

Kubota Corporation

Result Briefing for the 1st half of FY2021 ending December 31, 2021

Q & A Session (Conference call, August 5, 2021)

Q. You mentioned tightness in supply and demand, but is there a high possibility that the use of air transportation will increase in the future?

A. We believed until last summer that it would take some time for OEM clients to adjust their inventories, and that the recovery in demand would not start until after the beginning of 2021. However, since the beginning of last fall, we have received a large number of orders, and the volume has also increased considerably since the beginning of 2021. In addition, demand for our products, such as tractors, combine harvesters, and construction machinery, also had a tendency to increase in almost all markets due to the recovery from COVID-19 crisis. The combination of these two factors has resulted in an extremely tight supply and demand situation in engines. We are continuing to communicate with our OEM clients, and as for the outlook for the future, we do not believe that air transportation will continue to increase steadily. However, because the current high level of orders is expected to continue, we are currently looking into ways to increase our production capacity to meet this need. As air transportation is a burden for clients, we are making efforts to reduce it as much as possible. However, the current situation is that we cannot meet the needs of our some clients' production processes without air transportation.

Q. I would like to ask you about your company's initiative to smart farming. I have the impression that your introduction of ICT and robot technologies for agriculture are a little behind those of foreign manufacturers. In the meantime, Kubota has announced a research collaboration with Topcon. I have an impression that most of your initiatives have been in Japan, but I think that you will collaborate with Topcon's subsidiary in the U.S. So, please tell us again about the background and purpose of this research collaboration. In addition, not just in the case of Topcon, I would like you to explain what you think about the importance of smart farming and what you feel internally that you have to do to accelerate this initiative.

A. I think we are a little behind overseas competitors in some initiatives, such as smart farming and automation. In order to catch up with them, we will move forward while considering compartmentalization between areas where overseas competitors have been already undertaking and areas where we focus on. One of the first things we need to consider is that we are overwhelmingly lacking in internal resources to incorporate digital technologies into our products and solutions. Therefore, we need to move forward while incorporating various management resources from external, which is why we have been working on a partnership with Topcon and NVIDIA. In addition, through the Innovation Center, which we launched the year before last, we have been investing in various startups, and the current situation is that we are accelerating our initiative by compensating for shortage of internal resources through alliances with them. It is true that we have not yet reached the point where the effects can show our results of operation or we can make announcements external, but we are moving forward while accelerating considerably. Therefore, we hope to reach a point where we can meet your expectations in the years to come. As for the future, for example, there is no doubt that labor shortages of farmers are becoming more pronounced not only in Japan but also in Europe, North America, and various regions. In Asia, the need for mechanized agriculture is also becoming more and more pronounced. We have strength in rice farming, and I think that we will move forward from the fields we are good at. We will work on smart farming, including not only rice farming but also dry field farming. While incorporating automation technology, I am sure that there are many ways to make agriculture itself smarter, not only automatic driving. I believe that the need to smart farming will emerge not only in Japan but also in global regions such as Europe and Asia. With expanding our antennae more slightly, we will move forward while compensating for the lack of internal resources. I expect that this will become an important pillar of earnings for Kubota in 5 to 10 years.

Q. I would like you to tell about an example of what you think internally about fields that overseas competitors have not worked on, but Kubota can focus on.

A. The reality is that we have not yet reached a point where we can disclose the information, but of course, we are more advanced in rice farming in Asia, so I believe that we will never lose in rice farming. Overseas competitors have already made a lot of progress in so-called "row-crop" areas, such as corn, soybeans, and wheat. However, there are different types of farming and agricultural products in different regions, such as vegetables and fruit trees, and they are not able to handle all of them. In addition, while they have made progress in automation, they can have yet to start to make smarter from the perspective of ESG, such as how to reduce the burden on the natural environment. I think that is just the beginning, so I think there is room for us to enter.

Q. I would like to ask you about the price increase of the products. According to anticipated operating profit in this year, while the negative effect from a rise in material prices is -27.0 billion yen, the positive effect from sales price increase is +16.0 billion yen. The effects of sales price increase were catching up with the effects of soaring material prices in the 1st half, but the forecasts are that you will not be able to catch up in the 2nd half. Do you think about additional price increase in the future? In addition, I would like you to tell me how soon the price pass-on will be able to catch up. Furthermore, I think it is very easy to raise prices in the U.S. markets, but I would like you to tell me if it is possible to pass on prices in other markets such as Japan, Europe, and Asia.

