

KOMATSU LTD  
Form 20-F  
July 27, 2005  
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## SECURITIES AND EXCHANGE COMMISSION

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### FORM 20-F

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(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2005

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER: 1-7239

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## KABUSHIKI KAISHA KOMATSU SEISAKUSHO

(Exact name of registrant as specified in its charter)

# KOMATSU LTD.

(Translation of registrant's name into English)

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JAPAN

(Jurisdiction of incorporation or organization)

2-3-6 Akasaka, Minato-ku, Tokyo 107-8414, Japan

(Address of principal executive offices)

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**Securities registered pursuant to Section 12(b) of the Act:**

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
None	N/A

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

None

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

Common Stock

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

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991,420,696 shares (excluding 7,323,364 shares of Treasury Stock)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes , No

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18 .

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In this document, KOMATSU LTD. is hereinafter referred to as the Company, and together with its consolidated subsidiaries, as Komatsu.

Cautionary Statement with respect to forward looking statements:

This Annual Report contains forward-looking statements that reflect management's views and assumptions in the light of information currently available with respect to certain future events, including expected financial position, operating results and business strategies. These statements can be identified by the use of terms such as will, believes, should, projects, plans, expects and similar terms and expressions that identify events or expectations. Actual results may differ materially from those projected, and the events and results of such forward-looking assumptions cannot be assured. Any forward-looking statements speak only as of the date of this Annual Report, and the Company assumes no duty to update such statements.

Factors that may cause actual results to differ materially from those predicted by such forward-looking statements include, but are not limited to, unanticipated changes in demand for Komatsu's principal products, owing to changes in the economic conditions in Komatsu's principal markets; changes in exchange rates or the impact of increased competition; unanticipated costs or delays encountered in achieving Komatsu's objectives with respect to globalized product sourcing and new Information Technology tools; uncertainties as to the results of Komatsu's research and development efforts and its ability to access and protect certain intellectual property rights; the impact of regulatory changes and accounting principles and practices; and the introduction, success and timing of business initiatives and strategies.

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**Table of Contents****PART I****Item 1. Identity of Directors, Senior Management and Advisers**

Not applicable.

**Item 2. Offer Statistics and Expected Timetable**

Not applicable.

**Item 3. Key Information****A. Selected Financial Data**

The following data for each of the fiscal years ended March 31, 2001 through March 31, 2005 has been derived from the Company's audited consolidated financial statements. It should be read in conjunction with the Company's audited consolidated balance sheets as of March 31, 2004 and 2005, the related consolidated statements of income, shareholders' equity and cash flows for the three years ended March 31, 2003 through March 31, 2005 and the notes thereto that appear elsewhere in this annual report.

**Selected Financial Data**

(Millions of yen, except per share amounts)

	2005	2004	2003	2002	2001
<b>Income Statement Data:</b>					
Net Sales	1,434,788	1,196,418	1,089,804	1,035,891	1,096,369
Income (loss) before income taxes, minority interests and equity in earnings of affiliated companies	98,703	27,036	12,905	(106,724)	20,064
Income taxes	36,044	(3,519)	5,968	(21,930)	13,715
Net income (loss)	59,010	26,963	3,009	(80,621)	6,913
<b>Per Share Data:</b>					
Net income (loss)					
— Basic	59.51	27.17	3.09	(84.46)	7.24
— Diluted	59.47	27.16	3.09	(84.46)	7.24
Cash dividends					



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Yen	9.00	6.00	6.00	6.00	6.00
U.S. cents	8.41	5.77	5.10	4.50	4.80
<b>Depreciation and amortization</b>	69,020	69,863	70,229	61,581	65,106
<b>Capital expenditures</b>	89,019	78,049	70,473	74,468	79,310
<b>Research and development expenses</b>	46,448	42,602	39,027	44,083	45,282

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(Millions of yen)

<b>Balance Sheet Data:</b>					
Total Assets	1,449,068	1,348,645	1,306,354	1,340,282	1,403,195
Shareholders Equity	477,144	425,507	395,366	395,143	474,257
Number of Shares Issued at year-end	998,744,060	998,744,060	998,744,060	958,921,701	958,921,701
Number of Shares Outstanding at year-end	991,420,696	992,488,276	992,528,649	954,401,729	954,009,889

The following table provides the noon buying rates for Japanese yen in New York City as reported by the Federal Reserve Bank of New York expressed in Japanese yen per U.S. dollar during the periods indicated. The average yen exchange rates represent average noon buying rates on the last business day of each month during the respective period. The most recent practicable exchange rate for Japanese Yen into United States dollars was ¥110.82 =U.S.\$1 as of June 30, 2005.

**Yen Exchange Rates per U.S. dollar:**

(Yen)

	<u>Average</u>	<u>High</u>	<u>Low</u>	<u>Period-End</u>
<b>Year ended March 31</b>				
2001	111.65	104.19	125.54	125.54
2002	125.63	115.89	134.77	132.70
2003	121.10	115.71	133.40	118.07
2004	112.75	104.18	120.55	104.18
2005	107.28	102.26	114.30	107.22
		<u>High</u>	<u>Low</u>	<u>Period-End</u>
2005				
January		102.26	104.93	103.55
February		103.70	105.84	104.25
March		103.87	107.49	107.22
April		104.64	108.67	104.64
May		104.41	108.17	107.97
June		106.64	110.82	110.82

**B. Capitalization and Indebtedness**

Not applicable.



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### **C. Reasons for the Offer and Use of proceeds**

Not applicable.

### **D. Risk Factors**

#### General Background

Komatsu's primary business is the manufacture and sale of construction and mining equipment (approximately 74% of consolidated net sales for the fiscal year ended March 31, 2005), industrial machinery, vehicles and others (approximately 19% of consolidated net sales for the fiscal year ended March 31, 2005), and electronic materials (approximately 7% of consolidated net sales for the fiscal year ended March 31, 2005). Approximately 36% of consolidated net sales were sold in Japan and 64% were exports and/or products produced and sold overseas. Manufacturing facilities are dispersed geographically but production of most of key components such as engines, hydraulic components and final drives, are concentrated in Japan. Significant additional detail and commentary is provided in year versus year and segment information provided in Items 4 and 5.

Komatsu believes that it maintains its management strategy and resources to win against the competition within a foreseeable scope based on available information. Komatsu has identified the following primary risk factors to its global operations.

**(1) As a global company, Komatsu's results of operations are affected by the economic and market conditions.**

As Komatsu engages in business on a global basis, market conditions differ depending on the regions. The demand for Komatsu's products and business environment for Komatsu could change substantially, affected by the regional market, political and economic conditions.

Both construction and mining equipment business and industrial machinery, vehicles and others business are generally economy-cyclical in advanced economic regions. Therefore, factors which are beyond control of Komatsu, such as housing starts, industrial production level, public investments in infrastructure development, and private-sector capital outlays, could affect demand for Komatsu's products, bring about an improper balance between inventory level and production capacity, and consequently force down the sales prices for Komatsu's products. Such changes in the business environment could result in lowered profitability, additional restructuring expenses, and consequently have adverse effects on Komatsu's growth strategy and results of operations.

Electronics business experiences very drastic changes in market conditions and demand. Such changes in the business environment could affect Komatsu's results of operations. Reduced sales volume and lowered sales prices of silicon wafers caused by changes in the semiconductor market and fluctuations in supply and demand could substantially affect the profitability of the Electronics business, and give unfavorable effects on Komatsu's results of operations.

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**(2) As a global company, Komatsu's results of operations are affected by foreign currency exchange rate fluctuations.**

Approximately 64% of Komatsu's total sales come from sales outside Japan, and a substantial portion of overseas sales is affected by foreign currency exchange rate fluctuations. In general, the Japanese yen's appreciation against other currencies negatively affects Komatsu's results of operations, while the yen's depreciation affects them positively. Foreign currency exchange rate fluctuations could also affect the comparative prices of products that Komatsu and foreign competitors sell in the same market and costs of materials used in production. Komatsu is working to alleviate the effect of such foreign currency exchange rate fluctuations by diversifying plant locations and placing production bases close to the market. Komatsu also engages in hedging activities to minimize the effects of short-term foreign currency exchange rate fluctuations. However, the foreign currency exchange rate fluctuations beyond the projected fluctuation range could adversely affect Komatsu's results of operations.

