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Major questions and answers for the explanatory meeting for business results for the first quarter ended June 30, 2023

Date:	**Thursday July 27, 2023, 16:00-17:00**	
Speaker:	Keiichiro Shiojima	Vice President and Executive Officer, CFO
	Hidehiko Matsui	Vice President and Executive Officer, CMO
	Eiji Fukunishi	Vice President and Executive Officer, President of Spare Parts & Service Business Unit
	Tooru Sugiyama	Executive Officer, Vice President of Mining Business Unit
	Tatsuya Kubo	President of Corporate Brand & Communications Group

※Some excerpts are included in this report.

1. Market Environment and Business Outlook

Q: At the beginning of the fiscal year, you assumed that demand would be sluggish in Western Europe and other regions due to rising interest rates and other factors, but, in 1Q, it seems that demand was strong except in Russia and China. What is your outlook for the future?

A: Matsui: Demand was strong in 1Q. In particular, demand grew in Japan, India, and the Middle East. As for Western Europe, we originally set our annual forecast at -15% year on year, assuming a decline in housing-related demand due to rising interest rates, but the 1Q result was -7% year on year. We expect Western Europe to remain in line with our forecast to some extent, as dealers' inventory levels are gradually normalizing. Demand in North America remains very strong.

Q: In terms of "comparison of consolidated income," sales volume, model mix, & others for the current fiscal year have been revised downward from the initial plan (+¥34.0 billion) to +¥21.8 billion. Demand should be good, but what is the difference?

A: Shiojima: In 1Q, the actual exchange rate was weaker than the assumed exchange rate, and our results also increased. 1Q results were generally in line with our expectations, except for the exchange rate effect. However, European dealer inventories have returned to a normal basis from a depleted situation, and the thermal coal price is falling. Also, 1Q has just ended. In light of these circumstances, we maintained our previous forecast for the full year. As a result, we have adjusted our 2Q-4Q forecast by factoring in a buffer from the 1Q foreign exchange impact, and have reduced the foreign exchange impact and adjusted for sales volume, model mix & others.

Q: Rather than there being a message in the change in the figures, is it correct to understand that there is a wrinkle from the upward currency movement in 1Q?
A: Shiojima: Yes.

Q: I understand that 1Q results were in line with your plan, but what is your assessment of operating income? I have the impression that the results were better than expected, but was the upward swing due to the impact of foreign exchange or the Americas business?
A: Shiojima: The main factor is the exchange rate. At the beginning of the fiscal year, the yen was close to ¥130 to the U.S. dollar, so we set this as the assumed exchange rate. However, the current depreciation of the yen caused the 1Q results to exceed the internal plan. On a local currency basis, the results were almost in line with the plan.

Q: I would like to ask about inventories. You mentioned that, although inventory levels were high in 1Q, you expect to be able to ship inventory because of inquiries. What are your thoughts on this?
A: Shiojima: Inventories increased by ¥74.3 billion from the end of March, of which ¥25.7 billion was due to foreign exchange effects, a net increase of ¥48.7 billion on a local currency basis. The main components are the production inventories and inventories before shipping of the non-consolidated. Specifically, "Raw materials, WIP, and etc.: +¥25.7 billion vs. Mar' 2023" on page 21 of the presentation material refers to production inventories at domestic plants. Some of the mining machinery is being assembled locally. We mentioned that dealers' inventories are normalizing in Europe, but we have inquiries in Japan, the Americas, and Europe, so we would like to make firm shipments and link them to sales and revenue.

2. The Americas Business

Q: The Americas business appears to be doing very well. The revenue forecast has been revised slightly upward, and progress is also good, but which is the reason for this: construction or mining? I think there are some uncertainties in the market environment, but will your unique factors contribute to future growth?
A: Shiojima: 1Q results were very strong in the Americas. Compared to the same period of the previous year, overall revenue in the Americas increased by 49% year on year, and developing own business increased by 51% year on year, for an increase of ¥18.9 billion. Of the developing