A. As for sales price increase, raw materials prices in the U.S. have risen so much that they are dragging down our results, so I think basically that we would like to pass on the price increase if soaring material costs continue. However, this year, we have not been able to supply what the dealers order in a timely manner, and we have been causing a lot of trouble for dealers. Under these circumstances, I think it would not be appropriate for us to further burden dealers with additional price increases, considering our long-term relationship with them. The increase in burden of raw material prices assumed this time is based on the assumption that the current level will continue, and I think we will have to absorb this. The problem is after next year. If the current level of steel prices continue, we will have to think about passing the price on. However, I think that the rise in steel prices is also mainly due to the rapid economic recovery and the effect of labor shortages in the U.S. While closely watching whether this situation will continue in the future, we will consider what the burden will be from the next year, and then we would like to try to pass on the price. I think that the situation that we are affected by the rise in material prices is the same as competitors, and the situation that it is easy to raise product prices will occur not only in North America but also in other regions. Of course, we will make various rationalization efforts, but as for burden that rationalization do not compensate and we have to ask our customers for, we will basically think to try to pass on the price.

Q. Is it correct to understand that the price of steel products has risen the most in the U.S.?

A. That understanding is correct.

Q. What do you think about the appropriate level of dealer inventories in the U.S.? In addition, based on that, I would like you to explain about way of thinking about the North American business in the next fiscal year. Probably, the current level of less than 2 months is too low, and I do not think it is necessarily enough even at the end of the fiscal year. Will you raise it to 6 or 7 months like in the past? Or will you be able to control it within about 4 months to some extent? Depending on not only the situation of retail sales but also how you think about the appropriate level, I think the outlook for the next fiscal year may change, such as whether you will increase wholesales one more step in the next fiscal year. It may be too early to ask at the 1st half of the year, but you mentioned that you will be able to control the inventory appropriately in the midst of the recent decline in inventory, so I would like you to tell us about the level of inventory in the future and your approach about North America for the next fiscal year based on that?

A. I think the current level of less than 2 months is extremely too low. To be honest, if we had had little more inventories, we would have been able to increase retail sales a little more in May and June, and this is where we

really feel ashamed. As for how much is appropriate, if we had a little more inventories this year, we would have had more data to make a decision. Unfortunately, inventories were so tight that it was not possible to determine the appropriate level. In that sense, as I explained at the beginning of the year, I do not think that the annual average will return to 6 or 7 months. The current forecast at the end of the year is less than 4 months. While about 4 months may be fine at the end of the year, I think it is necessary to adapt to the demand period, such as returning to 5 or 6 months by the end of March, and reducing inventories slightly again after August and September. Therefore, we have not yet made a clear forecast for the next year, but even if the demand for compact tractors, which increased along with strong demand caused by stay-at-home lifestyle, declines slightly next year compared to this year, I think we will have to ship a large amount of shortages of inventories this year at wholesale. If I were to give you an answer now about how much we should set the appropriate level, I think one of the levels would be to return to the level we thought at the beginning of the year, which is about 5 months at the end of the year. However, the level of inventories at the end of the year will be decided depending on the content of the products, the portfolio, the situation of dealers, and how to view after 2023. Therefore, I cannot say anything definitive, but at the present time, I would like you to understand that there is no material reason to change the way of thinking about dealer inventories that we had assumed at the beginning of the fiscal year.

Q. Anticipated revenue in North America on a local currency basis is an increase of 24% for the full year. What assumptions do you have in mind regarding bottlenecks in wholesale, such as port conditions and production?

A. Shipments in North America this year have not been able to be as planned. We are assuming to some extent that the situation of port congestion, which we gave as one of the factors, will improve from now on. I worry about the possibility that port will be crowded again in October and November when the shopping season for Christmas starts, but basically, we assume that it will not get worse more than now. As for delay in production, which is another factor, the factor was that not only workers at our plant in North America did not gather, but also workers at the factory of manufacturing companies that supply the parts did not gather as well. The outlook for this year is based on the assumption that employees in our company and our parts suppliers will come back and we will be able to supply normally. As for the assumption of revenue forecast announced this time, basically, we do not believe that it will be worsen from the current situation. As of July, employees have returned to some extent, so the figures are based on the assumption that the situation will gradually recover and improve from now on. Of course, there is a risk that results will be a slight downturn if further infection of COVID-19 occur and the situation reverse. However, I would like you to understand that we have taken into account what we can produce at this point.

