Operating and Financial Review and Prospects

1. Operating Results

Overview

Organization

The Company is one of Japan's leading manufacturers of a comprehensive range of machinery and products including farm equipment, pipes for water supply and sewage systems, environmental control plants, and industrial castings. The Company also provides credit services, which primarily finance sales of equipment by dealers, for the purpose of enhancing sales of equipment to individual customers.

The Company's business segments consist of "Internal Combustion Engine and Machinery", "Pipes, Valves, and Industrial Castings", "Environmental Engineering" and "Other".

The Company generates revenues and cash primarily from the sales of products to dealers, affiliated companies and trading companies or direct sales of products to end users.

For more than a century since its founding, the Company has continued to help improve people's quality of life and the development of society through its products and services. Currently, the Company is focusing on prioritizing the allocation of its resources, emphasizing agility in its operations, and strengthening consolidated operations. Through these measures, the Company intends to improve its ability to respond with flexibility to the changing times, to achieve high enterprise value.

Business Environment

(Japan: The Domestic Market)

According to report of JFMMA (Japan Farm Machinery Manufacturer's Association), the shipment amount of agricultural machinery in 2008 for the domestic market increased by 1.7% from the prior year. However, this slight rebound was mainly due to increases in product prices by major manufacturers of agricultural machinery and the true picture of market was sluggish.

Budgets for public works projects have been gradually decreasing due to the growing budget deficits in the Japanese national and local governments. For example, the budget of the Japanese Government for the water supply decreased by 6.1% and budget for the sewage system also decreased by 5.2% from the prior year.

(North America)

U.S. Economy entered into a serious recession from the latter half of 2008 and demand for tractors and construction machinery was adversely affected by stagnation in the housing market, worsening sub-prime loan problem and shockwaves from the Lehman Brothers' collapse. According to a 2008 report by AEM (Association of Equipment Manufacturers), industry retail sales units of tractors under 40hp (horse power) decreased by 14.6% and industry retail sales units of tractors from 40 to 100hp decreased by 13.1% from the prior year.

In Canada, demand for agricultural machinery continued to grow and demand for construction machinery was steady. As for tractors, industry retail sales units of tractors in Canada in 2008 increased 20.4% from the prior year according to the AEM report.

(Europe)

The economy in Europe entered a recessionary phase in 2008, which was changed from a favorable economy in recent years. The growth rate of the GDP of 27 countries of the European Union was 0.9%, a decrease from 2.9 % in the prior year.

Demand for construction machinery, which was said to have much sensitivity for economic condition, decreased substantially. Markets of most industrial machinery entered into inventory adjustment phases and demand for engines for industrial use also decreased. Demand for small sized tractors and mowers, which were mainly used by professional mowing companies and governments, was relatively stable in Europe.

(Asia Outside Japan)

The Company believes that development of economy and industrialization as well as an increase in farmers' income in a country are important factors for the progress of agricultural mechanization. GDP per capita in Thailand exceeded US$ 3,000 for the first time several years ago, and demand for agricultural machinery has been rapidly increasing since then due to economic development and out migration of the population from the agriculture sector to other industrial sectors.

In China, government subsidies to enhance agricultural mechanization are increasing each year. As for rice farming, the Chinese government establishes target ratios of agricultural mechanization, and these policies is helping to grow demand for agricultural machinery over the long term.

Revenues

For the year ended March 31, 2009, revenues of the Company decreased ¥47.1 billion (4.1%), to ¥1,107.5 billion ($11,301 million), from the prior year.

In the domestic market, revenues decreased ¥23.0 billion (4.0%), to ¥549.2 billion from the prior year. Revenues in Internal Combustion Engine and Machinery decreased due to depressed sales of farm equipment and engines resulting from stagnant market conditions and substantially lower sales of construction machinery due to demand shrinkage accompanied by economic slowdown. Revenues in Pipes, Valves, and Industrial Castings increased due to a substantial increase in sales of ductile iron pipes and spiral welded steel pipes, while sales of industrial castings decreased. Revenues in Environmental Engineering increased due mainly to increased sales of water and sewage engineering products. Revenues in Other decreased mainly due to a decrease in sales of vending machines and construction.

Revenues in overseas markets decreased ¥24.0 billion (4.1%), to ¥558.3 billion from the prior year. In Internal Combustion Engine and Machinery, sales of combine harvesters and rice transplanters increased favorably, however, sales of engines decreased substantially and sales of tractors decreased slightly. In addition, sales of construction machinery significantly decreased in North American and European markets. Revenues in Pipes, Valves, and Industrial Castings increased due to increased sales of ductile iron pipes, while sales of industrial castings decreased. Revenues in Environmental Engineering decreased, however, revenues in Other increased. The ratio of overseas revenues to consolidated revenues was 50.4%, the same as the prior year.

The Company estimates that the unfavorable impact of foreign currency fluctuations on the Company's overseas revenues for the year under review was approximately ¥65.1 billion. The average rates of yen against the U.S. dollar were ¥103 and ¥118 in 2008 and 2007, respectively, and the average rates of yen against the Euro were ¥152 and ¥161 in 2008 and 2007, respectively. These currency fluctuations mainly influence revenues in the Internal Combustion Engine and Machinery segment, as these products account for most of the overseas revenues.