**(3) Komatsu's results of operations are subject to the fluctuations in the financial markets.**

The fluctuations in the financial markets, such as fluctuations in interest rates and fair value of marketable securities, principally affect Komatsu's interest expenses and pension costs. While it is working to improve efficiency of assets to reduce interest-bearing debt as much as possible, Komatsu currently has short-and long-term interest-bearing debt of approximately ¥430 billion in total. While the effects of interest rate fluctuations are alleviated since interest rates for more than a half of such interest-bearing debts are fixed, an increase in interest rates will continue to result in an increase in interest expenses. Fluctuations in the financial markets, such as fluctuations of the fair value of marketable securities and interest rates, could also increase the unfunded obligation of pension plans, which would result in an increase in periodic pension costs. Such increase in interest expenses and pension costs may adversely affect Komatsu's results of operations and financial conditions.

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- (4) Komatsu operates in a highly competitive industry in which its competitors may offer new or better products and services or lower prices, which could result in a loss of customers and a decrease in Komatsu's revenue and profit.**

Komatsu engages in businesses in competitive industries where other companies could provide new products and services with superior quality or lower-priced products. Through the Spirit of Manufacturers reform, Komatsu is working to realize higher profitability by providing products that feature both unique and unrivaled advantages and substantial cost reductions and by strengthening the superiority of such products. However, competitors' reinforcement of their products and marking down of their sales prices may further intensify the market competition and could reduce market shares of Komatsu's products as well as Komatsu's sales and profits.

- (5) Komatsu is subject to local regulations, and the costs relating to complying with future laws and regulations could adversely affect Komatsu's business and results of operations.**

Komatsu engages in business in many countries of the world, and is exposed to political and economic risks in each country where it operates. If the government of a given country enacts new regulations in the area of import/export duties, quotas, currency restrictions and taxation, etc., which are unfavorable for Komatsu, Komatsu may have to bear related costs in order to comply with such regulations. It is impossible for Komatsu to predict such future costs, and they could negatively affect Komatsu's results of operations.

- (6) Komatsu is subject to extensive environmental laws and regulations, and the costs to comply with existing or future laws and regulations could adversely affect Komatsu's results of operations.**

Komatsu's operations and products need to comply with increasingly stringent environmental laws and regulations in the numerous countries in which Komatsu operates. Such regulations govern, among other things, emissions into the air, discharges into water, the use, handling and disposal of hazardous substances, waste disposal and the remediation of soil and groundwater contamination. Komatsu expends a significant amount of resources to comply with regulations concerning the emissions levels of its manufacturing facilities and has recently incurred significant research and development expenses to develop products which meet such laws and regulations. However, if such laws and regulations are revised in the future, Komatsu may have to bear more costs and capital expenditures to comply with newly set standards and the increase of such costs could adversely affect Komatsu's results of operations.

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**(7) Komatsu may face product liability claims and if Komatsu's insurance does not cover these liabilities, Komatsu may incur significant costs which could reduce its profit.**

Komatsu manufactures heavy machinery used by its customers at excavation and construction sites and on roads, and works to sustain and ensure Quality and Reliability of its operations and products based on stringent standards established in-house. However, any defect in or improper operation of Komatsu's equipment can result in personal injury and death, and damage to or destruction of property, any of which could cause product liability claims to be filed against Komatsu. If they should not be covered by insurance, Komatsu would have to bear the costs, which could consequently reduce Komatsu's profit.

**(8) Komatsu's alliances with other entities may not produce successful results.**

Komatsu has entered into various alliances with other entities to reinforce its international competitiveness. While Komatsu expects its alliances to be successful, if differences were to arise among the parties due to managerial, financial or other reasons, such alliances may result in losses, which in turn could adversely affect Komatsu's results of operations.

**(9) The surging price of commodities may adversely affect Komatsu's results of operations, increasing costs of materials for Komatsu's products and bringing about short supply of parts and materials.**

Komatsu is facing the surging prices of commodities worldwide, which were triggered by the sharp growth of the Chinese economy and this price rise has accelerated mining activities and resulted in growth in demand for mining equipment produced by Komatsu. However, the price rise also leads to an increase in the costs of materials for Komatsu's products and Komatsu's production costs. At the same time, this market condition for commodities can result in a short supply of parts and materials, making it difficult for Komatsu to engage in timely procurement and production in response to expanded demand for its products, and thus lowering Komatsu's production efficiency. For increased costs for materials, Komatsu plans to reduce other costs and pass on the increased costs to sales prices of its products. Concerning the problems of timely procurement and production, Komatsu plans to minimize the loss by promoting closer collaboration among all related divisions. However, the more-than-anticipated surging price of materials and prolonging thereof could adversely affect Komatsu's results of operations.

**(10) Natural calamity on an unpredictable scale could adversely affect Komatsu's results of operations.**

As Komatsu conducts global business, it operates and maintains development, production, sales and other business facilities in many countries around the world. Komatsu is exposed to the risk of negative effects on its results of operations, when natural disasters, such as earthquakes and floods, occur on an unpredictable scale, devastatingly damage one or more facilities to the extent that such facilities' operations cannot be recovered in a short period of time, and cause delays or disruption of procurement of materials and parts, production or sales and service activities.

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### **Item 4. Information on the Company**

#### **A. History and Development of the Company**

The Company was incorporated in May 1921 under the Commercial Code of Japan as Kabushiki Kaisha Komatsu Seisakusho ( Komatsu Ltd. in English). Its registered office is located at 2-3-6 Akasaka, Minato-ku, Tokyo 107-8414, Japan, and its telephone number is +81-3-5561-2628 (Finance & Treasury Department).

Shortly after its formation in 1921, the Company commenced the production and marketing of sheet-forming presses. In 1931, the Company produced Japan's first crawler-type farm tractor and in the 1940s the Company began its production of bulldozers in Japan. The Company broadened its product range by beginning production of motor graders and dump trucks in the 1950s and wheel loaders and hydraulic excavators in the 1960s.

In terms of globalization, the history and development of the Company can be divided into 3 phases: (1) export from Japan; (2) offshore production; and (3) management of its global production and marketing network.

Since its first export to Argentina in 1955, the Company has gradually increased exports of its products, establishing its first liaison office in India in 1964 and sales companies in Europe, the United States and Asia from 1967 to 1971.

During the 1970s and 1980s, the Company started establishing its production facilities offshore and enhanced its offshore production by locating manufacturing plants close to the market. In 1975, the Company took the first step towards offshore production with the production of bulldozers in Brazil by Komatsu do Brasil Ltda., the first manufacturing plant established outside of Japan. Subsequently, Komatsu increased its global presence by establishing manufacturing plants in Indonesia, the United Kingdom and the United States during the 1980s. For example, during the late 1980s, the Company established Komatsu Dresser Company (currently known as Komatsu America Corp.), a joint venture with Dresser Industries, Inc. of the United States and made an equity investment in Hanomag AG of Germany (currently known as Komatsu Hanomag GmbH).

In the 1990s, the Company took measures to strengthen its offshore production and ensure a link between Komatsu's manufacturing plants and the global market. Komatsu has not only strengthened its local manufacturing capabilities but also has sought to optimize its production and distribution network on a global basis. The Company also formed business alliances, such as joint ventures. For instance, the Company established Komatsu Cummins Engine Co. Ltd. and Industrial Power Alliance Ltd. in Japan and Cummins Komatsu Engine Company in the United States, with Cummins Engine Company (currently known as Cummins Inc.). In addition, the Company entered into 3 joint ventures in China, and a joint venture with Mannesmann Demag of Germany to establish Demag Komatsu GmbH (currently known as Komatsu Mining Germany GmbH).



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The following are important events in the development of Komatsu's business during recent years.

In April 2000, Komatsu sold 65% of the outstanding shares of Komatsu Soft Ltd. (currently known as Qualica Inc.) to Toyo Information Systems Co., Ltd (currently known as TIS Inc.).

In June 2000, the Company acquired the shares of Komatsu Forklift Co., Ltd. ( Komatsu Forklift ), and converted Komatsu Forklift into its majority-owned subsidiary.

In October 2000, Komatsu sold its 69.15% equity holdings in Komatsu Construction Co., Ltd. ( Komatsu Construction ) to Takamatsu Corporation Co., Ltd.

In May 2002, the Company reached a global alliance agreement with Linde AG ( Linde ) of Germany, under which the two companies agreed to jointly own Komatsu Forklift.

In October 2002, the Company acquired all of the minority interests of Komatsu Forklift (48.5%) and Komatsu Zenoah Co. (45.7%) through stock for stock exchanges. As a result, Komatsu Forklift and Komatsu Zenoah Co. became wholly-owned subsidiaries of the Company.

In July 2003, the Company sold to Linde 31,011,000 shares of Komatsu Forklift's common stock, so that Linde owns 35% of the equity in Komatsu Forklift.