own business, construction grew significantly, contributing ¥13.0 billion in revenue growth, nearly 80% year on year. Mining grew steadily as planned, increasing by more than 50% year on year. Specialized parts & service business also grew, but by about 20% year on year. OEM for Deere & Company grew by about 45% year on year. As a result, revenue in the Americas grew by 50% year on year.
Due to the strong orders in construction, we have factored in a slight buffer from 2Q onward for the full year, but we made an upward revision on a local currency basis for developing own business. While we have not changed our annual forecast for mining as a whole, the reason for the downward revision in Latin America is that most of the production quotas for dump trucks have been decided, and those that had been prepared for Latin America have been allocated to Asia and Australia. We hope to cover this with production in the next fiscal year and beyond, and to receive firm orders in Latin America as well. As with other regions, we are maintaining a reasonable risk buffer for the sales of Deere & Company.

Q: Will the increase in dealers' inventories in North America continue through the next fiscal year? Is there any change in your view, including the expansion of the sales network?
A: Matsui: In this fiscal year, there is insufficient quantity to meet demand due to inventory replenishment for new dealers in addition to existing dealers. We believe that replenishment of dealers' inventories will continue throughout this fiscal year.

3. Increase in selling price/cost

Q: I would like to ask about the current price increase and the high cost of raw materials. I believe that raw material costs are falling. I believe that price increases are being promoted in developed countries. How about breaking it down into specific regions, products, and hard-to-penetrate areas?

A: Shiojima: In terms of material cost increases, price hikes for steel products have decreased compared to the previous year and the two previous fiscal years. Although there is a rise in material costs due to higher energy costs as expected at the beginning of the year, the extent of the rise was moderate in the 1Q, which is why we lowered our annual forecast slightly. Most of the increase is attributable to procurement at domestic plants. Price increases have been factored in worldwide. Of the ¥8.3 billion in 1Q results, slightly more than ¥5.0 billion is in the Americas, including both OEM for Deere & Company and developing own business. Price increases were also implemented in Japan, Australia, and India.

Q: You have raised your full-year forecast for the selling price increase, but is there a possibility that selling prices will rise further in the future, given the strength in North America?

A: Matsui: We have released an average 8% price increase in construction and mining worldwide, and, in terms of new machinery sales, the price increase is about 5%. We have also raised selling prices considerably in North America, and we are also raising prices on new models. In China and Southeast Asia, where competition is fierce, we are setting selling prices based on the competitive situation.

A: Shiojima: The difference between the release of the average price increase of 8% and the planned price increase of about 5% for new machinery sales is due to the time lag between when orders are received and when they are shipped. We will achieve a firm increase in selling prices in developed countries and elsewhere.

A: Kubo: Since FY2021, we have been working on a policy to recover rising material costs by raising selling prices, and we should be able to recover rising material costs soon. On the other hand, we have yet to recover the increase in logistics costs. With the understanding of our customers, we will steadily implement price increases.

4. Mining Business and Value Chain Business

Q: What is the status of the mining machinery business negotiations?

A: Sugiyama: Since demand for mining machinery is linked to resource prices, we analyze demand by mineral type and machinery class. Thermal coal price is trending downward, but hard rock (copper, gold, etc.) prices remain at high levels. We have a large backlog of orders at the moment and have no concerns about sales for the current fiscal year. Looking ahead, demand from small and medium-sized mines and contractors is expected to decline somewhat due to a drop in coal prices, especially thermal coal, but we have received a high level of inquiries for ultra-large hydraulic excavators and dump trucks, which are our forte, and we expect sales to remain steady.

Q: Revenue of parts and services for the mining business grew by 24% in 1Q year on year, including the effect of foreign exchange rates. What is the outlook for growth in machine operating hours and how much will demand for overhaul continue?

A: Fukunishi: In the fiscal year outlook for parts and services for the mining business, risks related to Russia and Ukraine are expected to continue for the time being, and the recent fluctuations in resource prices also need to be monitored closely. However, operations of mining machinery continue to be strong, and we expect to secure earnings by capturing demand for maintenance and overhaul. For the current fiscal year, we expect growth in the Americas and Africa, especially in Zambia.