Cost of Revenues, SG&A Expenses, and Loss from Disposal and Impairment of Business and Fixed Assets

The cost of revenues decreased 1.7% from the prior year, to ¥810.2 billion ($8,268 million). The cost of revenues as a ratio to consolidated revenues increased 1.7 percentage points, to 73.1%. The increase in the ratio was attributable to sharply rising material costs, including those for scrap iron and synthetic resin. The Company estimates that it was negatively impacted by approximately ¥16.0 billion ($163 million) from such sharply rising material costs consisting of approximately ¥11.0 billion ($112 million) in Internal Combustion Engine and Machinery from the increase in prices of thin and thick steel sheets, castings and resin parts and approximately ¥5.0 billion in Pipes, Valves, and Industrial Castings from the increase in prices of scrap iron, synthetic resin.

Selling, general, and administrative (SG&A) expense was ¥193.4 billion ($1,974 million), the same level as the prior year. However, the ratio of SG&A expenses to revenues increased 0.8 percentage point, to 17.5% due to lower revenues of the fiscal year under review.

Loss from disposal and impairment of businesses and fixed assets increased ¥0.3 billion ($3 million) from the prior year, to ¥1.0 billion ($10.4 million).

Operating Income

Operating income decreased ¥34.1 billion (24.9%), to ¥102.8 billion ($1,049 million), from the prior year. Operating income in Internal Combustion Engine and Machinery decreased largely due to decreased demand, appreciation of the yen and price hikes for raw materials. Decreases in operating income in Pipes, Valves, and Industrial Castings resulted from recorded surcharge related to the Anti-Monopoly Law corresponding to ductile iron pipe business. Operating loss in Environmental Engineering shrank, while operating income in Other decreased due to decreased sales of vending machines.

Operating income or loss in each industry segment (before the elimination of intersegment profits and corporate expenses) was as follows: Internal Combustion Engine and Machinery, operating income of ¥103.8 billion ($1,059 million), a 21.9% decrease; Pipes, Valves, and Industrial Castings, operating income of ¥11.3 billion ($115 million), a 25.7% decrease; Environmental Engineering, operating loss of ¥1.1 billion ($11 million), as compared to an operating loss of ¥5.0 billion in the prior year; and Other, operating income of ¥2.7 billion ($28 million), a 68.3% decrease.

Other Expenses

Other expenses, net, was ¥19.6 billion ($200 million), an increase of ¥5.3 billion from the prior year. This increase was mainly due to increases in foreign exchange losses and valuation losses on other investments. The Company recorded a foreign exchange loss-net of ¥11.5 billion ($117 million), increased by ¥2.5 billion compared with the prior year. Foreign exchange gains or losses mainly arises from the revaluation of foreign currency-denominated assets such as trade notes and receivables at the balance sheet date; the difference between carrying value and settlement value of foreign currency-denominated assets; and valuation on foreign exchange forward contracts and options. The large amount of foreign exchange losses resulted mainly from the revaluation of foreign currency-denominated assets such as trade notes and receivables due to the yen appreciation against major currencies during the fiscal year under review. U.S. dollar, Euro and Baht-denominated assets accounted for a large portion of foreign exchange losses. The valuation losses on other investment, which increased ¥1.9 billion, to ¥8.6 billion($88 million), were caused by a stock market declines in Japan and mainly related to the shares of Mitsubishi UFJ Financial Group and that of Tsukishima Kikai Co., Ltd.

Income from Continuing Operations before Income Taxes, Minority Interests in Earnings of Subsidiaries, and Equity in Net Income of Affiliated Companies

Income from continuing operations before income taxes, minority interests in earnings of subsidiaries, and equity in net income of affiliated companies was ¥83.3 billion ($850 million), a decrease of ¥39.3 billion from the prior year.

This decrease was due to a decrease in operating income and an increase in other expenses resulting from increases in foreign exchange loss and valuation losses on other investments.

Income Taxes, Minority Interests in Earnings of Subsidiaries, and Equity in Net Income of Affiliated Companies

Income taxes decreased 40.2% from the prior year, to ¥28.7 billion ($293 million). The effective tax rate was 34.5%. The decrease in tax rate was mainly due to the effect of reversing part of the deferred tax liabilities because of a tax law revision related to the taxation of dividends from overseas subsidiaries.

Minority interests in earnings of subsidiaries was ¥6.7 billion ($68 million), and equity in net income of affiliated companies was ¥0.2 billion ($2 million) at the same level of the prior year, respectively.

Income from Continuing Operations

Income from continuing operations decreased 29.1% from the prior year, to ¥48.1 billion ($491 million).

Income (Loss) from Discontinued Operations, Net of Taxes

There was no income from discontinued operations, net of taxes, because of the completion of the liquidation proceedings of industrial waste disposal operation in the prior year.

Net Income

Due to the factors described above, net income decreased 29.3% from the prior year, to ¥48.1 billion ($491 million). Return on shareholders' equity decreased 2.6 percentage points, to 7.8%, from the prior year.

Income per ADS

Basic net income per ADS (five common shares) was ¥188 ($1.92), as compared to ¥264 in the prior year.

Dividends

The Company paid ¥35 per ADS as year-end cash dividends. Accordingly, including the interim dividend of ¥35 per ADS paid by the Company, the total dividends for the year ended March 31, 2009 were ¥70 per ADS, which was the same as the prior year.

The Company's basic policy for the return of profit to shareholders is to maintain stable dividends or to provide increased dividends combined with share buy-backs and the cancellation of treasury stock. For reference, the Company purchased 8.40 million shares outstanding (¥5.3 billion, $54 million) during the year under review.