In November 2003, the Company entered into an agreement with KONE Corporation to acquire 100% of the shares of KONE's two subsidiaries - Partek Forest AB and Partek Forest Holdings, LLC - in order to make a full-scale entry into the forestry equipment market. The acquisition was completed in December 2003 and the two companies and their 12 subsidiaries have been treated as consolidated subsidiaries of the Company since December 31, 2003.

In December 2003, the Company entered into an agreement with Shimachu Co., Ltd. to sell its land in Kawasaki, Kanagawa, Japan. The contract was concluded in December 2003 and the land was duly delivered in July 2004.

In February 2004, the Company entered into an agreement to sell the land and buildings of Komatsu Silicon America, Inc., a wholly-owned subsidiary located in Hillsboro, Oregon, U.S.A., to the Park Company of Oregon, LLC. The land and buildings were duly delivered to the Park Company of Oregon, LLC in March 2004.

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In June 2005, Komatsu America Corp., Komatsu's U.S. subsidiary with 100% ownership interest in ASiMI, formally signed a definitive agreement with SGS Holdings Inc., a U.S. subsidiary of Renewable Energy Corporation AS ( REC ), a Norwegian company, to sell 75% of its ownership interest in ASiMI to REC. This transaction is scheduled to close at the end of July, subject to the satisfaction of certain conditions in the definitive agreement.

**PRINCIPAL CAPITAL EXPENDITURES**

Komatsu invests capital each year in the development and production of new products and the improvement of operating efficiency of its production infrastructure primarily focusing on the construction and mining equipment operating segment. Komatsu's capital expenditures for the fiscal years ended March 31, 2005, 2004, 2003 were ¥89,019 million, ¥78,049 million and ¥70,473 million, respectively. Capital expenditures for the fiscal year ended March 31, 2005 by operating segment were as follows.

**Capital Expenditures by Operating Segment**

	<u>Millions of Yen</u>	
	<u>Fiscal Year ended March 31, 2005</u>	<u>Percentage Change as compared to the Fiscal Year ended March 31, 2004</u>
Construction and Mining Equipment	¥ 64,547	14.6%
Industrial Machinery, Vehicles and Others	10,980	27.0%
Electronics	13,492	3.3%
<b>Total</b>	<b>¥ 89,019</b>	<b>14.1%</b>

\* Amounts include certain leased machinery and equipment accounted for as capital leases in conformity with SFAS No. 13 Accounting for leases .

In the construction and mining equipment operating segment, Komatsu made investments in Japan (i) to enhance its production capacity of major equipment components which are mainly produced in Japan, such as hydraulics units, final drives, transmissions and axles, (ii) to develop and produce products which meet the Tier III engine emissions standards of the United States and Europe and (iii) to improve product quality, workplace safety and environmental friendliness. Outside of Japan, Komatsu invested capital not only to develop new products and new models of existing products, but also to reorganize its production lines to promote effective utilization of its plants on a global basis.

In the industrial machinery, vehicles and others operating segment, Komatsu invested capital to increase operational efficiencies of its production lines, to replace aging facilities, and to develop new products and new models of existing products.

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In the electronics operating segment, Komatsu Electronic Metals Co., Ltd. ( KEM ) invested capital to expand production capacity of its 300mm silicon wafers in response to the increase in demand for such products. With the goal of enhancing the competitiveness of its 200mm wafers, KEM also made investments to improve its production facilities so that these facilities can manufacture higher quality products and increase its productivity. In addition, Formosa Komatsu Silicon Corporation made investments to increase the production capacity of its facilities that manufacture the 200mm silicon wafers.

Komatsu's capital expenditures were primarily financed by funds on hand and capital leases.

## **B. Business Overview**

### GENERAL

Komatsu is a global company that engages in the manufacturing, development, marketing and sale of a diversified range of industrial-use products and services. With Quality and Reliability as the cornerstone of its management policy, Komatsu is committed to providing safe, innovative products and services that satisfy its customers' needs and expectations.

While Komatsu's core business continues to be construction and mining equipment, Komatsu has engaged in other businesses, such as industrial machinery and vehicles, and electronics. Each such business is described in further detail below under the heading PRODUCTS AND SERVICES .

The manufacturing operations of Komatsu are conducted primarily at plants located in Japan, the United States, Germany, the United Kingdom, Sweden, Indonesia, Brazil, Italy, China and Taiwan. Komatsu's products are primarily sold under the Komatsu brand name and almost all of its sales and service activities are conducted through sales subsidiaries and sales distributors who primarily sell products to retail dealers in their respective geographic area.

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## PRODUCTS AND SERVICES

Komatsu's business activities are divided into three operating segments, namely, (1) construction and mining equipment, (2) industrial machinery, vehicles and others and (3) electronics.

## Net Sales Information

Financial information (other than net sales figures by geographic segment) as presented in Komatsu's audited consolidated financial statements is reproduced and discussed below. The following table sets forth Komatsu's net sales by operating segment for the fiscal years ended March 31, 2005, 2004 and 2003, respectively.

**Net Sales by Operating Segment**

	(Millions of Yen)					
	Fiscal Year		Fiscal Year		Fiscal Year	
	Ended 3/31/2005		Ended 3/31/2004		Ended 3/31/2003	
Construction and Mining Equipment	¥ 1,061,161	73.9%	¥ 863,244	72.2%	¥ 767,840	70.5%
Industrial Machinery, Vehicles and Others	266,455	18.6%	241,991	20.2%	236,782	21.7%
Electronics	107,172	7.5%	91,183	7.6%	85,182	7.8%
<b>Total</b>	<b>¥ 1,434,788</b>	<b>100.0%</b>	<b>¥ 1,196,418</b>	<b>100.0%</b>	<b>¥ 1,089,804</b>	<b>100.0%</b>

## (1) Construction and Mining Equipment

Construction and mining equipment has been Komatsu's mainstay operating segment during the last several decades and it is expected to remain Komatsu's core operating segment. Net sales from this operating segment has been increasing gradually during the last few years and accounted for 73.9% of Komatsu's total net sales for the fiscal year ended March 31, 2005.

## Products

Komatsu offers various types of construction and mining equipment, ranging from super-large machines capable of mining applications to mini units for urban use. Komatsu's range of products in this operating segment includes a wide variety of attachments to be used with its products. Komatsu's principal products in this operating segment are broken into the following categories of equipment.



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<u>Category</u>	<u>Principal Products</u>
Excavating Equipment	Hydraulic excavators, mini excavators, and backhoe loaders*
Loading Equipment	Wheel loaders, mini wheel loaders, and skid-steer loaders*
Grading and Roadbed Preparation	
Equipment	Bulldozers, motor graders, and vibratory rollers
Hauling Equipment	Off-highway dump trucks, articulated dump trucks, and crawler carriers
Forestry Equipment	Harvesters*, forwarders*, and feller bunchers*
Tunneling Machines	Shield machines, tunnel-boring machines, and small-diameter pipe jacking machines ( <i>Iron Moles</i> )
Recycling Equipment	Mobile debris crushers, mobile soil recyclers, and mobile tub grinders
Other Equipment	Material handlers, auger/press-in pile drivers
Engines and Components	Diesel engines, diesel generator sets, and hydraulic equipment
Casting Products	Steel castings and iron castings*

Note: Those denoted with an asterisk (\*) are principal products and major lines of businesses of the Company's subsidiaries.

To remain competitive in this operating segment, Komatsu introduced the Dantotsu Strategy in 2003 and has been working to increase the number of Dantotsu products. Dantotsu means unique and unrivaled in Japanese. Komatsu only designates its product as a Dantotsu product if such product is considered unique and unrivaled as compared to those produced by Komatsu's competitors as these products are equipped with one or two features that its competitors cannot match for some time. Since the introduction of Dantotsu products, Komatsu has been working to replace many of its product models with Dantotsu products. Some of the initial Dantotsu products include the MR-2 Series Tight-Tail-Swing Mini Hydraulic Excavators and PC400 GALEO Series Hydraulic Excavators to name a few. Komatsu plans to continue to conduct model changes to replace a certain portion of existing models of its construction and mining equipment with Dantotsu models.

In addition to the sale of new products, Komatsu has also been focusing on downstream businesses, such as the used equipment business and the rental equipment business. Recognizing the increase in demand for used equipment outside of Japan, Komatsu Used Equipment Corp. has been facilitating the sale of used equipment by holding annual auctions in several locations in Japan since the mid 1990s. In addition, Komatsu has made efforts to improve the management efficiency and profitability of its rental equipment business by overhauling existing operations and functions of rental subsidiaries and introducing a new integrated business model.