Q. Please tell us about the way of thinking about Asia from the 2nd half. I think the strong sales in the 1st half of this year was due to favorable weather conditions as opposed to bad weather conditions in the past few years, but the price of rice seems to be on a downward trend again and subsidies seem to be decreasing in China. As for the situation from the 2nd half of the year to the next fiscal year, I would like you to explain a little about the structural factors that will contribute to the increase.

A. Prices of fragrant rice in Thailand has been declining a bit. In this sense, I think there is a risk that the demand at the same level as the prior year may weaken a little. However, we are gradually increasing sales of our products, not only to rice farming, but also to dry field farming. Even if there is a decline in the rice farming market, we are considering various arrangements to offset the decline. However, if we look at the 2nd half in Thailand on a YoY basis, we have to be a little conservative in our forecast. As for China, the subsidies itself is expected to decrease considerably from the prior year. I do not know if this will be reduced as it is or if there will be new support measures in various forms. However, in this expected reduction, there has not been much of a drop in purchasing sentiment, especially for tractors and rice transplanters. Season for sales of rice transplanters has already ended, but we expect that tractors will continue to grow to some extent. On the other hand, as for combine harvesters, the situation is that demand has been shifting to used machines and lower-priced machines. Depending on how much the market will recover from the trend toward, we do not expect much growth in the Chinese agricultural machinery market. As for next year and beyond, I think it is important to look at the trend of subsidies and the direction of Chinese policies, and I would like to keep a close on them.

Q. I would like to ask you about retail sales in North America. You explained that the decrease in retail sales in May and June was due to the decrease in dealer inventories. In fact, I think that there was also adverse reaction from the high level of retail sales in the prior year. Which one had more impact and how much was affected by the adverse reaction from the demand caused by stay-at-home lifestyle, or by the shortages of inventories? I think it is quite difficult to analyze, and in any case, we need to increase wholesalers and raise dealer inventories. Please tell us if there are any changes in market views and management stance in response to the situation of retail sales in May and June.

A. The decrease in retail sales of tractors in May and June may, of course, be due in part to a decrease in demand caused by stay-at-home lifestyle, but I believe that main factor for this is the decrease in dealer inventories. As for the reason for this, the pattern of purchasing products for consumers, which we call dealer traffic, is that customers visit the dealer's stores, confirm products, and purchase there. The number of traffic of these customers, including potential customers, stopping by the dealer's stores has not weakened compared to last year, although this is partly based on a sense. We recognize that the market itself is not likely to be a lull in demand caused by stay-at-home lifestyle. However, even if customers come to the dealer's stores, there is no product line, so it is not linked to retail sales. Therefore, we need to consider the inventory allocation first and foremost. As for our products, retail sales increased in March and April as the market grew, and our market share also increased. In May and June, the market share decreased to almost the same level as the previous year, but we do not understand that the competitiveness itself has been lost. Although other companies also reduced their inventories, we think that our products run out of inventories earlier than theirs. In the short-term, we believe that restocking inventories is a top priority. However, in North America, we believe that the peak of the demand for products for consumers will be over in June and July. While there are still some uncertainties, we are continuing to ship more and more, so we believe that the situation that retail sales fail to achieve or decrease due to declining inventories will gradually improve.

Q. I would like to ask about "Other" factors affecting operating profit. In the 1st quarter, it was a large increase factor of +10.5 billion yen, but it was a negative factor of -3.8 billion yen in the 1st half. In the April to June period in the year, I think the impact of temporary deterioration of profitability has become smaller, but it was still a negative factor of about 15.0 billion yen. I would like to know whether fixed manufacturing costs or selling expenses are increasing or not. In addition, according to your forecast for the full year, you have revised "Other" upward this time, but will the negative factors of "Other" caused by selling expenses and fixed manufacturing costs become larger in the next fiscal year? This year, I think it is positive partly due to adverse reaction from negative impact in the prior year. I would like you to explain about your thoughts on the latest cost and on the next fiscal year.