Comprehensive Loss

Comprehensive Loss was ¥45.3 billion ($462 million), ¥58.3 billion lower than the prior year. This decrease was mainly due to increase in negative effect of foreign currency translation adjustments resulting from the appreciation of the yen.

Critical Accounting Estimates

The consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The preparation of these statements requires the uses of estimates and assumptions about future events. Accounting estimates and assumptions discussed in this section are those that the Company considers to be the most critical to an understanding of its financial statements.

1) Impairment of Long-Lived Assets

The application of impairment accounting requires the use of significant estimates and assumptions. Impairment testing for assets requires the allocation of cash flows to those assets and, if required, an estimate of fair value for the assets. The Company's estimates are based upon business prospects in accordance with management's authorizations. The Company uses assumptions which are believed to be reasonable and reflect the most recent economic condition, however, those assumptions are inherently uncertain and unpredictable, and would not reflect unanticipated events and circumstances that may occur. Losses from impairment of long-lived assets in fiscal 2009 and 2008 amounted to ¥0.7 billion ($8 million) and ¥0.1 billion, respectively.

2) Allowance for Doubtful Receivables

The evaluation of the collectability of the Company's notes and accounts receivable, finance receivables, and non-current receivables requires the use of certain estimates. Such estimates require consideration of historical loss expense adjusted for current conditions, and judgments about the provable effects of relevant observable data including present economic conditions such as financial health of specific customers and collateral values. Sharp changes in the economy or a significant change in the economic health of a particular customer could result in actual receivable losses that are materially different from the estimated reserve. Allowance for doubtful notes and accounts receivable in fiscal 2009 and 2008 amounted to ¥2.5 billion ($26 million) and ¥2.0 billion, respectively. Allowance for doubtful non-current receivables in fiscal 2009 and 2008 amounted to ¥0.9 billion ($9 million) and ¥1.0 million, respectively. Allowance for finance receivables in fiscal 2009 and 2008 amounted to ¥1.6 billion ($16 million) and ¥1.4 billion, respectively.

3) Revenue Recognition for Long-term Contracts

The Company uses the percentage of completion method to recognize revenue from long-term contracts primarily in construction works with the Japanese national government and local governments. The percentage of completion method requires the use of estimates and assumptions to measure total contracts, remaining costs to completion, and total contract revenues. The Company continually reviews the estimates and assumptions. Any revisions in revenue, cost, and profit estimates or in measurements of the extent of progress toward completion are accounted for in the consolidated statements of income for the fiscal year in which those revisions have been made.

4) Pension Assumptions

The measurement of the Company’s benefit obligation to its employees and the periodic benefit cost requires the use of certain assumptions, such as estimates of discount rates, expected return on plan assets, retirement rate, and mortality rate. The Company immediately recognizes net actuarial gains and losses in excess of 20% of the larger of the projected benefit obligation or plan assets in the year following the year in which such gains and losses were incurred, while the portion between 10% and 20% is amortized over the average participants’ remaining service period. Accordingly, significant changes in assumptions or significant divergences of actual results from the assumptions may have a material effect on periodic benefit cost in the future periods.

In preparing the financial statements for the years ended March 31, 2009, 2008, and 2007, the Company assumed a discount rate of 2.5%. A lower discount rate increases benefit obligations, which could affect the periodic benefit cost in the following years by an increase in service cost, a decrease in interest cost, and, if amortized, an increase in amortization cost through the amortization of actuarial loss. A decrease of 50 basis points in the discount rate increases the benefit obligations at March 31, 2009, by approximately ¥7.9 billion ($81 million).

The Company assumed an expected return on plan assets of 3.0% for the years ended March 31, 2008 and 2007. The Company lowered the expected return on plan assets to 2.5% for the year ended March 31, 2009 in consideration of the revision of the portfolio of pension plan assets by increasing the portion of fixed income securities in order to stabilize the return on plan assets, which increased the periodic benefit cost for the year ended March 31, 2009 by approximately ¥0.5 billion ($5 million).

The lower rate of return on plan assets decreases the expected return amount in the next year. A further decrease of 50 basis points in the expected rate of return on plan assets increases the periodic benefit cost for the year ending March 31, 2010, by approximately ¥0.4 billion ($4 million). On the other hand, the divergence between the expected and actual return on plan assets could affect the periodic benefit cost, if amortized, in the following years by an increase or decrease in amortization cost through the amortization of actuarial gain or loss.

5) Income Taxes

During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. As a result, the Company recognizes tax liabilities based on estimates of whether additional taxes will be due. These tax liabilities are recognized when, despite the Company's belief that its tax return positions are supportable, the Company believes that certain positions are likely to be challenged and may not be fully sustained upon review by tax authorities. The Company uses a more likely than not threshold to the recognition and derecognition of tax positions. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact income tax expense in the period in which such determination is made.

Significant judgment is also required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, the Company considers all available evidence, including past operating results, estimates of future taxable income, and the feasibility of ongoing tax planning strategies. In the event that the Company changes its determination as to the amount of deferred tax assets that can be realized, the Company will adjust its valuation allowance with a corresponding impact to income tax expense in the period in which such determination is made.

Deferred tax assets less valuation allowance in fiscal 2009 and 2008 amounted to ¥73.0 billion ($745 million) and ¥77.8 billion, respectively.