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### Parts and Services

Komatsu is committed to providing superior customer support to ensure that its customers can use its equipment in complete confidence and at minimum cost. Some of these superior customer support measures include (i) providing information systems to optimize the productivity of Komatsu's products, (ii) keeping an extensive supply of equipment parts available and (iii) offering on-site replacement of major equipment components with remanufactured components.

#### *(i) Information Systems*

In recent years, Komatsu has developed proprietary technologies to be used with its construction equipment and mining equipment in order to optimize the productivity of such equipment. With respect to construction equipment, Komatsu has developed a proprietary technology known as the KOMTRAX asset management system. The KOMTRAX system transmits mechanical information every hour concerning machine location, daily and cumulative hours of operation, fuel consumption, radiator temperature and replacement schedule for oil and filter. In addition, the system provides real-time alerts when abnormal conditions, such as clogging of filters, are detected. With such information, Komatsu and its customers are able to troubleshoot issues and undertake repairs more efficiently and effectively. KOMTRAX also enables Komatsu to develop periodic inspection plans and provide inspection based on the service meter readings so as to assist its customers in maintaining the equipment. In addition to improving the service efficiencies of Komatsu's distributors and providing better services to customers, KOMTRAX's real-time service meter readings allows Komatsu to collect information that enables it to promptly assess and evaluate market changes, thereby enabling it to quickly respond to market conditions and strategically assess its production and sales needs.

While KOMTRAX was initially available only in Japan, KOMTRAX has been installed on Komatsu's hydraulic excavators as a standard feature since February 2004. In China, with Komatsu (China) Ltd. ( KC ), Komatsu has led the construction equipment industry in providing new support programs by taking advantage of the KOMTRAX system. In March 2004, KC created the KOMTRAX Monitoring Center with three full-time staff members and has commenced providing comprehensive support to customers and distributors. As of April 30, 2005, Komatsu offers services based on KOMTRAX information to over 3,600 machines throughout China. In addition, customers may also obtain KOMTRAX information concerning their machine conditions from their cellular phones and personal computers. KC has given KOMTRAX trainings to its distributors throughout China, and they have established support programs based on daily information from the KOMTRAX system.

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Separate from the KOMTRAX system that is used for construction equipment, Komatsu has designed a similar information system that is available for its mining equipment, known as the Vehicle Health Monitoring System ( VHMS ) and WebCARE. Through the use of VHMS and WebCARE, Komatsu can monitor the conditions of main components of mining equipment, such as engines, transmissions and hydraulic units. VHMS provides real-time and stored information and such information collected from each equipment can be analyzed using WebCARE for machine maintenance, troubleshooting and preventive maintenance. The maintenance crew can access the information stored on each equipment by directly hooking their laptop computers to the VHMS controller on the machine which gathers information from sensors mounted on the main components of such equipment, or via telecommunications satellites (optional). In the latter case, real-time information of the mining equipment in operation is available.

Designed for comprehensive analyses of equipment, WebCARE serves as an internet database for VHMS and other monitored data. This database is accessible by Komatsu's divisions that work together to provide technical support to distributors. It is also accessible by registered distributors and can assist such distributors to develop optimal maintenance schedules in addition to producing weekly reports for their customers concerning machine health evaluations and operating conditions. Currently, VHMS and WebCARE are available for six large dump truck models, three large hydraulic excavator models, two large wheel loader models, and two large bulldozer models. Some 600 units of Komatsu mining equipment are equipped with VHMS around the world. Taking advantage of these two systems, Komatsu and its distributors, as a single team, work to facilitate the reduction of repair expenses for customers' machines, helping them improve their operating costs and maximize their productivity.

### *(ii) Parts Supply*

Construction equipment is often required to operate under demanding conditions and the time in which the equipment may be inoperable is a very serious problem for customers. While the total number of parts for Komatsu machines including older models is approximately 1.3 million, Komatsu carries some 300,000 parts in stock to assist its customers in decreasing the downtime of its equipment. To ensure smooth and efficient parts supply to its customers, Komatsu operates P-WINS, a worldwide supply network whose service is available around-the-clock, through which customers may order parts. During the fiscal year ended March 31, 2005, Komatsu embarked on restructuring its parts depots around the world by consolidating its parts inventory to a few key facilities in order to expand the area of next morning delivery of parts and to reduce the number of parts that Komatsu and its distributors held in inventory.



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In North America, the world's largest market for construction and mining equipment, Komatsu customarily supplied parts to all of its distributors across the United States from its Parts Center in Ripley, Tennessee. Komatsu America Corp. ( KAC ), Komatsu's regional headquarters for the Americas, has been working to establish sub-depots in strategic areas throughout the United States to allow for faster delivery of parts. In January 2004, KAC established a sub-depot in Pittsburgh, Pennsylvania by consigning the storage and retrieval of parts to a distributor in that area. KAC is planning to open its own depot in Las Vegas, Nevada in June 2005. In addition, by the end of 2005, KAC is planning to open depots in Colorado, Minnesota, and Oregon. KAC's ultimate plan is to have depots in Texas as well as Florida. With a total of seven sub-depots and the Parts Center, KAC plans to ensure overnight delivery of parts to its customers located in the United States.

In Europe, Komatsu Europe International N.V. ( KEISA ), Komatsu's regional headquarters for Europe, commenced the Komatsu Europe Parts Operation in January 2004 by consolidating its three parts depots in Hannover, Germany and Noventa, Italy and Vilvoorde, Belgium, each of which supplied parts for different equipment, into a single major parts depot located in Vilvoorde, Belgium. With this consolidation, KEISA unified its parts ordering system, simplifying order placement processing on the part of its distributors and expanded the area in which it was able to deliver parts the next morning, while reducing the distributors' inventories in unnecessary parts. KEISA has also completed expanding its warehouse space for parts, thereby reinforcing its capability to supply parts to some 60 countries in Europe, the Middle East and Africa.

### *(iii) Remanufactured Equipment Components*

Komatsu offers speedy on-site replacement of major construction and mining equipment components that function at reduced operational rates as a result of mechanical failure or aging with high-quality and reasonably priced remanufactured components called Reman components. Komatsu has eight Reman centers around the world, and at such centers major components and engines for generators are reconditioned into Reman components under rigorous quality control and delivered to many customers. These reconditioned Reman components offer Komatsu's customers an alternative to purchasing new equipment.

### *(2) Industrial Machinery, Vehicles and Others*

While net sales of the industrial machinery, vehicles and others operating segment only accounted for 18.6% of Komatsu's total net sales as compared to over 20% of Komatsu's total net sales for the last two fiscal years, net sales derived from this operating segment has been increasing for the last three fiscal years. During the fiscal year ended March 31, 2005, Komatsu received increased orders from its customers for large presses that incorporated new technologies, and Komatsu expects further growth in this operating segment.

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The products available in this operating segment are used by a wide range of businesses and include industrial machinery (*i.e.* forging and sheet metal machinery), forklift trucks and other services such as logistics and the creation of training materials. Komatsu's principal products in this operating segment fall into the following categories of equipment.

<b><u>Category</u></b>	<b><u>Principal Products</u></b>
Metal Forging and Stamping Presses	Large presses, small and medium-sized presses*, forging presses*, and AC-servo presses*
Sheet-Metal Machines and Machine Tools	Press brakes*, shears*, laser cutting machines*, fine plasma cutting machines*, and crankshaft millers*
Industrial Vehicles, Logistics	Forklift trucks*, packing and transport*
Defense Systems	Ammunition and armored personnel carriers
Outdoor Power Equipment	Chainsaws* and trimmers/brushcutters*
Others	Commercial-use prefabricated structures

Note: Those denoted with an asterisk (\*) are principal products and major lines of businesses of the Company's subsidiaries.

## (3) Electronics

Net sales derived from the electronics operating segment has been increasing for the last three fiscal years despite the fact that it only accounted for 7.5% of Komatsu's total net sales and the percentage has been decreasing for the last three fiscal years. Komatsu offers a diverse range of products in this operating segment, ranging from silicon wafers for semiconductors, parts and materials for sensors and devices, to construction equipment-mounted controllers. Komatsu's principal products in this operating segment fall into the following categories.

<b><u>Category</u></b>	<b><u>Principal Products</u></b>
Electronic Materials	Silicon wafers*, polycrystalline silicon* and monosilane gas*
Communications Equipment and Control Equipment	Network information terminals*, LAN peripheral equipment* and vehicle communication terminals
Temperature-Control Equipment	Thermoelectric modules* and temperature-control equipment for semiconductor manufacturing*

Note: Those denoted with an asterisk (\*) are principal products and major lines of businesses of the Company's subsidiaries.

