Kubota Corporation

Result Briefing for the 1st half of FY2020 ending December 31, 2020

Q & A Session　(Conference call, August 7, 2020)

Q.　Regarding revenue in North America in this fiscal year, you expect a 6% decline from the prior year on a local currency basis. Is your forecast based on the assumption that dealer inventory level rises to 5.3 months stock? Would you tell us about your outlook for retail sales and wholesale from now on, and the possibility that revenue in North America will exceed your forecast?

A.　Our forecast is based on the dealer inventory level of 5.3 months stock at the end of this fiscal year. We believe that retail sales will continue to be favorable, but wholesales will not keep up with strong retail sales. We really would like to increase our wholesale corresponding to the increase in retail sales, but wholesales will continue to be delayed compared to retail sales. One of the reasons for that was because we had no choice but to shut down our plants this spring due to the impact of the infection spread of COVID-19. Furthermore, at the end of March and early April, the impact of COVID-19 was extremely uncertain, therefore we lowered our production plan. However, our retail sales were much stronger than expected, so this reduction in production impacted on our business results in the 1st half of this fiscal year so much. As a result, the gap between our retail sales and wholesales is expected to continue until the end of this fiscal year. In addition, some parts are purchased from suppliers in India. Although the supply of such parts is not disrupted, it is difficult to increase production under the circumstances of the lockdown. Our plants in the U.S. and Japan manufacture products as usual at this time, but production increase is difficult. Therefore, the situation that the volume of wholesale is lower than that of retail sales will continue until the end of this fiscal year. However, there are considerable uncertainties in the future, including the upcoming Presidential Election, so I think this level of dealer inventory may be at an appropriate with the wisdom of hindsight.

Q.　The impact of COVID-19 on revenue is estimated at JPY158 billion on a full-year basis. Accordingly, it is my understanding that the impact of COVID-19 on operating profit is estimated to be the range from the higher JPY40 billion to JPY50 billion based on the simple calculation. Is my understanding correct? In addition, which is the main region that the negative impact of COVID-19 on sales appear prominently?

A.　Regarding the effect of COVID-19 on operating profit, the sales reduction of JPY140 billion YoY is expected to impact on operating profit by minus JPY37 billion in our latest forecasts. The total amount of the negative impact of COVID-19 on revenue is about JPY158 billion, so the negative impact of COVID-19 on operating profit is higher than JPY370 billion. In addition, the negative impact of the decline in the operation capacity in our plants caused by COVID-19 is expected to be JPY9 billion this year. Furthermore, there was a JPY8.7 billion impact by the deterioration in profitability along with the reduction of production volume in the 4th quarter of the previous fiscal year. If there are no similar problems in the next fiscal year, I think these negative effects in this fiscal year will be a positive factor on operating profit in the next fiscal in a year on year comparison. I think that the impact of COVID-19 on our sales has been considerable in Japan, Europe, and North America. However, in the U.S., our retail sales remain strong, and the impact of COVID-19 has been seen more in the manufacturing than in retailing. The impact on manufacturing side, which is partly due to our decision to reduce production, has led to a decline in revenue. Meanwhile, retail sales of farm equipment in Europe and Japan have been declining, resulting in a decline in wholesale and production. The sort of impact may be different region by region. Regarding sales of engines for OEM clients in Europe and North America, the impact of COVID-19 has been considerable due to the production adjustment by OEM clients. However, inventory adjustment has been carried out by OEM clients since the previous fiscal year, so it seems difficult to distinguish what the impact of COVID-19 is.

Q. Please explain the outlook of the result of operation in the next fiscal year. I consider that the forecast of operating profit in this fiscal year excluding the impact of COVID-19 is around JPY200 billion, which is the same level as the forecast set originally at the beginning of this period. Is it possible to increase operating profit from the original operating profit forecast of JPY200 billion from the next fiscal year onward? In addition, are there any areas in which you can expand your business opportunities from the perspective of food, water, and the environment under the circumstances with COVID-19?