6) Loss Contingencies

The Company is currently facing asbestos-related issues, and is involved in some legal proceedings. The Company reviews the status of each matter and assesses its potential financial exposure on a regular basis. If the potential losses from these matters are considered probable and the amount can be reasonably estimated, the Company accrues a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Because of uncertainties related to these matters, accruals are based only on the best information available at the time. As additional information becomes available, the Company reassesses the potential liability and may revise the estimates. Subsequent revisions in the estimates of the potential liabilities could have a material impact on the Company's results of operations and financial position in the period they are made.

2. Liquidity and Capital Resources

Finance and Liquidity Management

The Company's financial policy is to ensure adequate financing and liquidity for its operations and to maintain the strength of its balance sheet. Through cash and cash equivalents, other current assets, cash flows provided by operating activities, and borrowing, the Company is in a position to fully finance the expansion of its business, R&D, and capital expenditures for current and future business projects. The specific methods of obtaining financing available to the Company are borrowing from financial institutions, establishing committed lines of credit, and the issuance of bonds and commercial paper (CP) in the capital markets.

Annual interest rates of short-term borrowings ranged primarily from 0.20% to 5.41% at March 31, 2009. The weighted average interest rate on such short-term borrowings was 3.1%. As for long-term debt, both fixed and floating rates were included in the interest rates, and the weighted average interest rate on such long-term debt at March 31, 2009, was 2.9%. With regard to the maturity profile of these borrowings, please refer to Item 5.F "Tabular Disclosure of Contractual Obligations".

In the United States, financing by securitization of trade receivables was quite difficult in the year ended March 31, 2009 because of turmoil in the U.S. financial markets. The Company switched the funding source from sale of trade receivables to borrowing from financial institutions. Although the credit crunch occurred from instability of global money market, the Company was able to raise enough funds for business operations soundly and has not encountered financing problems.

Regarding the lines of credit, the Company has established committed lines of credit totaling ¥25.0 billion ($255 million) with certain Japanese banks. However, the Company currently does not use these lines. The Company also maintains a CP program allowing for the issuance of CP of up to ¥100.0 billion ($1,020 million). There was ¥6.5 billion ($66 million) outstanding issue of CP as of the end of March 2009.

The Company utilizes Group financing. With Group financing, the Company centralizes and pursues the efficiency of cash management domestically through the Kubota Cash Management System, under which the excess or shortage of cash at most of its subsidiaries in Japan is invested or funded, as necessary.

To maintain the strength of its balance sheet and help secure adequate funding resources, the Company carefully monitors its interest-bearing debt, excluding debt related to sale financing programs. The Company is providing sale financing programs to support machinery sales in North America and Thailand. The Company believes an increase of debt related to sales financing programs is a result of business expansion. At the end of March 2009, the amount of interest-bearing debt increased ¥38.1 billion, to ¥401.1 billion ($4,093 million). Of the ¥401.1 billion, ¥350.6 billion ($3,577 million) was borrowings from financial institutions, ¥6.5 billion ($66 million) was issue of CP, and the remaining ¥44.0 billion ($449 million) consisted of corporate bonds.

The Company plans its capital expenditures considering future business demand and cash flows. The Company intends to fund the investment basically through cash obtained by operating activities, and to also utilize available borrowings from financial institutions. The Company's commitments for capital expenditures are not material. The Company has underfunded pension liabilities of ¥56.6 billion ($577 million), which relate primarily to the parent company, as of the end of March, 2009. The Company's contributions to pension plans for the year ending March 31, 2010 are expected to be ¥13.9 billion ($142 million).

The Company's basic policy for the return of profit to shareholders is to maintain stable dividends or raise dividends together with repurchases of treasury stock. The Company uses net cash provided by operating activities for these dividends and repurchases.

The amount of working capital increased ¥18.8 billion, to ¥322.0 billion ($3,285 million), from the prior year-end. Additionally, the ratio of current assets to current liabilities increased 6.8 percentage points, to 165.1%, due primarily to switching the funding source from sale of trade receivables to short- and long-term borrowing from financial institutions. There is some seasonality to the Company's liquidity and capital resources because a high percentage of the notes and accounts receivable from local governments is collected during April through June each year. Currently, the Company believes the working capital is sufficient for the Company's present requirements.

All things considered, the Company believes that it can support its current and anticipated capital and operating requirements for the foreseeable future. The currencies in which the Company has its debt are mainly Japanese yen and U.S. dollars. There are no restrictions regarding the manner in which the funds may be used.

There are restrictive covenants related to its borrowings including clauses of negative pledges, rating triggers and minimum net worth. The financial covenants are as follows: the rating trigger covenant states that the Company shall keep or be higher than the "BBB－"rating by Rating and Investment Information, Inc. (R&I) and the minimum net worth covenant states that the Company shall keep the amount of shareholders' equity of more than ¥454.0 billion ($4,633 million) on a consolidated basis and more than ¥322.0 billion ($3,286 million) on a parent company-only basis. The Company is in compliance with those restrictive covenants at March 31, 2009.

<u>Ratings</u>

The Company has obtained a credit rating from R&I, a rating agency in Japan, to facilitate access to funds from the capital market in Japan. The Company's ratings are "A+" for long-term debt and "a-1" for short-term debt as of March 2009 and its outlook is positive. The Company's favorable credit ratings provide it access to capital markets and investors.

<u>Assets, Liabilities, and Shareholders' Equity</u>

1) Assets

Total assets at the end of March 2009 amounted to ¥1,385.8 billion ($14,141 million), a decrease of ¥78.4 billion (5.4%) from the end of the prior year.

