Komatsu's Growth Strategies

# Message from CFO

## Review of First Year of Mid-Term Management Plan (FY2019–FY2021)

FY2019, the first year of Komatsu's mid-term management plan, DANTOTSU Value – *FORWARD* Together for Sustainable Growth, proved to be a challenging year. Factors behind this difficulty included declines in demand in strategic markets as well as the impacts of the global COVID-19 pandemic that emerged in the fourth quarter of the fiscal year. During the year, Komatsu continued to pursue sustainable increases in its corporate value by building a sound financial position and strengthening its competitiveness. We made steady progress during FY2019 in advancing key initiatives based on the three pillars of growth strategies described in the mid-term management plan. Examples of this progress included the introduction of the SMARTCONSTRUCTION solution and the launch of electric mini excavators. Faced with the current adverse operating environment, we are now pressed to demonstrate the true value of Komatsu that we have cultivated through our efforts to date.


## Financial Strategies Formulated in Response to Operating Environment Changes

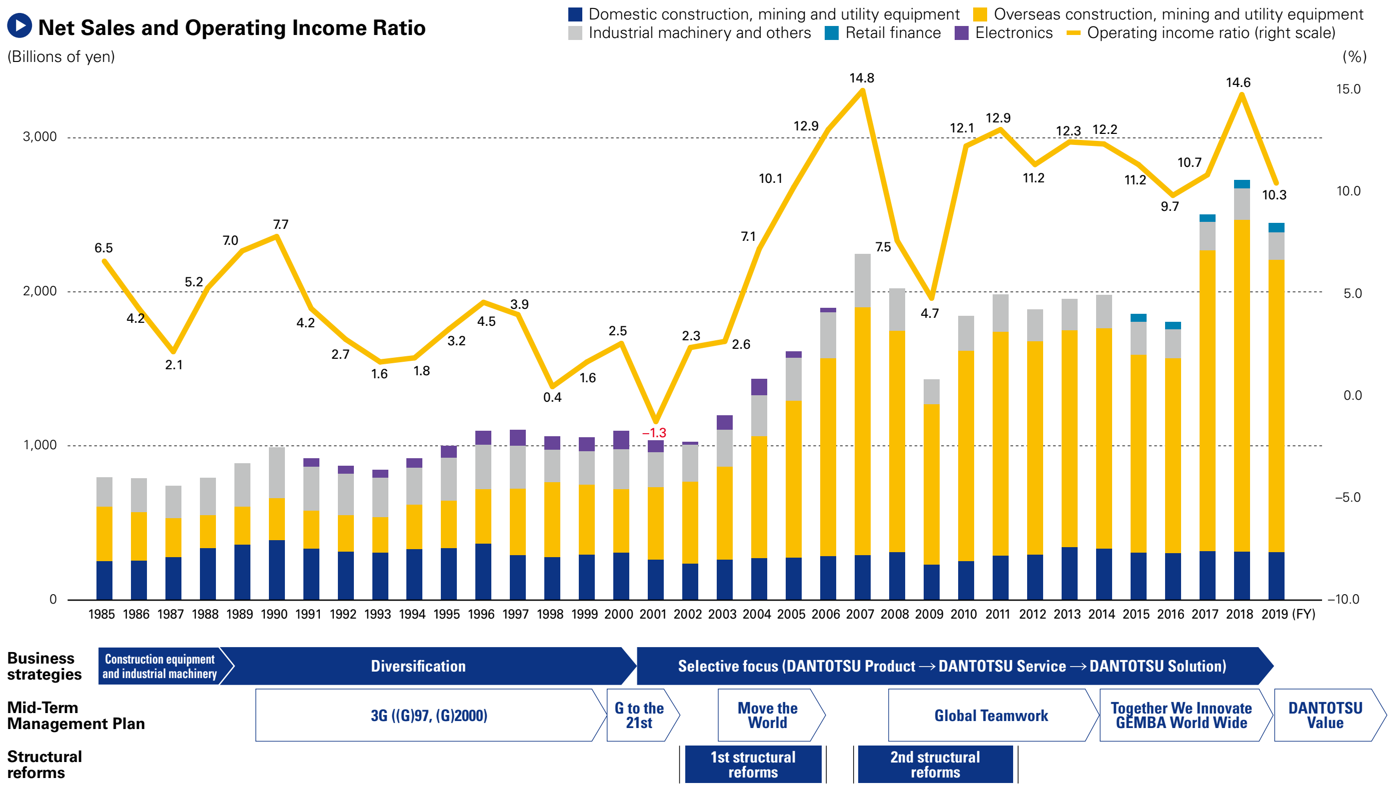
To maximize growth and profits, our accounting and finance departments are responsible for the roles of developing business plans, managing business performance, and studying indices and methods thereof, as well as setting up investment decision-making criteria and making judgment on investment projects.