We believe there is room for revenue expansion in the Americas, including Latin America, as the amount of our mining machinery in operation is second only to Australia. In addition, in the second half of the current fiscal year, we plan to launch a new remanufacturing parts base exclusively for mining parts. This will enable us to expand our lineup of remanufacturing parts and secure earnings.

In Zambia, we received a large order for mining hydraulic excavators and dump trucks last fiscal year, and we plan to deliver them sequentially from this fiscal year through next fiscal year. In Southern Africa, including Zambia and neighboring Congo, we expect demand for parts and services to grow, including for machinery already delivered and for machinery to be delivered in the future, and we intend to capture this demand without fail. In Australia, Indonesia, and India, revenues are expected to increase slightly from the previous year.

Q: Has there been a recent decrease in the operating hours of mining machinery?

A: Fukunishi: Although there has been a partial decline in coal prices, the current total operating hours have remained steady.

Q: In the Specialized parts & service business, the income margin is improving and revenue is growing. Do you see the end of the business restructuring that you have been working on? Or is the income margin improving because revenue is growing?

A: Sugiyama: The specialized parts & service business consists of Bradken and H-E Parts. Bradken is in the mining consumables business and H-E Parts is in the mining-related service solutions business, and their performance is linked to the mining business climate. High resource prices have created a favorable business environment for mining companies, resulting in increased revenue for the two companies. To improve profitability, the two companies have been working on structural reforms to focus on highly profitable businesses, and, while these reforms are not yet complete, they are having an effect, and both companies' income margins are improving.

Q: I think the specialized parts & service business is aiming for a higher income level than the construction machinery business, but can we expect a further upturn in the next fiscal year and beyond?

A: Sugiyama: I will refrain from giving specific figures, but we are moving forward with higher targets than the current ones in our medium-term management plan.

A: Shiojima: The specialized parts & service business invested not only in synergies in the mining business, but is also a stepping stone to the Americas mining initiative prior to the dissolution of the joint venture with Deere & Company. As a PMI, we have been working to improve profitability over the top line by specializing in focused businesses and streamlining them while also taking impairment losses. We intend to further concentrate its operations as it grows its Americas business, and use the cash it earns from this to grow its top line, with an eye toward establishing a foundry in the Americas.

Q: You have revised downward your annual forecast for rental revenue; what is the reason?

A: Shiojima: The forecast for rental revenue for the fiscal year has been revised slightly downward. This is due to the fact that we are reviewing our holding range of rental assets in Japan. Rental revenue includes sales from the sale of rental assets, but the current allocation priority is on new machinery sales, and we are not able to supply new machinery for rental assets, resulting in a delay in the sale of rental assets.

A: Matsui: In the rental business, new machines are first introduced as rental machines and then sold as used equipment. Currently, customers have a strong desire to purchase new machines, so we are prioritizing sales of new machines over an increase in rental assets.

The utilization rate of rental machinery is favorable, including in Europe, but we have revised this fiscal year forecast downward slightly in light of delays in the sale of rental assets.

Q: I would like to ask you about the situation in Russia and Ukraine, where export restrictions have been tightened since April. Since you made conservative assumptions from the beginning of the fiscal year, do you think the impact on your earnings forecast will be negligible?

A: Fukunishi: We have made conservative assumptions about parts and services revenue in Russia from the beginning of this fiscal year in light of export restrictions, so there is no major impact on our earnings forecast.

5. Shareholder Return

Q: Regarding shareholder returns, I believe you have not yet announced your dividend forecast for the current fiscal year, but, once again, I would like to know your thoughts on the dividend policy.

A: Shiojima: The dividend forecast for the current fiscal year has not yet been determined, and we are refraining from giving a numerical answer. Since our performance tends to show low revenue in 1Q and higher revenue as the period progresses, we would like to determine the dividend amount based on actual results. In the medium-term management plan that started this fiscal year, the consolidated dividend payout ratio target was raised from “30% or more” to “stable and continuous implementation with a consolidated dividend payout ratio of 30%-40% as a guide,” and we intend to gradually increase the target to 40% during the medium-term management plan period. Currently, our developing own business in the Americas is performing very well, and we believe that this is an excellent opportunity to expand our business. We would like to determine the amount of dividends, taking into consideration the investment required for business expansion.