Current assets were ¥816.3 billion ($8,330 million), a decrease of ¥6.3 billion from the prior year-end. Cash and cash equivalent decreased and short-term finance receivables decreased resulting from the appreciation of the yen. As a result of reduced sales of trade receivables in North America, trade accounts receivable substantially increased and interest in sold receivables substantially decreased at the same time. Inventory turnover dropped 0.2 point, to 5.4 times. Investments and long-term finance receivables substantially decreased due to a decrease in long-term finance receivables resulting from appreciation of yen and shrinkage of unrealized gains of securities affected by stock market slump. Property, plant, and equipment decreased ¥12.5 billion to ¥225.6 billion ($2,302 million), while other assets increased ¥10.8 billion to ¥63.9 billion ($652 million) mainly due to an increase of long-term deferred tax assets.

2) Liabilities

Total liabilities amounted to ¥769.6 billion ($7,853 million), a decrease of ¥3.4 billion (0.4%) from the end of the prior year.

Current liabilities were ¥494.4 billion ($5,045 million), a decrease of ¥25.1 billion from the prior year-end, interest-bearing debt such as short-term borrowings increased substantially resulting from switching the funding source from sale of trade receivables to borrowing from financial institutions, while trade notes payable, trade accounts payable and income taxes payable decreased. On the other hand, long-term liabilities increased ¥21.7 billion, to ¥275.2 billion ($2,808 million). Accrued retirement and pension costs and other long-term debt increased largely, while other long-term liabilities decreased due to a decrease of deferred tax liabilities affected by shrinkage of unrealized gains of securities.

3) Minority Interests

Minority interests amounted to ¥38.0 billion ($388 million), a decrease of ¥5.3 billion (12.2%) from the end of the prior year mainly due to a decrease in foreign currency translation adjustments of foreign subsidiaries resulting from the appreciation of the yen.

4) Shareholders' Equity

Total shareholders' equity amounted to ¥578.3 billion ($5,901 million), a decrease of ¥69.8 billion (10.8%) from the end of the prior year.

Retained earnings increased steadily due to recorded net income, however; accumulated other comprehensive income decreased substantially due to decreases in foreign currency translation adjustments and unrealized losses on securities. The Company repurchased ¥5.3 billion ($54 million) of treasury stock during the year under review.

The shareholders' equity ratio* was 41.7%, 2.6 percentage point lower than at the prior year-end. The debt-to-equity ratio** was 69.4%, 13.4 percentage points higher than at the prior year-end.

* Shareholders' equity ratio = shareholders' equity / total assets
** Debt-to-equity ratio = interest-bearing debt / shareholders' equity

Derivatives

To offset currency and interest rate fluctuation risks, the Company uses various types of derivatives, including foreign exchange forward contracts, currency swaps, and interest rate swaps. As a basic policy, the Company conducts its derivative transactions within the range of its outstanding credit and obligations, and the Company does not engage in speculative derivative transactions. The counterparties for the Company's derivative transactions are financial institutions with high creditworthiness; therefore, the Company does not anticipate any credit losses on such transactions. For more specific details, please refer to Note 13 to the consolidated financial statements.

Off-Balance Sheet Arrangements

The Company previously utilized accounts receivable securitization programs, which were important for the Company to broaden its funding sources and raise cost-effective funds. However, in the United States, financing by securitization of trade receivables was quite difficult in the year ended March 31, 2009 because of turmoil in the U.S. financial markets. Under this situation, the Company terminated all securitization programs during the year ended March 31, 2009. As a result, the Company has no sold receivables at March 31, 2009.

The Company provides guarantees to distributors, including affiliated companies, and customers for their borrowings from financial institutions. The Company would have to perform under these guarantees in the event of default on a payment within the guarantee periods. The maximum potential amount of undiscounted future payments of these financial guarantees as of March 31, 2009 was ¥2.5 billion ($26 million).

Tabular Disclosure of Contractual Obligations

The following summarizes contractual obligations at March 31, 2009.

	Millions of yen				
		Payments due by period			
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Short-term borrowings	¥132,100	¥132,100	¥ —	¥ —	¥ —
Capital lease obligations	6,521	3,457	2,849	188	27
Long-term debt	262,445	56,921	152,010	40,327	13,187
Deposits from customers	2,466	2,466	—	—	—
Operating lease obligations	2,845	1,017	1,065	631	132
Commitments for capital expenditures	2,822	2,822	—	—	—
Interest payments	13,125	6,010	5,875	1,032	208
Total	¥422,324	¥204,793	¥161,799	¥42,178	¥13,554

	Thousands of U.S. dollars				
		Payments due by period			
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Short-term borrowings	$1,347,959	$1,347,959	$ —	$ —	$ —
Capital lease obligations	66,541	35,275	29,072	1,918	276
Long-term debt	2,678,010	580,827	1,551,122	411,500	134,561
Deposits from customers	25,163	25,163	—	—	—
Operating lease obligations	29,031	10,378	10,867	6,439	1,347
Commitments for capital expenditures	28,796	28,796	—	—	—
Interest payments	133,929	61,327	59,949	10,531	2,122
Total	$4,309,429	$2,089,725	$1,651,010	$430,388	$138,306

Long-term debt represents unsecured bonds and loans principally from banks and insurance companies.

The Company's contributions to pension plans for the year ending March 31, 2010 are expected to be ¥13,884 million ($142 million).

Payments due by periods for interest payments are calculated using the contract rate of each borrowing or debt at March 31, 2009.

