

Dialogue Session between Komatsu's Outside Director and Investors

Date: Thursday, December 5, 2024 14:05–14:50

Speaker: Naoko Saiki, Outside Director, Auditor of the International Law Association of Japan

Moderator: Do you feel Komatsu's Board of Directors is effective?

Saiki: I was appointed as director in June 2021, and I recognize Komatsu's Board of Directors as being highly effective. Komatsu endeavors to enhance and accelerate its management decision-making process at its Board of Directors meetings, while also trying to conduct stricter management and supervision of its execution of duties. In my opinion, Komatsu is a considerably steady and reliable company that strives to reform and strengthen its governance system, especially in terms of improving transparency and objectivity through outside directors. A total of 16 Board of Directors meetings are held annually, including those for approving financial results. Sufficient time is allocated to each agenda item, with important matters addressed as discussion items before they are taken up as agenda items to be voted on. In some cases, matters are freely discussed repeatedly, with ample time and careful consideration given before any resolution is reached. Such unique ways of setting agenda items also help enhance the effectiveness of board meetings. Agenda items are categorized into items to be decided, reported, and discussed, according to a set of criteria. Periodic reports made by each division cover almost all of Komatsu's businesses on a consolidated net sales basis, leading to extensive discussions at the board meetings. The Board of Directors is composed of nine directors, of whom five are internal directors and four are outside directors. Of the five Audit & Supervisory Board Members, two are standing members and three are outside members. One of the internal directors is the Chairman of the Board, who has no representative authority and isn't directly involved in the execution of business. I don't think the balance between internal and external members is a major concern for now but, from the viewpoint of ensuring governance, some argue that outside directors should comprise a majority of board members, and the matter has been under repeated discussion at the Board as well as the Nomination Advisory Committee. The Board members are diverse in terms of gender, specialty, nationality, background, etc.

Audience member: In a discussion session featured in Komatsu's integrated report, Director Saiki talks about the two-line model strategy, pointing out that other scenarios should be prepared. What kind of scenarios do you specifically mean?

Saiki: My views are from both macro and micro perspectives. In macro terms, I believe Komatsu should assume diverse scenarios if it wants to remain competitive amid the rapidly changing external environment and secure its sales capability in the market. In micro terms, my concern is whether it is effective to uniformly implement the two-line model strategy across all strategic markets. The two-line model strategy for construction equipment aims to provide models for light-load applications at lower prices in strategic markets, but my point is that the strategy may need to be tailored to the market features of each country or region. For example, in Indonesia, it may be highly likely that light-load application models will sell well, resulting in horizontal expansion of the business across the country, but this may not be the case in other countries. Komatsu may need to consider concrete country/region-specific strategies to introduce different models to each market. This approach will incur costs, and needs to be studied to see if it's actually appropriate, but I wanted to bring this matter up because it hadn't been discussed at Board meetings. Furthermore, as part of the two-line model strategy, Komatsu could start offering a secondary brand. I personally had this scenario in mind, although it requires substantial and comprehensive consideration. At any rate, cannibalization is an issue that will always come up, so we'd like to consider the scenarios with a focus on Komatsu's profitability and market shares. Also, right now Komatsu only adopts the two-line model strategy for its construction equipment and not for its components, whereas our competitors provide components under secondary and tertiary brands. The matter is being discussed internally. In my view, components based on a two-line model strategy need to be launched on the market on a trial basis. In the discussion featured in the integrated report, I wanted to suggest that a range of scenarios should be considered.

Audience member: With regard to Komatsu's remuneration system for directors, the proportion of stock-based remuneration is low at about 30% in contrast to CAT's 70%. I believe that stock value rises more when shareholders and directors have a common interest. What do you think about this? In relation to the directors' compensation system, is leverage maintained at a low level because financial soundness is a part of its KPI?