## PRINCIPAL MARKETS

Komatsu operates and competes in the following six principal markets: (i) Japan, (ii) the Americas, (iii) Europe, (iv) China, (v) Asia (excluding Japan and China) and Oceania and (vi) the Middle East and Africa.

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In this annual report, information regarding net sales by geographic segment is presented in the following two ways: (1) by sales destination (based on the country where the purchaser is located), and (2) by sales origin (based on the country where the seller is located). The following table sets forth Komatsu's net sales recognized by sales destination for the fiscal years ended March 31, 2005, 2004 and 2003, respectively. Net sales data by geographic origin are set forth in Note 21 to Komatsu's audited consolidated financial statements, included elsewhere in this report.

**Table of Contents****Net Sales by Region**

	(Millions of Yen)							
	Fiscal Year Ended		Fiscal Year Ended		Fiscal Year Ended			
	3/31/2005		3/31/2004		3/31/2003			
Japan	¥ 521,135	36.3%	¥ 483,749	40.4%	¥ 458,000	42.0%		
Americas	359,572	25.1%	277,302	23.2%	251,371	23.1%		
Europe	203,581	14.2%	151,619	12.7%	145,455	13.3%		
China	55,837	3.9%	87,127	7.3%	52,465	4.8%		
Asia (excluding Japan and China) and Oceania	210,861	14.7%	135,542	11.3%	123,712	11.4%		
Middle East and Africa	83,802	5.8%	61,079	5.1%	58,801	5.4%		
<b>Total</b>	<b>¥ 1,434,788</b>	<b>100.0%</b>	<b>¥ 1,196,418</b>	<b>100.0%</b>	<b>¥ 1,089,804</b>	<b>100.0%</b>		

**SALES AND DISTRIBUTION**

Komatsu's international and domestic sales and distribution functions in its construction and mining equipment operating segment are conducted primarily through a network of subsidiaries, affiliates and independent distributors, and to a lesser extent by its partners of jointly-owned companies.

Komatsu's construction and mining equipment sales and distribution operations in Japan focus principally on retail sales to customers, partly on an installment basis. In addition, Komatsu has enhanced equipment rental services in Japan through rental companies, especially for its construction and utility equipment, in response to strong demand from its customers. Distributors and dealers form the core of the service network providing total customer-support services in Japan.

Komatsu's overseas sales of construction and mining equipment are made through a sales and service network consisting of approximately 200 distributors. Komatsu supplies its products to distributors around the world through trading companies and the Company's subsidiaries and affiliated companies, supported by Komatsu's liaison offices. Komatsu's major sales subsidiaries and affiliates are located in Australia, Belgium, Brazil, Chile, China, France, Germany, Italy, Russia, Singapore, South Africa, Sweden, the United Arab Emirates and the United States. These subsidiaries and affiliates provide additional inventory and technical assistance to Komatsu's distributors while facilitating the delivery of emergency spare parts. Outside of Japan, these subsidiaries and affiliates as well as Komatsu's distributors provide the services that customers may require with respect to their construction and mining equipment.

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Komatsu's sales of products in the industrial machinery, vehicles and others operating segment include direct sales to customers and sales through distributors, dealers and trading companies. For example, large presses are mainly sold directly to customers while small and medium-sized presses are primarily sold through distributors and dealers. Komatsu's electronics products are mainly sold directly to customers and to a lesser extent sold through distributors and dealers.

## **SOURCES OF SUPPLY**

As it is not economical nor efficient for Komatsu to manufacture all component and parts, Komatsu produces some of its major equipment components internally and purchases other components and parts such as electrical components, tires, hoses, and batteries, etc. from other manufacturers who specialize in manufacturing these products. In addition, Komatsu procures some parts, such as metal forgings, machine components, sheet metal parts and various accessories, from its business partners. Therefore, the fluctuations in prices of materials for such components, such as steel materials, would affect Komatsu's results of operations. Of the ¥913,653 million consolidated overseas net sales (recognized by sales destination) for the fiscal year ended March 31, 2005, export by the Company of products manufactured in Japan accounted for ¥310,961 million. Komatsu believes that it has adequate and reliable supply sources for its material components, parts and raw materials, and that it has appropriate alternative sources available consistent with its prudent business practices.

## **SEASONALITY**

Komatsu's businesses have historically experienced some seasonal fluctuations in sales. While there are variations by market and product, Komatsu's consolidated sales for the fourth quarter have been highest for the past four years. However, this seasonality has generally not been material to Komatsu's results of operations.

## **PATENTS AND LICENSES**

Komatsu holds numerous Japanese and foreign patents, design patents and utility model registrations relating to its products. It also has a number of applications pending for Japanese and foreign patents. Under Japanese law, a utility model registration is a right granted with respect to inventions of less originality than those which qualify for patents. Komatsu also manufactures a variety of products under licensing agreements with various other companies.

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While Komatsu considers all of its patents and licenses to be important for the operation of its business, it does not consider any of its patents or licenses or any related group of them to be so important that its expiration or termination would materially affect Komatsu's business as a whole, nor does it believe that any category of its activities is materially dependent upon patents or licenses, or patent or license protection. Komatsu also owns and maintains a substantial number of trademarks and trade names that are registered or otherwise protected under the laws of various jurisdictions.

## COMPETITION

### *Construction and Mining Equipment*

As a manufacturer of a full line of construction equipment, Komatsu provides a broad range of products for mining and general construction as well as utility equipment. Komatsu's competitors in the construction and mining equipment operating segment consist of global competitors, regional competitors and locally specialized competitors. While competition is severe in all of the product categories in this operating segment, Komatsu maintains its firm position as one of the largest manufacturers in the industry. The competitive environment for the fiscal year ended March 31, 2005 by geographic area is described in further detail below.

In Greater Asia which includes Asia, the Middle East and the Commonwealth of Independent States ( CIS ), Komatsu held a strong position against its competitors. It is expected that the economies in Greater Asia will achieve strong growth in the future and while Komatsu considers the market to be promising, it also expects the market to be highly competitive. While demand for construction and mining equipment sharply decreased in China for the fiscal year ended March 31, 2005, the market has not become excessively competitive.

North America is the largest market for construction equipment in the world and competition is fierce within each product category. Among Komatsu's competitors, Caterpillar Inc. is the market leader in construction and mining equipment. The North American market grew significantly during the fiscal year ended March 31, 2005, and Komatsu benefited from the robust market conditions in the United States, along with other construction equipment manufacturers.

In Europe, in addition to global companies, there are many regional or locally specialized competitors who have firm footings in the local market. Komatsu competes with different competitors in each country or region, and the market is very competitive and it has not been easy for Komatsu to improve its market position in Europe.

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In addition, Komatsu has made considerable technological advances with respect to its hydraulic excavators for which demand is increasing in recent years. While the competition in the hydraulic excavators market is fierce, Komatsu maintains its position as one of the market leaders. Komatsu also believes that its use of such information technologies as KOMTRAX, VHMS and WebCARE to enhance data collection and analysis efficiencies will provide Komatsu a competitive advantage.

### *Industrial Machinery, Vehicles and Others*

In the industrial machinery, vehicles and others operating segment, Komatsu's principal products consist of (i) metal forging and stamping presses, (ii) sheet metal machines and machine tools and (iii) forklift trucks. As discussed below, the market for these products is highly competitive.

#### *(i) Metal Forging and Stamping Presses*

Komatsu manufactures and sells stamping presses that are used to press doors, roofs and other automobile parts into shapes. With respect to large presses, which are mainly sold to automobile manufacturers, Komatsu considers Ishikawajima-Harima Heavy Industries Co., Ltd., Hitachi Zosen Fukui Corporation and AIDA Engineering, Ltd. ( AIDA ) of Japan and Schuler AG and Müller-Weingarten AG of Germany to be its major competitors. In Japan, Japanese manufacturers including Komatsu who have advantageous positions over non-Japanese manufacturers compete with other Japanese manufacturers. Likewise, German manufacturers have dominant positions in the German large press market. In other markets, Komatsu competes with regional and locally specialized competitors in addition to the above-mentioned manufacturers. The competitive environment has become increasingly severe in China where many automobile manufacturers have been establishing manufacturing plants and making a large capital investment.

With respect to small and medium-sized presses, the major markets for Komatsu are Asia (including Japan) and North America. Major competitors include AIDA and Amada Co., Ltd. ( Amada ) of Japan, Minster Machine Company of the United States and Chin Fong Machine Industrial Co., Ltd. of Taiwan.