Payments under interest rate swap contracts for the year ending March 31, 2010 are expected to be ¥2,533 million ($26 million).

Liabilities for unrecognized tax benefits of ¥6,759 million ($69 million) at March 31, 2009 are excluded from the table. Liabilities for unrecognized tax benefits are due mainly to a bilateral Advance Pricing Agreement (APA), and it is reasonably possible that the amount of unrecognized tax benefits may significantly increase or decrease within the next 12 months depending on the business results of the U.S. subsidiaries in the future periods.

There are ongoing potential remediation issues. However, effect cannot be quantified.

3. Cash Flows

Net cash used in operating activities during the year under review was ¥22.6 billion ($231 million), and cash inflow decreased ¥112.7 billion ($1,150 million) from the prior year. Cash inflow decreased substantially due to decreased net income, reduced sales of trade receivables in North America and increased inventories. Such amounts exceeded the cash provided by increases in other current liabilities.

Net cash used in investing activities was ¥74.0 billion ($755 million), an increase of ¥1.7 billion from the prior year. Cash used in purchases of investments and change in loan receivables increased largely; however, a decrease in purchases of fixed assets, an increase in proceeds from sales of property, plant, and equipment, and a slowdown in finance receivables decreased our cash outflow. As a result, net cash used in investing activities was almost at the same level as the prior year.

Net cash provided by financing activities was ¥84.9 billion ($866 million), an increase of ¥96.5 billion from the prior year, due to increases in short-term borrowings and long-term debt resulted from switching the funding source from sales of trade receivables to borrowing from financial institutions in North America.

Including the effect of exchange rate, cash and cash equivalents at the end of March 2009 were ¥69.5 billion ($709 million), a decrease of ¥19.3 billion from the prior year.

Over the past three years, the amount of net cash provided by operating activities was ¥164.4 billion in aggregate and net increases in borrowings were ¥130.3 billion in aggregate. Additionally, during the same period, proceeds from sales of property, plant, and equipment and proceeds from sales of investments were ¥10.0 billion in total. The aggregate amount of these cash flows was used chiefly to fund increases in finance receivables, which exceeded collections of finance receivables by ¥140.5 billion, purchase of fixed assets of ¥103.0 billion, payment of dividends to stockholders of ¥50.2 billion and repurchase of common stock for ¥21.9 billion.

4. Capital investments

Capital investments in fiscal 2009, 2008 and 2007 amounted to ¥33,337 million ($340,173 thousand), ¥35,163 million, and ¥44,715 million, respectively. The funding requirements for these capital investments were mainly provided by internal operations, and partially provided by external debt financing.

5. Research and Development

The following table shows the Company's research and development expenses for the last three fiscal years.

	Millions of yen			Thousands of U.S. dollars
	2009	2008	2007	**2009**
R&D expenses	**¥26,290**	¥24,784	¥22,925	**$268,265**
As a percentage of consolidated revenues	**2.4%**	2.1%	2.4%	—

The R&D activities are conducted principally in R&D departments in each business division and subsidiary. In our business divisions and subsidiaries, there are 33 R&D departments. Each department promotes the R&D activities fortifying each business.

Total R&D expenses of four industrial segments, which are Internal Combustion Engine and Machinery, Pipes, Valves, and Industrial Castings, Environmental Engineering, and Other segment, were ¥19.7 billion, ¥1.8 billion, ¥2.5 billion, and ¥2.3 billion, respectively.

6. Risk Factors

Declines in economic conditions in the Company's major markets, including private-sector capital expenditure, construction investment, and domestic public investment, may adversely impact the results of operations of the Company.

Industrial and capital goods make up a substantial portion of the Company's products. Accordingly, revenues of the Company may decrease due to declining demand resulting from declines in general economic conditions, including private-sector capital expenditures, construction investment, and domestic public investment. In addition, governmental agricultural policies may adversely affect domestic sales of agriculture-related products. In overseas markets, especially those of North America and Europe, sales of the Company's products, such as utility/compact tractors, may decrease due to declines in general economic conditions, including private consumption and residential construction investment in those regions.

Fluctuations of foreign exchange rates, including a stronger yen, may reduce revenues and adversely affect the results of operations of the Company.

The Company has overseas revenues and manufacturing subsidiaries. The financial results of each overseas subsidiary are consolidated into the results of the parent company after translation into Japanese yen. In addition, the transactions between the parent company and overseas subsidiaries or customers are generally denominated in the local currencies. The payments received in local currencies on such transactions are converted to Japanese yen. As a result, fluctuations in foreign exchange rates affect the consolidated financial results. In general, a stronger yen against other currencies adversely affects revenues and the results of operations of the Company.

If the prices of raw materials increase and the Company has difficulties in procuring adequate supplies of them, there may be a material adverse effect on the Company's results of operations.

The Company purchases substantial raw materials and parts from outside suppliers. If the prices of raw materials substantially increase due to the supply and demand gap and changes in market conditions, and stay at high levels for a long time, they may deteriorate the Company's profitability. Also, if the Company has difficulties in procuring adequate supplies of raw materials, there may be a material adverse effect on the Company's results of operations due to difficulties in production and sales activities.

The risks associated with international operations may adversely affect revenues and profitability of the Company.