Saiki: As for your contention that the proportion of stock-based remuneration should be increased, I'd like to bring to your attention the fact that changes in the stock-based remuneration system were approved at the shareholders' meeting in June following discussions at the Compensation Advisory Committee. First, a trust-type stock-based remuneration system was introduced in place of the restricted stock compensation system. Second, the maximum amount of Stock-Based Remuneration A, or the remuneration linked to consolidated performance for a single fiscal year, was increased from 12 months' worth to 15 months' worth of monthly remuneration, which resulted in an increase in the total maximum amount of consolidated performance-linked remuneration for a single fiscal year including bonus from 24 months' worth to 27 months' worth of monthly remuneration. I regard this revision to be appropriate from the perspective of shareholders. The remuneration amounts for the CEO and directors of CAT are far higher than the amounts at Komatsu. We need to discuss the ratio between stock-based remuneration and cash by comprehensively taking this difference into consideration.

As Komatsu formulates the next mid-term management plan, discussions are underway as to how financial soundness metrics should be incorporated into KPIs, and the topic is also taken up at the Compensation Advisory Committee. We will delve deeper into this matter going forward.

Audience member: During your three-and-a-half-year tenure on the Board, have there been any changes in dialogues with the capital market and discussions regarding capital allocation? In particular, given the Tokyo Stock Exchange's approach to promote management that is focused on capital costs and stock prices, how have deliberations at Komatsu's board meetings changed in the eyes of an independent director? Also, did the change in TSE's policy have any impact on Komatsu's decision on this fiscal year's share buyback?

Saiki: Komatsu has always valued communication with the capital market, so the TSE's new policy hasn't brought about any sudden changes, but we are seeing deeper discussions concerning management's focus on the cost of shareholders' equity and stock prices. For example, the Board has discussed repurchases of shares and carried out a comprehensive review of the shareholder return policy and financial conditions. I have no objection to this fiscal year's share buyback, and believe that the timing and scale of it were appropriate. Basically, we place the highest priority on making investments for growth and enhancing corporate value but, at the same time,

we are committed to a dividend payout ratio of 40% or more as shareholder return, and also strive to ensure a sound balance sheet in preparation for future M&As. The Board actively discusses these matters in an effort to increase corporate value for shareholders.

Audience member: I understand that you have started freely discussing the next mid-term management plan. What issues do you think the current mid-term management plan has? Under the current plan, targets are not set in absolute figures but in relative terms compared to industry figures. Considering that the plan is a tool for the company to communicate its strategy to investors, I believe that it is important to include cash allocation in absolute amounts, along with whether cash flow can be generated easily, over the next three years. There must be better ways to present targets, setting aside whether or not the figures can be achieved. I also feel that the stock market has not fully recognized Komatsu's growth stories and growth strategies. Perhaps there is room for improving how you communicate specific initiatives such as Smart Construction as part of the company's growth stories. Please share your policies in formulating the next mid-term management plan.

Saiki: Setting aside whether its targets are relative or absolute, the current mid-term management plan has been successfully implemented as planned toward the targets. I take your point about absolute figures being more appropriate for better communicating the company's message to the market, and will consider the matter going forward.

You are also quite right about our growth stories. I believe Komatsu is a company that steadily achieves results, but the market may not be aware of the sense of excitement it delivers. The important thing is to make strategic plans, execute them steadily to maximize the company's earning power, and share its exciting innovation-driven future growth stories. In the next mid-term plan, I particularly hope to present the company's innovation-based progress in carbon neutrality and DX toward a dream future. Strengthening human capital is another area we focus on. Strategies to recruit and empower human resources will be a major part of the next plan, and we will implement them with speed.

Audience member: My question concerns your assessment of Komatsu's advocacy activities in the United States and what challenges you perceive. In Japan, Komatsu is making substantial achievements through Smart Construction, which aligns with

the i-Construction initiative led by Japan's Ministry of Land, Infrastructure, Transport and Tourism. Meanwhile, in the United States, the home market of Komatsu's competitor, I believe regulatory, legal, and tariff-related issues stand in the way of proliferating Smart Construction and other innovations. I'd like to ask you whether Komatsu is actually working on these issues to develop its business in the country.

Saiki: I appreciate your positive assessment of Komatsu's leadership in advancing public-private initiatives in Japan such as i-Construction. In contrast, there should be more we can do in America. Networking is key for this. We must find key people and obtain information from them, while permeating Komatsu's ideas through them. It won't be easy to identify appropriate key figure but, with advice from the International Advisory Board (IAB) and other external experts, I believe we will be able to step up our activities in America.