At the same time, we monitor management indices pertaining to profitability, financial soundness, and asset efficiency, areas for which we have defined management targets, in light of the volatility in demand in the construction and mining equipment business.

In regard to profitability, we strive to build a financial position capable of weathering drastic market changes, and we will continue to thoroughly control fixed costs to this end. Fixed costs have been on the rise over the past several years as a result of M&A activities. However, we have also made steady gains in efficiency through post-merger integration of the operations of acquired companies. In FY2019, we were able to absorb the rise in expenses for increased costs stemming from investments in growth areas through reductions in general expenses. As a result, total fixed costs were relatively unchanged year on year. As for financial soundness and asset efficiency, we began working to cut inventory assets in the first quarter of FY2019. These efforts saw us systematically adjusting production levels while seeking to lessen the impact on our suppliers from these efforts. As a result, inventories stood at ¥805.3 billion on March 31, 2020, down ¥32.2 billion from the previous fiscal year-end. However, the inventory turnover period remains slightly above our ideal level, due in part to the impacts of the global COVID-19 pandemic. There is thus a need to further shorten this period as we move toward the end of FY2020.

When selecting fund procurement sources, we aspired to secure funding reliability by considering factors such as source diversification and continuity along with procurement costs. Komatsu also issued its first green bond in July 2020. Through these bonds, we hope to spread awareness regarding Komatsu's efforts to address environmental issues while also expanding our investor base.

**Net Sales and Operating Income Ratio**



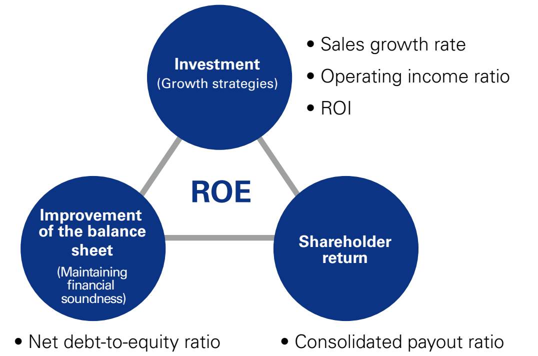

Note: Concerning the figures for the fiscal year ended March 31, 2002 and earlier, Komatsu Electronic Metals Co., Ltd. and its subsidiaries and outdoor power equipment (OPE) of Komatsu Zenoah Co. and its subsidiaries engaging in the OPE business were not reclassified as discontinued operations resulting from the sale thereof.

## Growth (Fund Allocation Policy)

In order to achieve sustainable growth, we are targeting a well-balanced allocation of our funds to 1) investment for growth, 2) improvement of the balance sheet (maintaining financial soundness), and 3) shareholder return.