In some businesses of the Company, substantial overseas operations are conducted. Accordingly, the Company is subject to a number of risks inherent in doing business in those markets. If such risks occurred, the Company may face difficulties in stable production and sales of products in overseas markets that may affect revenues and profitability of the Company or they may hinder growth of the Company in specific countries. The following risks are serious concerns for the Company:

- Unexpected changes in international, or in an individual country's, tax regulations;
- Unexpected legal or regulatory changes in a country;
- Difficulties in retaining qualified personnel;
- Underqualified technological skills or instability between management and employee unions in developing countries; and
- Political instability in those countries.

Among the United States, the EU, and Asian countries, which are important markets for the Company, the previously mentioned risks in Asian countries seem to be relatively higher than those of other regions.

If strategic alliances, mergers, and acquisitions do not generate successful results as planned, then the Company's profitability may deteriorate.

The Company expects to use strategic alliances, mergers, and acquisitions to seek further growth. The success of these activities depends on such factors as the Company's business environment, the ability of its business counterparts, and whether the Company and its counterparts share common goals. Therefore, if these activities are not successful and returns on related investments are lower than expected, the Company's profitability may deteriorate.

If the Company is not able to successfully create new businesses or businesses complementary to the current ones, then there may be a negative impact on the Company's financial position.

As part of its structural renovation, the Company is attempting to cultivate new businesses or businesses that are complementary to the current ones. In general, there are numerous competitors, and competition is very harsh in those markets. If the Company fails to develop the required personnel or abilities to produce and market appropriate products, subsequent impairment charges may be taken, or there may be a negative impact on the Company's financial position.

Stock market fluctuations may have a material adverse effect on the Company's results of operations, financial position.

Stock market declines may cause impairment losses on the Company's investments in marketable securities or cause an increase in actuarial loss of the Company's retirement and pension plans as a result of a decline in the fair value of pension plan assets, which may have a material adverse effect on the Company's results of operations, financial position.

The Company is subject to intensifying competitive pressures. Unless the Company surpasses other companies in each of its businesses, revenues and/or net income may decrease in the future.

The Company is exposed to severe competition in each of its businesses. Unless the Company surpasses other companies in such areas as terms of trade, R&D, and quality, revenues and/or net income may decrease in the future.

If the Company's products and services are alleged to have serious defects, such allegations may have a material effect on the Company's results of operations, financial position.

If the Company's products and services are alleged to have serious defects, the Company may have liability for significant damages, and there may be a material effect on the Company's results of operations, financial position. If such claims are asserted, the Company may lose the confidence of the public and suffer a reduction in its brand value, which may result in decreased revenues or demand for its products.

The Company may be required to incur considerable expenses in order to comply with various environmental laws and regulations. Such expenses may have a material effect on the Company's results of operations, financial position.

The Company is subject to various environmental laws and regulations that apply to its products and activities. If these environmental laws and regulations, such as those that impose carbon dioxide emission controls, emission controls, and usage restrictions for certain materials which are used in the Company's products, are strengthened or newly established in jurisdictions in which the Company conducts its businesses, the Company may be required to incur considerable expenses in order to comply with such laws and regulations. Such expenses may have a material effect on the Company's results of operations, financial position. To the extent that the Company determines that it is not economical to continue to comply with such laws and regulations, the Company may have to curtail or discontinue its activities in the affected business areas.

The Company may be required to incur significant expenses in connection with environmental damage its activities may allegedly cause. Such expenses may have a material effect on the Company's results of operations, financial position.

Claims may arise that the Company's activities have caused environmental contamination, including the release of hazardous materials or air pollution, water pollution, and/or soil contamination. In such an event, the Company may elect or be required to implement costly corrective actions to resolve any issues associated with the release or presence of such hazardous materials or contamination and may face associated litigation. These factors may have a material effect on the Company's results of operations, financial position.

If the Company is required to incur significant expenses relevant to asbestos-related issues, then there may be a material adverse effect on the Company's results of operations, financial position, and its liquidity.

The Company previously manufactured products containing asbestos from 1954 to 2001. The Company may be required to incur various expenses, including payments to the individuals concerned or face lawsuits related to the asbestos-related health hazards. If such expenses become significant or any lawsuits result in judgments unfavorable to the Company, there may be a material adverse effect on the Company's results of operations, financial position, and its liquidity.

The Company may experience a material effect on its results of operations and financial position if it faces issues related to compliance.

The Company has declared its intention to conduct its corporate activities in compliance with legal regulations and ethical principles, and to exert efforts to cause all management and staff of the Group companies not to act in violation of various legal regulations, ethical standards, or internal regulations. However, in the event that compliance issues arise, there is a possibility that the Company may be subject to disciplinary action by government ministries supervising its activities or to lawsuits, or may suffer a loss of public confidence, that could have a material effect on the Company's results of operations, financial position.

If the Company is damaged by natural disasters, then the Company's operations may suffer great losses.

Japan is a country with frequent earthquakes. If a strong earthquake or related tidal wave occur, the Company may be affected in the operation of its manufacturing, logistics, and sales activities, and may lose revenues and profits depending on the severity of the earthquake or tidal wave. Japan also is hit by typhoons very frequently. If major plants are struck by a large and powerful typhoon, the Company's operations may suffer great losses due to disruption of operations, delay in production and shipment, and restoration costs for facilities.

7. Matters Related to the Health Hazard of Asbestos

Background

Until 1995, the Company's plant in Amagasaki, Hyogo Prefecture, which is now a company office, had produced products containing asbestos. In April 2005, the Company was advised that some residents who lived near the former plant suffered from mesothelioma, a form of cancer that is said to be mainly caused by the aspiration of asbestos. The Company announced its intention in June 2005 to act seriously and faithfully concerning various issues of the health hazard of asbestos from the viewpoint of corporate social responsibility (CSR) as a company that had once manufactured products containing asbestos for a long time.