A. There are many uncertainties about the prospects for next fiscal year, so I would like to refrain from giving a clear answer. However, sales are declining in many areas due to the impact of COVID-19 this year, therefore we can expect an increase in revenue and operating profit accompanied by increased revenue in the next fiscal year, if it completely recovers. Moreover, as inventory adjustment has been carried out in the U.S. and Thailand, it is expected that this will have a positive effect on our business results in the next fiscal year. In addition, deterioration in profitability of production plants, which occurred in the 4th quarter of the prior fiscal year, has been realized in this fiscal year, and the temporary suspension of the plants caused by the infection spread of COVID-19 is expected to have negative effect on our business results of this fiscal year. If there are no such factors in the next fiscal year, I expect that will be a factor behind the increase in profit. However, this is premised on a complete recovery from the negative impact of COVID-19, and it is uncertain whether it can be expected in the next fiscal year. In addition, there may be differences in different regions, so I think that we need to consider the next fiscal year' s forecasts carefully.

Relating to the circumstances after and with COVID-19, I heard that there have been moves to seek housing in the suburbs in the U.S. along with an increase in the number of people working at home, and this move will have positive effect on our business. If this trend continues, housing will increase in suburbs where we are strong, and the needs for gardening and cutting lawn will be growing. In addition, compact construction machinery is used for housing construction, so I think there is a possibility that such a situation will be a positive factor, and we will closely watch it. However, this fiscal year's retail sales in North America have been much more favorable than we expected, so there are some concerns about reactionary decline in the next fiscal year. Therefore, I don' t think that we can be completely optimistic about the next fiscal year.

Q. Regarding the trend of compact construction machinery and medium- and large-sized farm equipment for agriculture, when will the market for them turn around?

A. Regarding compact construction machinery, our retail sales were positive compared to the previous fiscal year, although the demand fell slightly, and we expect this full year's results to be positive year on year as well. The problem is the sales of medium- and large-sized farm equipment, especially in market with more than 60 horsepower. As our largest tractors have 200 horsepower or less, they are not the full-scale farm tractor used for row crop farming, such as corn. Therefore, I think it is important what happens to the market of livestock and dairy farming. In the U.S., the demand is falling in the food industry due to the stay-at-home lifestyle. Recently trade frictions between the U.S. and China have also had some negative effects, so I feel that it will take some period to recover. Consumers are relatively more likely to use tractors with less than 60 horsepower, so the market for them is strong and different from the situation of tractors with more than 60 horsepower. I think this situation will continue in the future.

Q. In the presentation material, there is a comment that the market shares of medium- and large-sized tractor increased. I would like to ask you to explain why your market share increased.

A. We announced the MX tractor last fall, and it resulted in an increase in shipments and retail sales. We have introduced cabin-equipped models with air conditioners, which we hadn' t had in our lineup, and we also introduced model-changed products without cabins. These products enabled us to respond to customer needs more. This is one of the major factors behind the increase in our market share. In addition, for both tractors and construction machinery, we are continually strengthening our dealer network. In particular, as our business is growing, dealers are investing in their facilities. In recent years, some dealers in the U.S. bought larger lands and opened their new shops. Although it is a little difficult to give quantitative information about the impacts, the fact that sales capabilities are improving also seems to have contributed to an increase in our market share.

Q. You mentioned that the prices in the U.S. and Canada had been raised. What is the current situation with regard to trends in selling prices in other regions?

A. We have not raised prices so much except for North America. When we launch a new product, we compare its price with its function, and we make some adjustments in its price. However, we haven't made any large price increases in other regions which we should point out in our operating profit analysis.

