts of the company, including human resource development, R&D, management strategies, corporate ethics, environmental conservation, management transparency and information disclosure, in addition to standard management indices for profitability, financial position, growth potential and payout ratio for shareholders and investors. When a company or an employee of the company displays misconduct, or when the company neglects information disclosure concerning the misconduct, it won't be reflected quickly in financial indices but can give detrimental damage to trust, resulting in a drop in market value. While market value is also affected by overall market trends, I still believe market value reflects corporate value containing the diverse evaluations of stakeholders. Accordingly, I have set the goal of continued management of Komatsu by keeping market value in mind as we always engage in appropriate information disclosure, in addition to ensuring thorough compliance and improving CSR efforts.

● ● **Q : Will you elaborate on the second-stage Reform of Business Structure project, which was launched this year?**

Sakane: In the Reform of Business Structure project launched in 2001, we worked on a variety of reform tasks centering on the three core elements of fixed costs reduction, enhancement of market position in Greater Asia and launchings of DANTOTSU (Unique and Unrivaled) products. Of the three, we will have to wait for customers' evaluations on DANTOTSU products since we are making a full-scale market introduction starting in 2006. In this light, we haven't completed the first-stage Reform project, and thus we will be working on two reform projects for a while.

In the second-stage Reform of Business Structure project, we have identified about 60 subject matters concerning top-down and middle-up processes in order to further strengthen Komatsu Group's corporate muscle, and we are already undertaking specific activities. Of all reform activities, we are placing special attention on the reform of our value chain by focusing on IT. Another important matter calls for promotion of human resource development around the world, since it is human resources that support corporate growth. However, we are not only going to emphasize classroom education. Rather, we are going to form cross-organizational teams with key persons from Komatsu Group companies as well as distributors and suppliers around the world. In this way, we will promote growth of our people through reform activities of actual business operations.

Reforming the Value Chain on a Global Level by Focusing on IT

Putting aside how the value chain is defined in management textbooks, I have used the value chain in the recent management policy to mean that a chain of values generated from all our business activities from the most upstream to the downstream or from R&D and production to sales, including financing, and service. To improve this value chain, we are going to promote our reforms by deploying IT.

For example, because demand for construction and mining equipment entails some cyclical elements, we believe we can have advantages over our competitors by adjusting our sales, production and inventory statuses according to market changes before our competitors. Thanks to rapid advances of IT, we have become able to determine market changes directly on a real-time basis, especially from the operating conditions of our customers' machines. We are working to develop a framework to share global sales and production information with our distributors, plants and suppliers after we analyze such data.

Q : The mining equipment market is continuing to grow dynamically. What is your view on the outlook? Would you also tell us Komatsu's strengths and tasks ahead in this business?

Sakane: The prices for major commodities, such as iron ore and copper, are staying at high levels, and mining companies are staying determined to invest in development and machines. However, when you look at the trends of global demand for mining equipment, in 2004 demand returned to the last peak level of 1996 and has just surpassed the peak level in 2005. When you compare today with 1996, you see the mining market thriving around the world, resulting from expanded demand for energy, for example, in China and India with huge population and expanding economies. Furthermore, in these two countries themselves, mining investments are already underway. Thus, I believe demand for our equipment will remain at the current high level. In fact, a substantial increase in coal production is underway in China, and in January 2006 we won a large-lot order, worth around 10 billion yen, for our mining equipment, including 27 units of the 930E super-large dump truck made by Komatsu America Corp.

Population is growing mainly in emerging economies, and I believe this trend will continue into the future. Coupled with population growth, urbanization is also in progress. As we see in China and India, these two factors have triggered an increase in infrastructure investments and expansion of energy consumption volume. Accordingly, there is a need to expand power generation and crude steel production worldwide, which will lead to an increase in production volume of commodities like copper, coal and iron ore.

Komatsu Group's sales of mining equipment for the fiscal year ended last March expanded to the 2 billion dollar level, due mainly to the facts that we have faithfully developed and reinforced the relationship with large-scale mining companies and that we have accelerated sales in Indonesia where we enjoy a high market share. At present, we are facing very tight procurement of tires for super-large dump trucks, and thus orders for these machines have plateaued. The same situation applies to our competitors as well. However, as the number of opportunities in emerging markets of China, India and some other countries are growing, we are building new plants in Japan and India to expand our production capacity. Start-up of these new plants is scheduled for January 2007.

In the mining equipment business, our strength also lies in leading-edge IT applications. Currently, we are testing our autonomous haulage system with super-large dump trucks in our customer's mine. By developing new IT-based business models, we would like to make contributions to mining efficiency, facilitating the differentiation from competitors.



We are going to introduce this 930E super-large dump truck (same model) in the Chinese market for the first time.



●● Q: Please share your thoughts with us concerning production capacity and investment, as you anticipate future developments of the construction and mining equipment market.