According to the Company's basic policy, the Company started the program of consolation payments to patients with mesothelioma who lived near the former plant and to the families of residents who died from mesothelioma. In April 2006, the Company decided to establish the relief payment system in place of the consolation payment system and make additional payment to the residents to whom consolation payment were eligible to be paid or payable.

After the Company established its internal policies and procedures of relief payment system, the Company has received claims for relief payments from 198 residents and paid or accrued relief payments to 178 of those residents after carefully reviewing those claims as of March 31, 2009.

With regard to the procedures for making claims to the Company for relief payments, the Company has asked the residents or the bereaved family of the residents who lived close to its former plant to communicate with the Company through Amagasaki Occupational Safety and Health Center with the documents requested by the Company.

With regard to current and former employees of the Company who are suffering from or have died of asbestos-related disease, in accordance with the Company's internal policies, the Company shall pay compensation which is not required by law. Upon certification of medical treatment compensation from the Workers' Accident Compensation Insurance for asbestos-related diseases, the compensation for asbestos-related disease shall be paid. In case an employee dies during medical treatment and are certified for compensation from the Workers' Accident Compensation Insurance for bereaved families, the compensation for asbestos-related disease for the bereaved family shall also be paid. In addition, the Company shall provide other financial aids, such as medical expenses during medical treatment which are incurred by the diseased employees or salary payments during the period of their absence from work. The cumulative number of current and former employees who are eligible for compensation in accordance with the Company's internal policies that are not required by law is 152 as of the end of March 2007, 160 as of the end of March 2008, and 162 as of the end of March 2009.

In August 2006, the Company announced that the Company would provide a total donation of ¥1.2 billion to Hyogo College of Medicine made over 10 years and a ¥0.5 billion to Osaka Medical Center for Cancer and Cardiovascular Diseases over five years. And the Company donated ¥200 million ($2,041 thousand) as a contribution for the year ended March 31, 2009.

As a result of the asbestos issue becoming an object of public concern, the Japanese government newly established the Law for the Relief of Patients Suffering from Asbestos-Related Diseases (“New Asbestos Law”) in March 2006. This law was enacted for the purpose of promptly providing relief to people suffering from asbestos-related diseases who are not eligible for relief by compensation from the Insurance in accordance with the Workers’ Accident Compensation Insurance Law. The relief aid payments are contributed by the national government, municipal governments, and business entities. The contribution includes a special contribution by companies which operated a business closely related to asbestos, and was made by business entities commencing from the year ended March 31, 2008. During the year ended March 31, 2007, the Company accounted for ¥735 million ($7,500 thousand) of the special contribution as a lump sum expense, which is imposed based on the New Asbestos Law during the four-year period commencing on April 1, 2007.

Contingencies Regarding Asbestos-Related Matters

The Company expenses the payments for the health hazard of asbestos based on the Company’s policies and procedures. The expenses include payments to certain residents who lived near the Company’s plant and current and former employees, and a special contribution in accordance with the New Asbestos Law. The amounts of these expenses during the year ended March 31, 2009 were approximately ¥1,155 million ($11,786 thousand). Of the ¥1,155 million ($11,786 thousand), ¥876 million ($8,939 thousand) represented expenses relating to the payment for the relief payment system established in April 2006. The Company has no basis or information to estimate the number of residents and current and former employees that are going to apply for payments.

Although the Company is currently a defendant in litigations relating to asbestos, the ultimate outcome of these litigations is also unpredictable with certainty due to inherent uncertainties in litigation.

Accordingly, the Company believes it is not possible to reasonably estimate the amount of its ultimate liability relating to asbestos issues. However, the Company believes asbestos-related issues contain potentially material risks for the Company’s consolidated results of operations, financial position, and its liquidity.

8. Outlook for the Next Fiscal Year

The Company forecasts consolidated revenues for the year ending March 31, 2010 will decrease from the year under review. Domestic revenues are forecast to decrease due to a decrease of revenues in Internal Combustion Engine and Machinery, and Pipes, Valves, and Industrial Castings, while revenues in Environmental Engineering are expected to be the same level as the year under review. In overseas markets, although revenues in Pipes, Valves, and Industrial Castings, and Environmental Engineering are expected to increase from the year under review, revenues in Internal Combustion Engine and Machinery are forecast to decrease substantially. As a result, total overseas revenues are forecast to decrease from the year under review.

The Company forecasts operating income will decrease from the year under review, mainly due to a significant decrease in revenues and the appreciation of the yen.

The Company expects income from continuing operation before income taxes, minority interests in earnings of subsidiaries, and equity in net income of affiliated companies and net income for the next fiscal year will decrease from the year under review mainly due to a decrease in operating income.

Cautionary Statements with Respect to Forward-Looking Statements

This document may contain forward-looking statements that are based on management’s expectations, estimates, projections and assumptions. These statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Therefore, actual future results may differ materially from what is forecast in forward-looking statements due to a variety of factors, including, without limitation: general economic conditions in the Company's markets, particularly government agricultural policies, levels of capital expenditures, both in public and private sectors, foreign currency exchange rates, continued competitive pricing pressures in the marketplace, as well as the Company's ability to continue to gain acceptance of its products.