#### *(ii) Sheet Metal Machines and Machine Tools*

With respect to sheet metal machines, Japan is the major market for Komatsu's products and competitors include Japanese manufacturers such as Amada and Koike Sanso Kogyo Co., Ltd. Amada enjoys a large market share with a wide range of products in the industry. To effectively compete in this industry, Komatsu takes a niche-market strategy.

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The principal products of Komatsu's machine tool business include crankshaft millers, camshaft millers, multiplex machine tools and components for liquid crystal display panels manufacturing. Major competitors in the crankshaft millers market include Boehringer Werkzeugmaschinen GmbH (Boehringer) and Gebrüder Heller Maschinenfabrik GmbH (Heller) of Germany. In Japan, Komatsu enjoys a predominant position in the crankshaft miller market. On the other hand, German manufacturers dominate the market in Germany. In other markets such as North America and China, Komatsu mainly competes with Boehringer and Heller.

### *(iii) Forklift Trucks*

The major markets for forklift trucks have been Europe, the United States and Japan. Recently, China has been developing into the fourth market as well. While European and U.S. manufacturers of forklift trucks sell not only forklift trucks but also warehousing equipment, Japanese manufacturers primarily focus on forklift trucks. Major competitors in this market include Japanese manufacturers such as Toyota Industries Corporation (Toyota), Mitsubishi Heavy Industries, Ltd. (Mitsubishi) and Nissan Forklift (Nissan), German manufacturers such as Linde and Jungheinrich AG (Jungheinrich) and U.S. manufacturers such as NACCO Industries, Inc. (Nacco) and Crown Equipment Corporation (Crown).

Toyota, the market leader, has reinforced its market penetration worldwide by expanding its product range through the acquisition of BT Industries AB, a European warehousing equipment manufacturer. In Europe, Toyota follows Linde and Jungheinrich, but these German manufacturers have dominant positions in the largest German market. In the United States where Nacco and Toyota have strong market positions, there is intensified competition among Nacco, Toyota, Komatsu, Mitsubishi, Nissan and Crown. In Japan and Asia where there is severe competition mainly among the major Japanese manufacturers, Komatsu has the second largest market share in terms of unit sales following Toyota. In China, locally specialized manufacturers providing lower-priced products account for approximately 70% of the total market share.

### *Electronics*

In the electronics operating segment, Komatsu's principal products consist of (i) electronic materials and (ii) temperature control equipment such as thermoelectric modules used for semiconductor manufacturing equipment and optical communications systems. The competitive environment of these major products is discussed below.



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*(i) Electronic Materials*

With respect to the silicon wafers business, Komatsu's principal competitors include Shin-Etsu Handotai Co., Ltd. (Shin-Etsu), Sumitomo Mitsubishi Silicon Corporation (SUMCO), and Toshiba Ceramics Co., Ltd. of Japan, Siltronic AG of Germany and MEMC Electronic Materials, Inc. (MEMC) of the United States. With respect to the 300mm silicon wafers for which demand has been growing rapidly, Japanese manufacturers such as Shin-Etsu and SUMCO take a lead in the market and maintain dominant position. Despite entering into the market at a later stage, KEM has been steadily increasing its 300mm wafers production capacity. As customers demand higher quality products each year, the silicon wafer industry is becoming very competitive.

With respect to the polycrystalline silicon business, Komatsu's principal competitors include Hemlock Semiconductor Corporation and MEMC of the United States, Tokuyama Corporation of Japan and Siltronic AG of Germany. Polycrystalline silicon is used in semiconductor applications and more recently has been used in solar applications. As the demand for solar powered products has increased in recent years, the demand for polycrystalline silicon has increased as well. As a result, the demand for polycrystalline silicon has exceeded the supply and the price has been increased during the fiscal year ended March 31, 2005.

With respect to the monosilane gas business, Komatsu's principal competitors include MEMC of the United States, Denal Silane and Mitsui Chemicals, Inc. of Japan. The demand for monosilane gas has increased rapidly as it is used for liquid crystal displays (LCD), in addition to semiconductor applications.

*(ii) Temperature Control Equipment*

Komatsu Electronics Inc. possesses the most advanced level of thermoelectric technology in the world and is a market leader in the micro module market which utilizes this technology. As a result, Komatsu holds a strong market position in the micro modules market and Komatsu considers its principal competitor in this industry to be Marlow Industries Inc. of the United States. The precision requirements for temperature control in the semiconductor manufacturing process have become increasingly severe due to the continually shrinking line width and the shift to 300mm wafers. With Komatsu Electronics Inc.'s state-of-the-art thermoelectric technology, Komatsu believes that it will continue to have opportunities to increase its sales volume in the temperature control equipment market.

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REGULATIONS

Komatsu is subject to a wide range of laws and regulations in the countries and regions where it operates, including safety regulations, restrictions on emissions, noise and vibration from its products, various environmental controls regulating the manufacturing processes such as the management of toxic chemicals and hazardous wastes, green procurement and recycling. Komatsu's operations and products are designed to comply with all applicable environmental regulations currently in effect in the relevant jurisdictions. Komatsu expects to remain in substantial compliance with existing applicable environmental control regulations and does not expect that the cost to comply with foreseeable regulations will have a material effect upon its financial position and the results of operations. Some of the important environmental laws and regulations that affect Komatsu's businesses are summarized below.

*Regulations regarding engine emissions*

The Ministry of Land, Infrastructure and Transport of Japan ( MLIT ) introduced the type approval system for low-emission type construction equipment used in construction in 1997, setting the maximum emission levels by model and power range. While the maximum emission levels set by MLIT are not legally binding, they function as practical standards on engine emissions, since only construction equipment which has obtained such approval is allowed to be used in construction projects that are under the direct control of MLIT. The engine emissions standards currently applicable are the Tier II standards introduced in October 2003. The Tier II standards have also set additional procedures for on-road special vehicles under the Road Transportation Vehicle Law. At the start of the application of the Tier III standards which is scheduled in October 2006, it is expected that new laws will be implemented to broaden the scope of the regulations to include off-road construction equipment.

In the United States, the Environmental Protection Agency introduced Tier I standards for equipment under 37 kW (50 hp) in 1998 and the more stringent Tier II and Tier III standards for all equipment will be phased-in from 2000 to 2008. The Tier III emissions regulations will be in effect in the United States in January 2006, calling for a substantial reduction of NOx.

In Europe, the Engine Emissions Directive 97/68/EC regarding the measures against emission of gaseous and particulate pollutants from internal combustion engines to be installed in off-road mobile machinery went into effect in 1999 and the second stage of the directive was implemented from 2002 to 2004. The third stage of the directive will be implemented from 2006 to 2008.

While it is technically demanding to develop equipment which meets the Tier III engine emissions standards in Japan, the United States and Europe, Komatsu believes that it will be able to remain in substantial compliance, taking advantage of its capability to produce engines internally.

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### *Regulations regarding noise and vibration*

In Japan, the type approval system for low-noise emission and low-vibration type construction equipment was established by MLIT in 1983. Under this system, manufacturers are required to file an application with MLIT for the approval of their low-noise and low-vibration type construction equipment which meets the standards set forth by MLIT. The current measurement method and limits on noise have been in effect since October 1997. The type approval system for low-vibration construction equipment started in October 1996, which is not legally binding but sets forth regulatory standards for vibratory hammers and hydraulic excavators.

In Europe, European Parliament and Council Directive 95/27/EC of June 1995 amending Council Directive 86/662/EEC on the limitation of noise emitted by hydraulic excavators, rope-operated excavators, dozers, loaders and excavator-loaders has been in effect since January 1997. This directive defined the maximum sound-power levels of airborne noise emitted by these earth-moving machines under dynamic operating conditions and required manufacturers to obtain an EC type-examination certificate. The second stage of the directive which requires further noise reduction will be applied from 2006. In January 2002, European Parliament and Council Directive 2000/14/EC relating to the noise emission in the environment by equipment for use outdoors went into effect. The regulation applies to a wide range of product types from gardening equipment to construction and waste-management equipment and such products must bear a CE-mark and the indication of their guaranteed sound-power level before they can be brought to the market. Manufacturers are required to confirm that the noise emitted from their products would not exceed the guaranteed sound-power level.