Audience member: With regard to your concerns over the possible geopolitical and other impact on Komatsu under the new Trump administration, what added value do you bring to the Board of Directors and what initiatives are you working on?

Saiki: It is difficult to predict which direction America will head in under the new Trump administration. Many experts point out that if tariffs are raised, illegal immigrants are deported, drastic tax cuts are made, and regulations are eased, America could face tremendous inflation. They also refer to the expected deep impact on the global or U.S. economy if President-elect Trump focuses on increasing tariffs. An article published in the New York Times in early November reported that Mr. Trump, during his presidential election campaign in 2016, criticized Komatsu in association with his concerns about the declining U.S. manufacturing sector. The article also pointed out that, during his second election campaign in 2024, he denounced Komatsu again for generating profit unfairly from the depreciation of the yen. However, Komatsu is a global company as well as an exporter in the United States. Its exports from the U.S. exceed its imports into the U.S. by the one-billion-dollar level per year, with cumulative exports from the U.S. in the past decade surpassing imports into the country by the eight-billion-dollar level. Employing over 8,000 people in the country, or twice as many when including distributors, Komatsu greatly contributes to the U.S. economy and by no means gains unfair profits. This needs to be made clearer to the public. We need to simulate the geopolitical and other risks anticipated under the new Trump administration, and should also strengthen our global cross-sourcing

and multi-sourcing plans to prepare for increased tariffs. Together with the executive divisions, I will bear in mind the significance of these points, and will continue with our efforts to consider the best way forward.

Audience member: There was a question earlier about the balance between Komatsu's growth investments, shareholder returns, and financial soundness. I think the elements are well balanced in view of enhancing corporate value. Komatsu controls fixed costs, invests in growth, and conducts share buyback as part of its shareholder return strategy. However, considering that its 15-billion-yen growth investment on underground mining is barely contributing to net sales and its free cash flow is higher than 300 billion yen, perhaps your share buyback of 100 billion yen could have been greater. I can understand that Komatsu's business faces cyclical performance fluctuations but, since its financial performance is becoming more stable thanks to components and services, I presume you have room to expand your growth investments and shareholder returns. Do you think Komatsu's cash allocation is well balanced?

Saiki: As you say, I believe investment for growth is crucial, but I would like you to understand that investments made this year will not bring immediate earnings. For example, last year we acquired American Battery Solutions (ABS), a start-up firm that developed and manufactured battery packs such as lithium-ion storage batteries. The company now supplies battery packs for commercial vehicles. The acquisition enabled Komatsu to advance into the battery business. ABS currently has a negative impact on Komatsu's earnings, but we judged that the acquisition was an indispensable step to enhance the company's future corporate value. By making such growth investment from the medium- to long-term perspective and increasing earnings, corporate value can be increased. Further, in the areas of carbon neutrality, electrification, remote control, and automation, we not only conduct proprietary R&D activities but also acquire and enhance new technologies through open innovation, partnerships, and M&As. Cash must be allocated primarily to strategic growth investments.

Audience member: Komatsu has been making growth investments in electrification, automation, Smart Construction, etc. Do you consider the investments to be insufficient?

Saiki: In the case of Smart Construction, our growth investment has not quite reached the level we planned, partly due to the yet-to-develop market. We are more than eager to make the investments, but the market is not ready for it. We are discussing ways to navigate through this difficulty.

Audience member: The role of outside directors is to prevent the company from running off course and to provide new insights. What added value do you think you bring to Komatsu? Please share past examples of proactive actions taken by outside directors for Komatsu, if any.

Saiki: Komatsu's management team rarely "runs off course." Rather, we are eager to give them a push. Specific areas of proactive engagement by outside directors include brand strategy and public relations strategy. Komatsu conventionally refrained from spending on advertising but, after discussions among outside directors, we told the management team that human resources were indispensable for Komatsu to achieve growth and enhance its corporate value and, for this, it was imperative for the company to improve its brand power. To attract new graduates and mid-career personnel, Komatsu needs to widely publicize what it does. The company must also hire people across the world. In an effort to enhance brand recognition and strengthen its global brand, Komatsu signed a principal partnership agreement with the Williams F1 racing team and an official sponsorship agreement with KidZania Tokyo. I believe these steps have helped us make progress in our brand strategy this year.

(End)