Q. I think that revenue is expected to recover in the 2nd half of this fiscal year compared with the 1st half of this fiscal year, but there seems to be no such large quantitative difference in revenue in the 2nd half of this fiscal year compared with the same period in the prior fiscal year. On the other hand, some positive factors have been pointed out, such as recovery in the weather. Are there any negative factors for a growth in the 2nd half of this fiscal year, for example, in the area of manufacturing? Please supplement your view of revenue in Thailand for the 2nd half of this fiscal year and the background behind it.

A. The condition of rain and the crop prices in Thailand are positive factors, and I hope that retail sales will continue to recover. However, sometimes water shortage happens and sometimes too much rain leads to flood, as every year. Therefore, we cannot be too optimistic. Of course, if retail sales are more favorable than expected, it would be possible to increase production a little more and increase sales. However, the market is largely affected by the weather, so at this point in time, it is difficult to predict it. In addition, inventories have accumulated at the end of the previous fiscal year, so we would like to steadily work on the rationalization of inventory level.

Q. I feel that new demand for variety of products are emerging along with the stay-at-home demand and there is a change in needs under the circumstances with and after COVID-19, rather than just a stay-at-home demand. If there are any changes in the market at present, or for next year and beyond, please suggest.

A. Firstly, the stay-at-home demand is not our first experience. We were worried about what would happen at the time of the terrorist attacks in 2001. In the end, people were afraid of flying or going on a vacation, and the market grew contrary to our expectations. I feel that the same thing is happening. At the present time, many of our target customers want to enjoy a country life, and if people working at home increase, they do not need to spend more time on commuting than before. So, people who prefer the lifestyle, such as enjoying cutting lawns and working at gardens at homes with larger plots of land, will increase. The President of the subsidiary in the U.S. says that the impact of COVID-19 is seen more in the urban areas, and not so many people are affected in rural areas. It seems that people living in urban areas are moving to suburbs, and if it continues as a trend, our dealers' location and our offerings will meet. Regarding our construction machinery business, our dealers were not so strong in urban areas, and it has been a challenge to compete in urban areas. However, if housing starts proceed in such areas, it means that dealers are located where they can easily respond to such needs. It is uncertain whether this trend will continue or not, and there will be differences according to region. However, if the direction of the lifestyles in the U.S. and the quality of life that they want remains unchanged, I expect that the sales of our products including construction machinery can grow under the circumstances with or after COVID-19.

Q. Could you tell us how much impact comes from production side out of the decrease in revenue of JPY158 billion caused by COVID-19? In addition, the negative impact of typhoon in the prior fiscal year was also realized in this fiscal year, but I am concerned that the impact by typhoons or COVID-19 is far greater than other companies. If there are any specific issues that your Company faces in terms of manufacturing or procurement, or if you are thinking of improving, could you please let us know?

A. In a very rough figure, I think it is about JPY30 billion to JPY40 billion. As you pointed out, the impact of natural disasters and the pandemic on the bottom line is significant. I think there are two reasons for that. One of them is that, in the past few years, the volume of production has been constantly increasing, and the production capacity has been quite tight. As a result, there is a significant impact if something happens. Second, our suppliers are concentrated on some limited number of companies and this is a part that we must think about in terms of strengthening the BCP in the future. If the number of our products is as large as that of automobile manufacturers, we can have multiple suppliers in several regions. However, in our case, it has been difficult for us to build a diversified layout of supply chain amid a small volume for each model. During the flooding in the previous fiscal year, there was a significant impact on our business results. The reason for that is because the supply of one of the specific parts supplied by just one supplier stopped. Therefore, in terms of short-term responses to such issues, we will review the ideal inventory level of extremely critical parts and involve ourselves in the BCP of our suppliers. As the medium-to-long term approach, we will work to make the supply chain more resilient with diversified suppliers.

Q. You reduced the amount of CAPEX from initial forecast of JPY115 billion to JPY85 billion amid the tight production capacity. What is the content of this revision? I know the amount of CAPEX depends on demand from the next fiscal year onward, but will you increase CAPEX again to more than JPY100 billion?