In FY2019, net cash used in investing activities totaled ¥190.9 billion, an amount equivalent to roughly 65% of the net cash provided by operating activities of ¥295.1 billion. One specific target of investments was the acquisition of mining- and forestry-related companies for the purpose of fueling future growth. Meanwhile, we accumulated cash and deposits to ensure our future ability to meeting funding demands in light of the global COVID-19 pandemic. As a result, interest-bearing debt on March 31, 2020 rose to ¥1,012.3 billion, up ¥81.6 billion from a year earlier, while the net debt-to-equity ratio was 0.43 times, unchanged from the previous fiscal year-end. As for shareholder returns, we adhered to the consolidated payout ratio target announced together with our financial results for the six months ended September 30, 2019, issuing returns that made for a ratio of 57.7%, regardless of the impacts of the COVID-19 pandemic.

There is currently no clear end in sight for the global COVID-19 pandemic. Accordingly, we must continue to take a flexible approach in responding to the massive changes seen in the operating environment while setting priorities based on cost-benefit analyses and assessments of strategic value. By advancing key initiatives based on our three pillars of growth strategies through this approach, Komatsu will target sustainable growth.




## Response to the COVID-19 Pandemic

Even prior to the global COVID-19 pandemic, Komatsu has been practicing global cross-sourcing and procurement for equipment bodies and parts. The goal of these efforts has been to absorb the impacts of demand and foreign exchange rate fluctuations. After the COVID-19 pandemic struck, these prior efforts enabled us to minimize the impacts on production by procuring the necessary articles from alternative sources and reallocating inventories. As a result, no issues have been faced with regard to our supply chain as of this point in time. We also are providing support as needed by distributors and suppliers suffering in this challenging environment. This support includes offering payment moratoriums to and purchasing the inventories of these distributors and suppliers.

Moreover, we have taken a number of steps to ensure sufficient liquidity to meet funding needs in this challenging environment. In addition to accumulating cash and deposits, we have concluded new commitment line agreements, namely a yen-denominated line in the amount of ¥300.0 billion and a U.S. dollar-denominated line in the amount of USD1.3 billion. The funds procured through these commitment lines can be distributed to other countries through the Group's global cash management system.

TOPICS

### Issuance of Green Bonds

In July 2020, Komatsu issued its first green bonds, unsecured straight bonds. Komatsu plans to use the proceeds from these green bonds to research and develop, promote, and popularize its products, such as hybrid hydraulic excavators and electric construction equipment; fuel-efficient operation support services utilizing offerings like KOMTRAX (Komatsu Machine Tracking System); and SMARTCONSTRUCTION and other ICT-intensive construction equipment. With these products, we will aim to contribute to reduced $CO_2$ emissions from product use. Komatsu also plans to use these proceeds for capital investment in facilities and equipment that help reduce $CO_2$ emissions in manufacturing and increase the ratio of renewable energy use.

In this manner, the issuance of green bonds has enabled for the diversification of procurement sources and the expansion of our investment base while also supporting the accomplishment of targets set for environmental, social, and governance (ESG) factors in the mid-term management plan. Going forward, the proactive and ongoing issuance of such bonds will be positioned as an ESG initiative to be advanced by our accounting and finance departments.

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## Profitability

### Operating Income Ratio

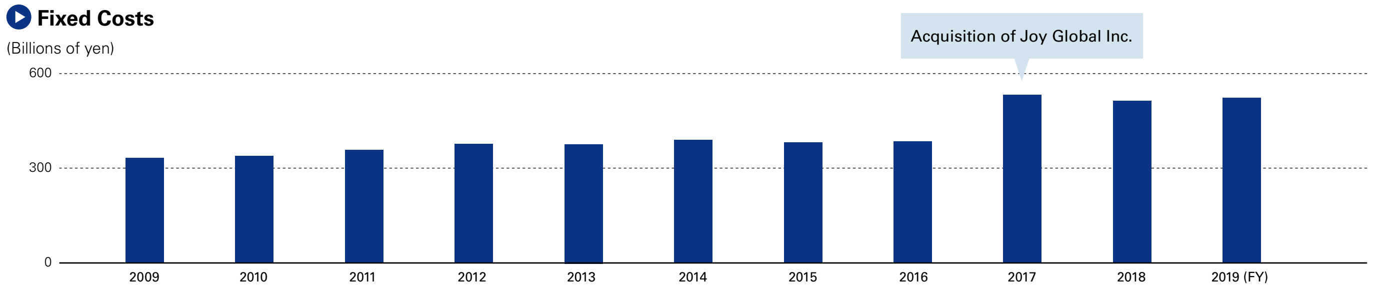
As the industry leader, it is important for Komatsu to maintain and increase sales prices while pursuing ongoing reductions in cost of sales and fixed costs. The operating income ratio is an index that comprehensively reflects our success in these tasks and is therefore an important indicator for evaluating this success. In the mid-term management plan, we have set the target of maintaining an industry's top-level operating income ratio. In FY2019, operating income came to 10.3%. This outcome was largely due to the heavy impacts of reduced sales volume, as partially affected by the global COVID-19 pandemic, a change in the geographic composition of sales, and adverse effects of the Japanese yen's appreciation. These unfavorable circumstances outweighed the benefits of our efforts to increase selling prices and absorb the rises in fixed expenses attributable to investment in growth areas.