Komatsu's management has defined environmental issues as one of its important management tasks and has made it a company-wide priority to promote awareness of environmental issues. In 1991, Komatsu's environmental management framework was built by creating the Earth Environment Committee chaired by the president (currently the director responsible for supervision of environment). In 1992, Komatsu's management established the Komatsu Earth Environment Charter and has put in place initiatives designed to reduce the environmental impact of its business operations to the environment, mainly focusing on its construction and mining equipment operating segment. In July 2003, Komatsu's management revised this Charter and established three new guiding principles: (1) contributing towards realization of a sustainable society, (2) striving to optimize both environmental and economic performance, and (3) observing corporate social responsibility. Simultaneously, Komatsu created the Environmental Affairs Department to expand Komatsu's environmental conservation efforts in all of its business operations and promote environmental management on a consolidated basis, including all of its overseas manufacturing subsidiaries.

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In 1997, Komatsu started auditing its manufacturing facilities in Japan to obtain ISO14001 certification. As a result, all of its manufacturing facilities in Japan acquired ISO14001 certification by the end of March 2003. However, audits based on ISO14001 are primarily designed to inspect functional effectiveness of the environmental management system at each facility, and thus are not necessarily capable of identifying potential environmental risks at the facility. In 2004, Komatsu started voluntary audits focusing more on environmental performance. Internal auditors of Komatsu evaluated facilities other than their own using the Komatsu Environmental Check Sheets and shared their findings not only with the audited facility but also on a Groupwide basis to promote further improvements. For additional information, such as figures and goals related to Komatsu's environmental measures as well as environmental accounting, please refer to Komatsu's *Environmental & Social Report 2005* issued in July 2005, which is available through Komatsu's website at <http://www.komatsu.com/>.

**C. Organizational Structure**

As of March 31, 2005, Komatsu Ltd. had 141 consolidated subsidiaries and 44 affiliates under the equity method. The following list shows the principal subsidiaries as of March 31, 2005.

<u>Name of the Company</u>	<u>Country of Incorporation</u>	<u>Ownership Interest (%)</u>
Komatsu Forklift Co., Ltd.	Japan	65.0
Komatsu Electronic Metals Co., Ltd.	Japan	62.6
Komatsu Zenoah Co.	Japan	100.0
Komatsu Castex Ltd.	Japan	100.0
Komatsu Kinki Ltd.	Japan	100.0
Komatsu House Ltd.	Japan	89.3
Komatsu Logistics Corp.	Japan	97.1
Komatsu Industries Corporation	Japan	100.0
Komatsu Chugoku Ltd.	Japan	100.0
Komatsu Tokyo Ltd.	Japan	100.0
Komatsu Machinery Corporation	Japan	100.0
Komatsu Hokkaido Ltd.	Japan	100.0
Komatsu Electronics, Inc.	Japan	100.0
Komatsu Used Equipment Corp.	Japan	100.0
Komatsu America Corp.	U.S.A.	100.0
Komatsu do Brasil Ltda.	Brazil	100.0
Advanced Silicon Materials LLC	U.S.A.	100.0
Komatsu Europe International N.V.	Belgium	100.0
Komatsu UK Ltd.	U.K.	100.0
Komatsu Hanomag GmbH	Germany	100.0
Komatsu Mining Germany GmbH	Germany	100.0
Komatsu Forest, AB	Sweden	100.0
Komatsu Utility Europe S.p.A.	Italy	100.0
Komatsu Asia & Pacific Pte Ltd.	Singapore	100.0
PT Komatsu Indonesia Tbk	Indonesia	68.4
Bangkok Komatsu Co., Ltd.	Thailand	74.8
Komatsu Australia Pty. Ltd.	Australia	60.0
Komatsu (China) Ltd.	China	100.0
Komatsu (Changzhou) Construction Machinery Corp.	China	85.0
Komatsu Shantui Construction Machinery Co., Ltd.	China	60.0

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### Notes:

1. Proportion of ownership interest includes indirect ownership and equals to the proportion of voting power.
2. In November 2002, the Company signed an agreement with Linde AG of Germany under which Linde would make an equity participation in Komatsu's forklift trucks business. In accordance with the agreement, Linde AG acquired and has a 35% equity stake in Komatsu Forklift Co., Ltd. as of March 31, 2005.
3. The Company invests in Komatsu do Brasil Ltda. through a subsidiary.
4. Advanced Silicon Materials LLC is a limited liability company incorporated under the laws of the State of Delaware, U.S.A. and the Company invests in this company through a subsidiary.
5. The equity stakes of the Company in Komatsu UK Ltd., Komatsu Utility Europe S.p.A., Bangkok Komatsu Co., Ltd. and Komatsu Australia Pty. Ltd. include the stakes held by the subsidiaries of the Company.
6. The ownership ratios for Komatsu Hanomag GmbH, Komatsu (Changzhou) Construction Machinery Corp. and Komatsu Shantui Construction Machinery Co., Ltd. include the ownership interests held by subsidiaries of the Company.

### **D. Property, Plants and Equipment**

Komatsu's manufacturing operations are conducted in 33 principal plants, 12 of which are located in Japan. As of March 31, 2005, the 33 plants had an aggregate manufacturing floor space of 1,575 thousand square meters (16,953 thousand square feet). In addition, Komatsu uses additional floor space at such plants and elsewhere for laboratories, office buildings, and employee housing and welfare facilities. Instead of installing a manufacturing plant, Komatsu could increase its production by requesting that its employees work overtime or by increasing the number of shifts working at its plants.

Komatsu owns most of the manufacturing facilities and the land on which they are located. A portion of the property owned by Komatsu is subject to mortgages or other types of liens. As of March 31, 2005, the net book value of the property owned by Komatsu was ¥366,660 million, of which ¥4,296 million was subject to encumbrances.

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The name and location of Komatsu's principal plants, their approximate aggregate floor space, and the principal products manufactured therein as of March 31, 2005 are as follows.

<u>Name and Location</u>	<u>Floor Space</u>		<u>Principal products</u>
	<u>Thousand</u> <u>sq. meter</u>	<u>Thousand</u> <u>sq. ft</u>	
<b>Japan:</b>			
Awazu Plant Komatsu, Ishikawa	227	2,443	Small and medium-sized bulldozers, Small hydraulic excavators,  Mini excavators,  Small and medium-sized wheel loaders
Komatsu Plant Komatsu, Ishikawa	44	474	Large presses, Small and medium-sized presses, press brakes, shears
Osaka Plant Hirakata, Osaka	157	1,690	Large bulldozers,  Medium-sized and large-sized hydraulic excavators, Recycling equipments
Mooka Plant Mooka, Tochigi	66	710	Large wheel loaders,  Dump trucks,  Road-building machines
Oyama Plant Oyama, Tochigi	193	2,077	Diesel engines,  Hydraulic equipment
Komatsu Zenoah Co. Kawagoe, Saitama	54 38	581 409	Mini-excavators, Skid steer loaders,
Koriyama, Fukushima	16	172	Outdoor power equipment,  Compact 2-stroke engines,  Hydraulic equipment
Komatsu Cummins Engine Co., Ltd. Oyama, Tochigi	*	*	Small diesel engines
Komatsu Castex Ltd. Himi, Toyama			Steel castings,  Iron castings,
Oyama, Tochigi	59	635	Pattern for casting
	*	*	

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Komatsu Forklift Co., Ltd.			Forklift trucks,
Oyama, Tochigi	75	807	Automated conveyance systems, etc
Komatsu Electronic Metals Co., Ltd.			Silicon wafers for semiconductors
Omura, Nagasaki	72	775	
	45	484	
Kiyotake, Miyazaki	27	291	
Komatsu Electronics, Inc.	1	11	Thermoelectric modules,
Hiratsuka, Kanagawa			Temperature control equipment
<b>The Americas</b>			
Komatsu America Corp.	125	1,346	
Tennessee, U.S.A.	31	334	Medium-sized hydraulic excavators, and Articulated dump trucks
Quebec, Canada,	14	151	
	18	194	Small and medium-sized wheel loaders
	62	667	
South Carolina, U.S.A.			Backhoe loaders, Skid steer loaders
Illinois, U.S.A.			Large dump trucks
Hensley Industries, Inc.	18	194	Buckets, Teeth, Edges, Adapters
Texas, U.S.A.			
Komatsu Forest, LLC	10	108	Forestry equipment (crawler type)
Wisconsin, U.S.A.			
Komatsu Mexicana S.A. de C.V.	19	205	Attachments for construction equipment
Sahagún, Mexico			
Komatsu do Brasil Ltda.	57	614	Medium-sized hydraulic excavators,
Suzano, São Paulo, Brazil			Small and medium-sized bulldozers,
			Wheel loaders
Advanced Silicon Materials LLC	36	388	Silane gas,
Montana, U.S.A.			Polycrystalline silicon products