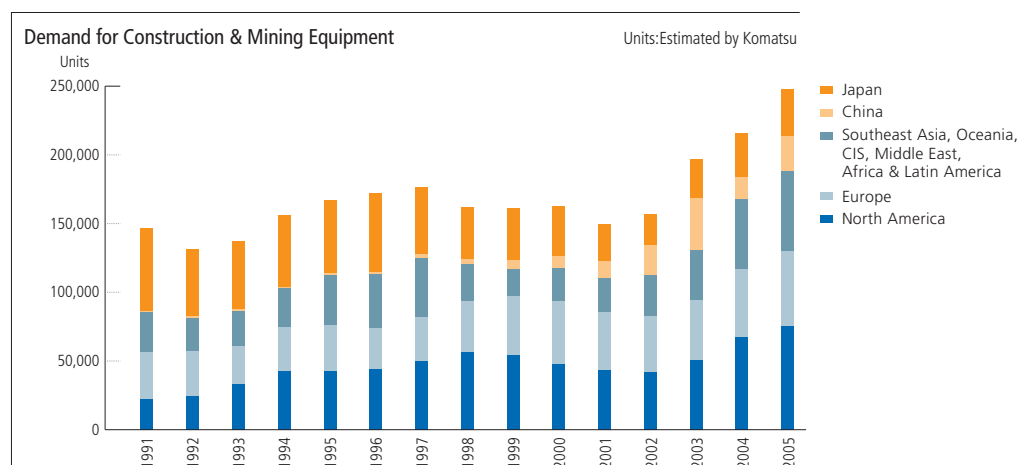
Sakane: When you look at global demand for the equipment in an interval of about 15 years, by excluding the Japanese market and the temporary leveling off of demand mainly caused by the currency crises of 1997 in Southeast Asia, you can see consistent growth with small ups and downs. The Japanese market, which used to account for 40% of global demand, has dropped to about one third in size compared to the bubble days and has bottomed out. So I think it will sustain the current level of demand with some fluctuations accompanied by the economic cycle. In regions other than Japan, North America and Europe, I expect demand to further expand, fueled by infrastructure investments, as their economies continue to grow.

We have aggressively worked to expand concentrated production capacity of key components such as engines, hydraulics and transmissions in Japan for the last few years. Yet, market expansion momentum is greater than the level we anticipated, and thus we are continuing investments in facilities to expand production capacity. With regard to key components, I will keep my stance consistent that we will continue their in-house production with no exception, because the combination of key components decisively determines machine performance and fuel consumption and this is the source of our competitive advantage, facilitating the differentiation from our competitors. Anticipating a further increase in demand, we are expanding production capacity with some additional allowance.

Concerning assembly plants, as I have said earlier, we are building new plants in Japan and India, with an eye to expanding production capacity for large equipment, mainly for mining use. While I was very careful about building new assembly plants until about two years ago, I have concluded that we would have more risks if we didn't invest in new plants and have thus decided for the investments.

The new Ibaraki Plant is being built in Hitachinaka City, Ibaraki Prefecture, about 110km northeast of Tokyo on the Pacific Ocean coast. We paid special attention to build new plants adjacent to international ports. Similar to a new plant for large presses, most of the equipment produced in these plants will be shipped to overseas by oceangoing vessels. By producing them adjacent to the ports, we will be able to cut down transportation costs with substantial reduction of on-land transport. We will also be able to reduce CO₂ emissions, the major cause of greenhouse effects on the earth. We estimate annual reduction of about 2,000 tons of CO₂ emissions just with the Ibaraki Plant.

In India, we are building a new plant in Chennai (formerly, Madras) in the southeast region with 100% investment of Komatsu Asia & Pacific. We are planning to produce dump trucks with payload capacities of 50 to 90 tons for the Indian market where demand for mining equipment is growing.



Applicable Machine Types: 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 : Can you tell us about Komatsu's current efforts to further improve profits in the industrial machinery and forklift truck businesses?

Sakane: Our industrial machinery business includes presses, sheet metal machinery and machine tools, and each company of this business segment accelerated profits for the fiscal year ended last March. While this improvement reflects thriving investments by the automobile industry, which accounts for about 60% of our total industrial machinery sales, it is also the direct result of competitors-differentiated products and services that each company developed and proposed.

Among those, with respect to large AC Servo presses, I have approved the DANTOTSU classification for them. We have seen strong orders for them from automakers, bringing about the need to expand production capacity, so we are building a new plant adjacent to the Port of Kanazawa in Ishikawa Prefecture on the Japan Sea coast. Our Servo presses are the source of our competitive edge in the industrial machinery business, but I am sure that competitors must be working very hard to develop their Servo presses. Since we are ahead in this field, and just to keep our competitors far behind, we are aggressively expanding our product range. To ensure further growth in this field, I believe that we need to propose systems with not only presses *per se*, but also peripheral equipment to further improve customers' production efficiency. So reinforcement of the peripheral equipment business is one of our tasks ahead.