### Cost Control

While making investments in growth areas, we have taken exhaustive steps to reduce cost of sales and fixed costs, thereby working to secure profitability (separation of costs from growth). In FY2019, we pursued steady decreases in cost of sales while also cutting general and other standard fixed costs. Meanwhile, efforts were made to limit fix costs associated with investments in growth areas by assessing and prioritizing investments based on strategic value.

**Fixed Costs**

(Billions of yen)



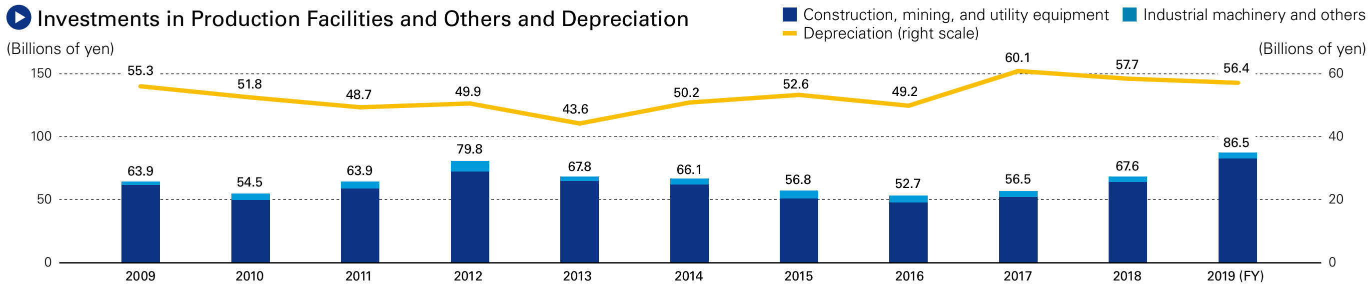

Note: Amounts for performance from FY2009–FY2019 have been translated based on the foreign exchange rates in the projection for FY2019 performance (JPY108.7 = USD1, etc.).

## Decision-Making of Investment

Concerning specific investment projects, we make careful decisions after considering strategic value and payback periods in our Strategy Review Committee and Steering Committee meetings. Based on these efforts, we are working to achieve growth and improve profitability above the industry's average. As for key initiatives currently underway, we will be sure to collect the returns on our investments after the initiatives have been completed to fuel ongoing growth.