A. There are several factors to reduce the amount of CAPEX by JPY30 billion. One of the factors is that we postponed an investment to increase production for products other than tractor, construction machinery, and engine, taking into account the market situation. However, the main factor is that there will be delays in the delivery of equipment due to COVID-19. Originally, most of equipment of the JPY115 billion was planned to be received in 4th quarter of this fiscal year, but some of them are expected to be received in the 1st quarter of the next fiscal year or later. As a result, we reduced the forecast largely, but it does not necessarily mean that we intentionally postpone or abandon investments of JPY30 billion. For the next fiscal year and beyond, we will review it once again, including this gap, and taking into account the market conditions from the next fiscal year onward. On the other hand, the original forecast of JPY115 billion included a considerable amount of IT-related investment. I think that we must continue to secure such investment in order to advance DX. So, if we take into account the delay, the amount of around JPY115 billion is quite possible in the next fiscal year. In addition, over the past few years, operating profit margin has been declining, and we have explained that this is due to increases in R&D investment, depreciation due to CAPEX, and fixed costs. As the increase in fixed costs and corresponding increase in sales and marginal profit are not fully matched, we intend to vigorously promote measures to sufficiently cover the funds for continuous R&D and CAPEX both in terms of cash and profit, which were already included in the plans for this fiscal year and will continue in the next fiscal year and thereafter.

Q. Regarding R&D, your employees in R&D department have visited the local areas to get feedback from users aggressively. However, amid the current COVID-19 pandemic, overseas business trip is restricted. Are there any problems in new product development or any delays? I think you hold a dealer meeting in North America in fall to announce a new product in normal circumstances. In that regard, could you tell us whether or not you can do the same as in a typical year?

A. In the short term, there will be no particular impact on the release of new products this fiscal year. However, as you pointed out, some engineers in Japan visited the local areas and conducted planning and marketing activities together with the users in the past to develop new products. Therefore, I am concerned that, if the situation of self-restraint on business trips abroad continues, it will gradually affect negatively on our development. Currently, we are doing our utmost by utilizing local people. However, I cannot say there is no trouble, and I think this will be a mid- to long-term challenge. As for this year's dealer meeting, it will be held, but it would be difficult to get together and show new products as usual. So we are planning to hold a web-based dealer meeting. This is the new initiative, so this year's situation is not the same as in the past.

Q. Please tell us your effort to deal with COVID-19. You don't intend to reduce CAPEX, but please tell us the current situation of efforts to curb short-term costs, including personnel costs and other expenses. In addition, there were discussions about changes in the market along with the stay-at-home demand and review of supply chain, are there any changes in your strategy in the medium- to long-term?

A. The issue of COVID-19 has become remarkable from the end of March. At the stage when we saw a possibility that it has a significant impact on the bottom line of our business results, we began to establish internal project to reduce costs and are carrying out the initiatives. Some of them will be effective in this fiscal year, while others will be effective from next fiscal year onward. We will set internal targets and are trying to reduce costs. Moreover, in the medium- to long-term, we are working on digital transformation within the Company to raise productivity targeting 2023. In addition to cost reduction, we are already facing a number of challenges. In order to allocate the human resources to deal with these challenges, we need to raise productivity. This will be part of the medium-term plan for the five-year period starting in January 2021. We constantly review the business portfolio and the product portfolio, and we need to consider how we have to change our organization considering the next five years. There are some uncertainties about how our customers will change in the market. Unfortunately, we cannot go on a business trip to the local areas, but we will take measures as much as possible in light of the future and want to make changes to our business.

Q. What is the image of the cost reduction you are aiming for through your internal project established this year?

A. I would like to refrain from saying exact figures, but targeting around 2023, we aim to create the net increase of the level of more than JPY10 billion on profit including cost increase along with the necessary investment, which will be compensated by cost reduction.

Cautionary Statements with Respect to Forward-Looking Statements