Our forklift truck business has recorded growth in sales and profits for four consecutive years, becoming an entity capable of generating stable profits. Unlike our construction and mining equipment business, this business has a larger percentage of sales in Japan and is very competitive, and thus profitability is still behind that of the construction and mining equipment business. Nevertheless, Komatsu Forklift has steadily increased profitability by launching renewed models and increasing selling prices. Furthermore, they embarked on full assembly of engine-driven forklift trucks in the fast-growing Chinese market last year. I believe it is one of the keys for their future growth to enhance their position in emerging markets like China.

In the industrial machinery and forklift truck businesses as well, we are going to continually compare ourselves with competitors and maintain relative advantages over them.

●● Q : Japanese manufacturers, including Komatsu, are regaining their competitive edge. What do you think you need to further maintain and reinforce this competitive edge in the globally competitive landscape?

Sakane: In the 1990s, Japanese manufacturers were losing their confidence because of the yen's appreciation which eroded profits. Komatsu was one of them. Today, we are regaining our confidence in Japanese manufacturing. However, unless we find out what facts our strengths are based on, we might lose our confidence again. I have thought about our strengths for the last three years or so, and I have determined the following four elements.

First, top management upholds concrete policies and plans based on jobsite footings. To this end, it is important for him or her to look straight at jobsites and in reality, that is, fact finding.

Second, it's policy implementation capability. In the case of Komatsu, I take pride in our speed of implementing top management's directives all the way to the end of the line is something outstanding among Japanese manufacturers. I believe this must be Komatsu's DNA which was imprinted during the years of total quality management in the past, but I am afraid that we are gradually losing it. So I would like to maintain it by all means.

Third, it is solid collaboration not only within the company but also with partners like distributors and suppliers. I believe the collaboration between development and production is especially important. Let me give you a specific example. We have two plants in Tochigi Prefecture, one each in Oyama and Mooka cities. They are about 30 minutes away from each other by car. In the past, the development operation of the products produced at the Mooka Plant was located in the Oyama Plant so that the Mooka Plant engaged in production exclusively.



As it turned out that this 30-minute distance was quite far, it took a longer time for the Mooka Plant to respond to problems compared to other plants. Because of that, we have transferred the development operation to the Mooka Plant. It's my conviction that the coalition of development and production is extremely essential to the extent of physical proximity.

Fourth, it's human resource development. As Japan has few natural resources, people are the most important asset. While we have aggressively worked on human resource development in Japan, we are going to expand the program on a global scale.

As we carry out activities under the second-stage Reform of Business Structure project, we would like to further strengthen these four elements.

Four Aspects that Japanese Manufacturers Must Maintain and Reinforce in Their Globalization

1. Top management's close contact with jobsites
2. Policy implementation capability
3. Collaboration between development and production operations
4. Human resource development

●● Q: Komatsu has honestly worked to strengthen corporate governance. What areas do you think are very important?

Sakane: We have worked steadily to strengthen corporate governance by consistently including reinforcement and thoroughness of corporate governance in mid-range management plans and annual management policies. This annual report describes our organizational framework and what we are doing to strengthen corporate governance. [See pages 14–16.] There are two things in my mind that I do think are very important for Komatsu to further strengthen corporate governance.

First, as the Board of Directors is the core of corporate governance, it is vital to enhance the effectiveness of the Board. To this end, Komatsu ensures that the Board always goes through three processes of reporting, discussions and decision making concerning important management agendas.

The other calls for group-wide reinforcement of corporate governance. To this end, directors, executive officers and senior managers of Komatsu Ltd. are assigned as part-time directors or auditors of subsidiaries. As shareholders, they actively participate in discussions in Board meetings in order to enhance the effectiveness of subsidiaries' Boards of Directors like that of Komatsu Ltd. We are always observed by our shareholders and investors, and we are doing the same to our subsidiaries.

I also make use of our interim and annual business result announcements, that is twice a year, to describe the business results directly to employees. Video recordings of these meetings are also distributed to Komatsu Group employees on the web. By engaging in face-to-face communications with employees, important stakeholders of Komatsu, I strive to share with them the directions that the Komatsu Group must take and the issues that the Komatsu Group is facing. I have asked the top management of subsidiaries to explain the business conditions in their own words directly to their employees.

In the second-stage Reform of Business Structure project, we are working to define our strengths and put them in statutory form as the KOMATSU Way in order to share them with all other Komatsu companies around the world. The KOMATSU Way won't be limited to manufacturing, but will include our ways to strengthen corporate governance. I believe the KOMATSU Way is what must be followed by Komatsu people, by whoever joins the company, and even must continue when the times change.