**Investments in Production Facilities and Others and Depreciation**

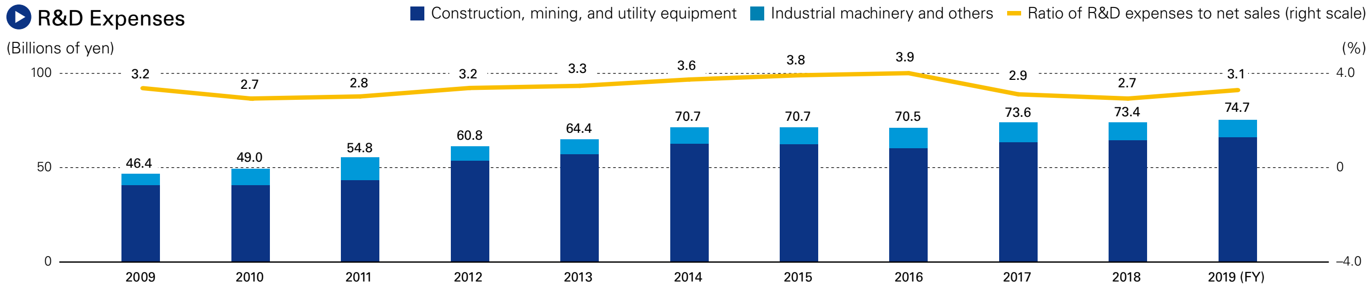
(Billions of yen)




Note: Excludes investments in rental assets

**R&D Expenses**

(Billions of yen)

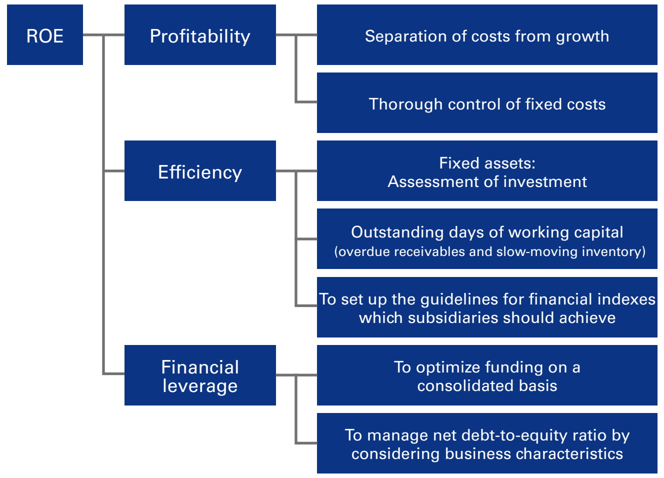



## Efficiency

ROE (return on equity) is a general index, covering profitability, asset efficiency, and financial leverage. Thus, we monitor it as one of our management indices while continuously keeping close attention to cost of shareholders' equity.

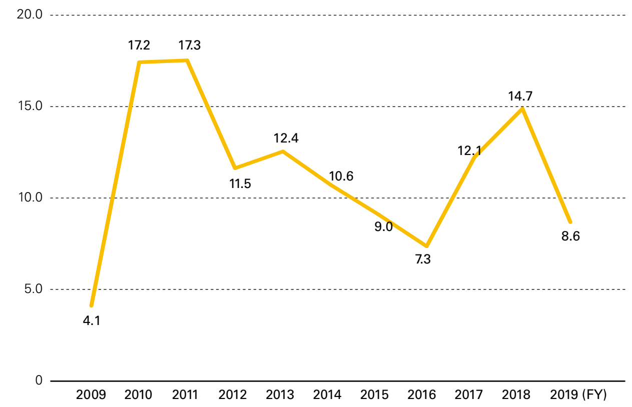
We estimate that our cost of equity is around 8% on a global basis. Thus, we have set an ROE of 10% or higher as the management target. To expand equity spread (ROE – cost of shareholders' equity), we will work to both improve ROE and reduce cost of shareholders' equity.

To promote improvement of ROE, we will work to improve profitability by giving weight to growth. Concerning asset efficiency, we apply ROIC (return on invested capital) to internal control. To control working capital appropriately in response to the volatility of market demand, we periodically monitor the cash conversion cycle of working capital through ROIC, for which invested capital in the ROIC formula is defined by the corresponding working capital plus tangible fixed assets. We recognize that improving asset efficiency is a task that we will need to emphasize over the foreseeable future, and we intend to ramp up efforts to curtail inventory assets to this end going forward.