A. There is an increase in selling expenses and manufacturing related costs in "Other" factors. I would like to say 2 points about this. For one point, selling expenses reduced significantly in the prior year because it was difficult to conduct sales activities worldwide due to the impact of COVID-19 especially in the prior year and we were operating under various restrictions. On the other hand, with the increase in revenue in the year, sales expenses and manufacturing costs have risen in some areas, so expenses increased from the prior year. In addition, we have launched a 5-year mid-term management plan this year and we are also working on various long-term vision themes for 2030. In this initiative, I think we would like to ensure enough R&D expenses to proceed with development steadily, so we will tend to spend more on R&D expenses, both in the 1st quarter and 2nd quarter of the year. This is an investment in the future, so we would like to make sure that it pays off. In addition, with the increase in revenue, we have been making various capital investments and IT investments, and these have led to an increase in depreciation and amortization expenses, which is one factor in the increase in expenses. These expenses are also the result of investments to achieve sustainable growth, so please understand that these expenses were expected from the beginning. However, from next year onwards, and of course this year as well, there is no doubt that these costs must be firmly controlled. I would like to take a harder look at R&D and capital investment to ensure that they are effective. Some of the selling expenses and manufacturing expenses were necessary along with a temporary and rapid increase, and there are naturally some expenses

that we can reduce from the next year. We are now working diligently within the Company to ensure that the cost will not continue to increase.

Q. As for the way of thinking for Asia, I understand that the strong sales in the 1st half of the year is due to the combination of weather factors, economic stimulus measures, and rice prices. On the other hand, I think that the growth measures in Asia that your company has been working on have been also realized considerably, and there is also a factor that the period of collecting the returns has come. I would like to ask you how you see the business situation in Asia from a mid- to long-term perspective. In the mid-term business plan, Asia is expected to grow, but again, based on the results of the 1st half and the new forecasts, what kind of progress and situation do you see in the growth of business in Asia in the mid-term business plan? I would like you to explain about your thoughts.

A. In the mid-term business plan, one of the major pillars is the expansion of business in Asia. I would like to make a few comments from that perspective. We have not been able to achieve our expectations slightly this year because of the impact of COVID-19. Although we have set Myanmar as one of the pillars of farm equipment in Asia, we have been focusing on, it has come to a halt due to political instability and I think the situation is a bit concern. However, we are getting a good feeling about expanding our business in other areas, such as Indonesia and the Philippines, as well as dry-field cropping-market in Thailand. Although the figures for a single fiscal year are not readily apparent, I think we are on track to increase the number considerably. As for construction machinery business, that in Thailand is at a bit of a standstill due to the impact of COVID-19, but I think we are steadily gaining ground. Therefore, as for agricultural and construction equipment in Southeast Asia, I believe that the sustainable growth that we are considering in our mid-term plan is possible. Another major pillar in Asia is India. Sales of tractors in India have been very strong for several years, and this year, have increased significantly, even amid the COVID-19 crisis. In addition, sales of combine harvesters are also growing. We have built a joint venture with the local manufacture and it started mass production at the end of last year and it is gradually starting up. I think that it will come out significant figure from next year onwards as well. We expect this to be the next growth driver, and although it has only been 6 months, we are getting a good feeling about the sales situation this year. In Asia, mainly ASEAN, as well as the favorable market, our initiative is working on significantly.

Q. In Q&A about air transportation of engines, you mentioned that you have considered investing in increasing production capacity. How much additional investment are you considering, and over what period of time? From a mid- to long-term perspective, I think it is very difficult to find a balance between investing in the engine business. Could you just give us a brief comment on what kind of discussions you are having in this area?

A. We have made considerable investments in the past, so meaning of the increase in production capacity, which I mentioned earlier, is that we are not planning any major investments at this time. The meaning is that we are considering how we can increase production capacity with the current production line, such as by increasing the number of shifts. I think the intension of your question is what we think about the balance between investing in the engine business amid various social issues, such as reduction in CO2, in the future. We are examining variously what kind of form diesel engines will be in the long-term and what kind of form the new power source will be. We aim at carbon neutral by 2050, so we will continue to consider various new power sources on a schedule that meets that goal. However, there are no alternatives to diesel engines at the moment. OEM clients, as well as our in-house machines, are increasing sales of applications with diesel engine applications, so at this point, we think it is important to supply diesel engines properly so as not to cause trouble to our customers. We will concentrate on this in the short-term. However, in the mid- to long-term, we need to consider various options, including new power sources.

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 as of August 5, 2021 (result briefing for the 1st half of FY2021 ending December 31,

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