**ROE**

(%)



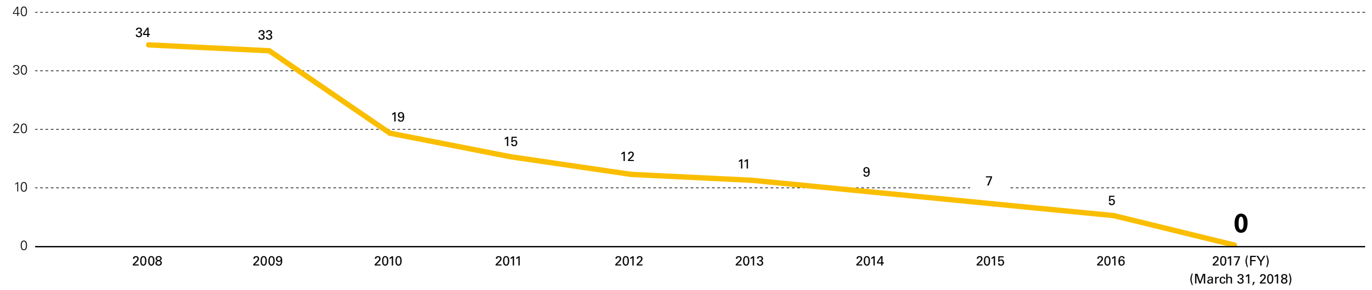

### Cross-Shareholdings

On March 31, 2009, Komatsu held shares of stock in 34 listed companies in the form of cross-shareholdings. Since then, we have proceeded to curtail such shareholdings while confirming those holdings that we continued to hold offered quantitative and qualitative benefits that exceeded the associated cost of shareholders' equity. As a result, these holdings had been decreased to five companies on March 31, 2017. It was during this period that the Tokyo Stock Exchange enacted Japan's Corporate Governance Code in 2015. In response to this code, Komatsu put forth a policy of not owning stocks of listed companies, unless they are necessary due to business relations or collaboration with the Company, for the purpose of avoiding the risk of stock price fluctuation as well as ensuring the efficiency of assets.

Later, a revision to U.S. GAAP standards prompted the Company to adjust profit figures to reflect gains and losses on valuation of marketable securities from FY2018. It was judged that the remaining five holdings, in general, offered satisfactory quantitative benefits. However, it was decided to sell all of these holdings through a reevaluation of the relations between the Company and the investees and the potential impacts of stock price fluctuations on profits. All of these holdings were sold as of December 2017.

**Cross-Shareholdings (Non-Consolidated)**

(Number of holdings)



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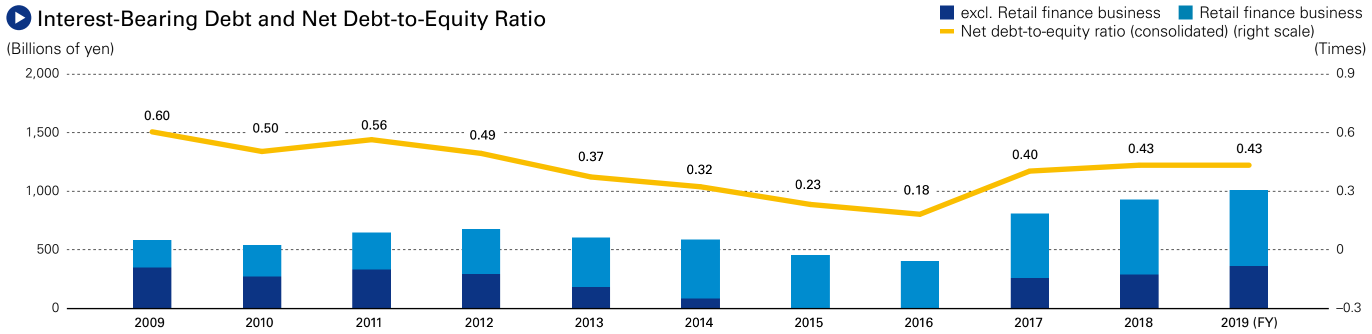
# Message from CFO

## Financial Position

### Monitoring of Net Debt-to-Equity Ratio

We believe it is important to maintain a sound financial position in order for us to achieve sustainable growth while being free from changes in market demand. Taking into account the business characteristics of retail finance and future investment opportunities, we monitor net debt-to-equity ratio as an index of soundness.

Interest-Bearing Debt and Net Debt-to-Equity Ratio




### Optimization of Funding on a Consolidated Basis

To optimize funding on a group-wide basis and reduce foreign exchange risks by matching assets and liabilities in each currency, we have built a funding system by region and maintain the policy of local funding. Equipped with a local funding function, each regional headquarter company advances funds to Komatsu Group companies regardless of business segment in the corresponding region mainly through the cash management system (CMS) for the region.

Furthermore, a global CMS has been established to link all regional headquarter companies, including the company in Japan. Through this system, we practice efficient funding on a consolidated basis to complement the funding sources used in each region under normal circumstances. In addition, we have established new yen- and U.S. dollar-denominated commitment lines through which the procured funds can to be supplied to different regions to function as a safety net for times of emergency.

## Retail Finance Business

### Role of the Retail Finance Business

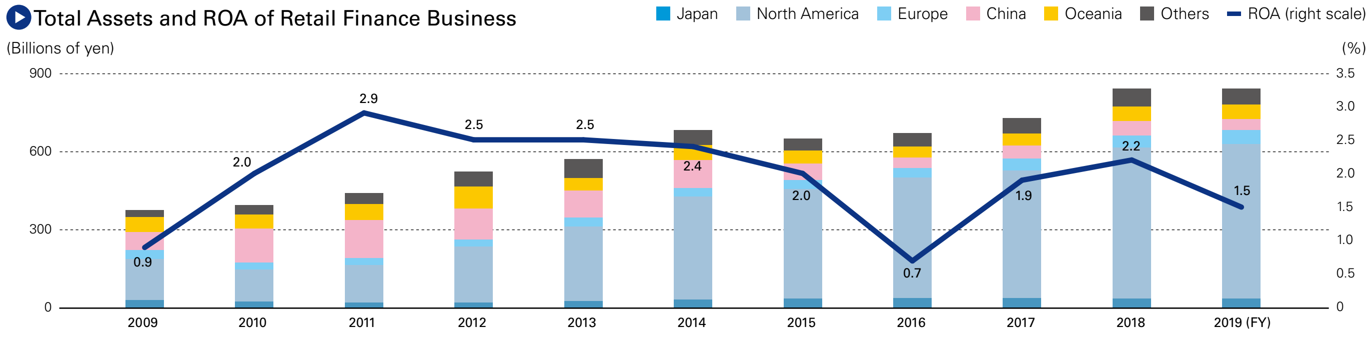
Our retail finance business, which handles financial products to help customers purchase our products, was separated into an independent business segment in FY2016. This segment is pursuing its own segment-specific management targets (1.5%–2.0% for ROA and 5 or under for net debt-to-equity ratio) to ensure transparency of profitability and financial conditions. This segment is also responsible for promoting sales our products. From this perspective, we are focused on generating synergies in this segment through measures such as financing forest machines, a key initiative of the mid-term management plan, in addition to financing mainstay construction and mining equipment.

### Risk Management of the Retail Finance Business

In an effort to reduce risks in the retail finance business, we diversify portfolios and match the currencies, interest rates, and periods of lending and funding. In addition, we also work to safekeep our credits by taking advantage of our strengths, for example, by using KOMTRAX, installed in our construction equipment as a standard feature, for credit management (monitoring the location and operating conditions of construction equipment).

Risk management is now more important than ever given that it is currently unclear when the global COVID-19 pandemic will end. We have received requests for payment moratoriums from certain customers and distributors as a result of the pandemic, and we are responding to these requests while confirming factors such as past histories of overdue payments.

Total Assets and ROA of Retail Finance Business

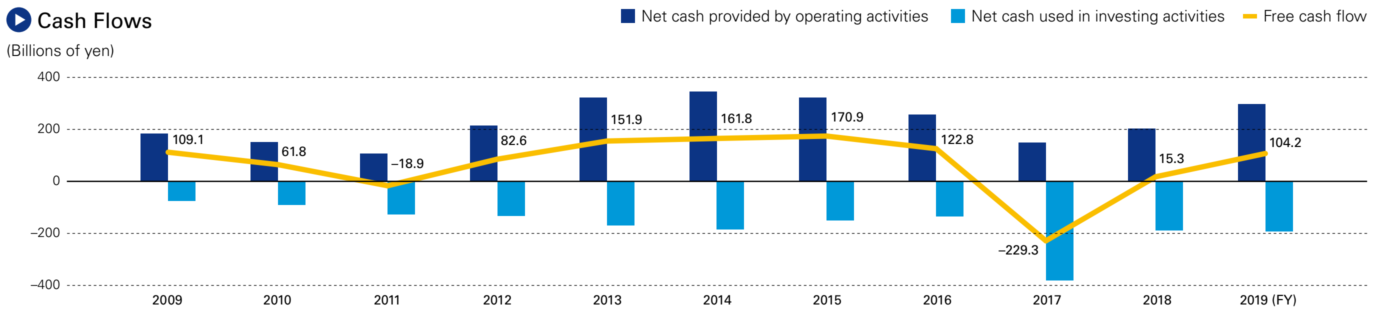



## Shareholder Return

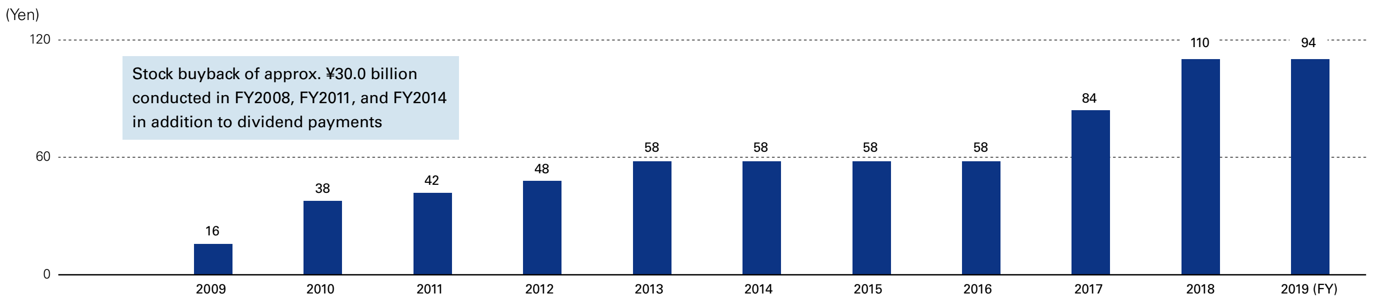
Concerning cash dividends, we have the policy of continuing stable payment of dividends after comprehensively considering consolidated business results and reviewing future investment plans, cash flows, and the like. Specifically, we have the policy of maintaining a consolidated payout ratio of 40% or higher. In FY2019, we issued dividend payments of ¥94 per share, a decrease of ¥16 per share from FY2018, out of reflection of performance in this fiscal year as well as the future business outlook. These payments made for a consolidated payout ratio of 57.7%, an increase of 17.2 percentage points year on year.

Concerning stock buybacks, we plan to do so timely and flexibly in response to market and financial conditions.

Cash Flows




Cash Dividends per Share




| Dividend policy | 20%–40% | | | | 30%–50% | | | 40%–60% | | | 40%~ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Consolidated payout ratio (Total return ratio) | 38.0%* | 24.4% | 24.2% [42.2%] | 36.2% | 34.7% | 35.8% [55.2%] | 39.8% | 48.2% | 40.3% | 40.5% | 57.7% |

* Excluding structural reform expenses