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Komatsu UK Ltd.	60	646	Large and medium-sized hydraulic excavators
Birtley, UK			
Komatsu Hanomag GmbH	77	829	Small and medium-sized wheel loaders, Mini wheel loaders, Compactors
Hannover, Germany			
Komatsu Forest AB	12	129	Forestry equipment (wheel type)
Umea, Sweden			
Komatsu Mining Germany GmbH	23	248	Super-large hydraulic excavators
Düsseldorf, Germany			
Komatsu Utility Europe S.p.A.	43	463	Mini excavators, Backhoe loaders, Skid steer loaders
Este, Italy			
<b>Asia(excluding Japan) and Oceania</b>			
PT Komatsu Indonesia Tbk	45	484	Medium-sized hydraulic excavators,
Jakarta, Indonesia			Small and medium-sized bulldozers,
			Small and medium-sized wheel loaders,
			Motor graders, Dump trucks
Komatsu (Changzhou) Construction Machinery Corporation	15	161	Wheel loaders, Motor graders, Medium-sized hydraulic excavators
Jiangsu, China			Dump trucks
Komatsu (Changzhou) Foundry Corporation	27	291	Iron castings and parts for construction equipment and industrial vehicles, Foundry molds
Jiangsu, China			
Komatsu Shantui Construction Machinery Co., Ltd.	34	366	Small and medium-sized hydraulic excavators
Shandong, China			
Bangkok Komatsu Co. Ltd.	14	151	Medium-sized hydraulic excavators
Chonburi, Thailand			Backhoe loaders
Formosa Komatsu Silicon Corporation	12	129	Silicon wafers for semiconductors
Mailiao, Yunlin, Taiwan			



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\* Komatsu Cummins Engine Co., Ltd. and Komatsu Castex Ltd. (Oyama Manufacturing Plant) are located at Oyama Plant of the Company.

The head office of the Company is located in a ten-story office building in Tokyo. Komatsu considers that its manufacturing plants and other facilities are well maintained and believes that its plant capacity is adequate for its current operating requirements. To the best of management's knowledge, management does not believe that there are any significant environmental issues that may materially affect Komatsu's utilization of its assets.

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## Plans for Installation and Disposal of Equipment

Komatsu conducts various businesses in Japan and overseas, and the details of future capital investment plans to install new more efficient equipment and to dispose obsolete equipment were not decided as of March 31, 2005. As of the filing date of this annual report, Komatsu plans to invest ¥98,000 million by the end of fiscal year ending March 31, 2006. The amount of capital investment expected to be invested by March 31, 2006, the principal investment objectives, and the source of funding by operating segment are set forth in the below table.

<u>Operating Segment</u>	<b>Expected capital investment amount</b>	<b>Principal investment objectives</b>	<b>Source of funding</b>
	<b>by March 31, 2006</b> <b>(Millions of Yen)</b>		
Construction and Mining Equipment	68,000	To increase operating efficiency of production lines and to develop new products, etc.	Funds on hand Bank borrowings
Industrial Machinery, Vehicles and Others	11,000	To increase operating efficiency of production lines and to renew obsolete equipment, etc.	Funds on hand Bank borrowings
Electronics	19,000	To enhance production capacity and to improve productivity	Funds on hand Bank borrowings
Total	98,000		

Notes: Capital investment plan amounts exclude consumption tax, etc.

In the construction and mining equipment operating segment, investment in Japan will continue to focus on the development of new and updated models, such as Dantotsu products, enhancement of production capacity and improvement of product quality, workplace safety and environmental friendliness. Outside of Japan, Komatsu has invested in the development of new products and model changes as well as enhancement of production capacity for construction and mining equipment.

In the industrial machinery, vehicles and others operating segment, Komatsu will invest capital to increase operating efficiency of its production lines, to replace aging facilities and to enhance overseas production.

In the electronics operating segment, Komatsu will invest in the expansion of production capacity for 300mm silicon wafers and the improvement of production facilities to enhance the competitiveness of 200mm silicon wafers by achieving higher quality and productivity.

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**Item 5. Operating and Financial Review and Prospects**

OVERVIEW

The following discussion and analysis provides information that Komatsu's management believes to be relevant to understanding Komatsu's consolidated financial condition and results of operations. The conversion of Japanese yen amounts into U.S. dollar amounts for the fiscal year ended March 31, 2005, is included solely for the convenience of readers and has been made at the rate of ¥107 to U.S.\$1, the approximate rate of exchange prevailing at the Federal Reserve Bank of New York on March 31, 2005.

*Komatsu's Business*

Komatsu is a global organization engaged in the manufacturing, development, marketing and sale of industrial-use equipment and products, with three principal operating segments: (1) construction and mining equipment, (2) industrial machinery, vehicles and others and (3) electronics. Sales for the fiscal year ended March 31, 2005 from the construction and mining equipment operating segment accounted for approximately 74% of consolidated net sales, while sales from the industrial machinery, vehicles and others operating segment and the electronics operating segment each accounted for approximately 19% and 7%, respectively. Of the consolidated net sales for the fiscal year ended March 31, 2005, approximately 36% of net sales were derived from sales to customers located in Japan and approximately 64% of net sales were derived from sales to customers located outside of Japan. For additional information about Komatsu's products, competitive position, organizational structure and property, plants and equipment, please refer to *Item 4. Information on the Company*.

As a global company, Komatsu is subject to various risks. For example, Komatsu's business is affected by the economic conditions and political climate of the regions in which it operates. Among numerous factors that affect Komatsu and its financial results, housing construction, industrial production levels, public investments in infrastructure development, private-sector capital outlays and trends in the semiconductor market are the factors most likely to have the greatest impact upon the demand for Komatsu's products. In addition, Komatsu is exposed to risks of foreign currency exchange rate fluctuations. Generally speaking, the Yen's appreciation against other currencies adversely affects Komatsu's results of operations, while the Yen's depreciation affects Komatsu positively. Foreign currency exchange rate fluctuations also affect the costs of materials and comparative prices of products that Komatsu and foreign competitors produce and sell in the same market. The average Yen/U.S. dollar exchange rates were ¥108 and ¥113 for the fiscal years ended March 31, 2005 and 2004, respectively. The average Yen/Euro exchange rates were ¥136 and ¥133 for the fiscal years ended March 31, 2005 and 2004, respectively. For additional discussion regarding risk factors and the effect of foreign currency exchange rate fluctuations to Komatsu's business, please refer to *D. Risk Factors* under Item 3. Key Information and segment information in the *Comparison of Fiscal Years ended March 31, 2005 and 2004* under Item 5.A. Operating Results.

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### *Management Policy and Key Management Indices*

Komatsu's cornerstone management policy is to maximize its corporate value by maintaining and enhancing the Quality and Reliability of its products and services. To achieve this goal, Komatsu's management takes the following five strategies into consideration when making management decisions: (1) accelerating the implementation of the growth strategy for the construction and mining equipment operating segment; (2) reinforcing the competitiveness of its products based on the Spirit of Manufacturers concept, which concept entails providing products and services that satisfy customers; (3) deriving greater profitability by selectively developing and manufacturing products with respect to which Komatsu enjoys a technological advantage; (4) reinforcing its competitiveness by strengthening its technological capabilities and financial soundness; and (5) reinforcing its corporate governance mechanism.

Since October 2001, Komatsu has worked to strengthen its business by carrying out the Reform of Business Structure project which focuses on developing new ways to promote growth in the construction and mining equipment operating segment, reducing fixed costs and substantially decreasing production costs. As a result of these efforts, Komatsu made the first step towards making a V-shaped recovery of its business performance for the fiscal year ended March 31, 2003.

In November 2003, Komatsu embarked on a three year mid-range management plan named Move the World. KOMATSU 5-800. The objective of this plan was to make aggressive efforts to seek new growth by the fiscal year ending March 31, 2006 given that the demand for construction and mining equipment in the overseas market showed signs of recovery. Four key financial indicators were selected by Komatsu's management to measure its success in achieving growth, profitability, effective utilization of assets and financial soundness. The key indicators consisted of: (1) net sales of ¥1,250 billion, (2) Segment Profit of ¥80 billion, (3) Return on Assets ( ROA ) of 5% and (4) Net Debt-to-Equity Ratio ( Net DER ) of 1 or under. The 5-800 in the name of this management plan stands for ROA of 5% and Segment Profit of ¥800 oku, which is the equivalent of ¥80 billion. Assisted by favorable market conditions during fiscal year ended March 31, 2005, Komatsu's results of operations for the fiscal year ended March 31, 2005 as measured by these key financial indicators showed that Komatsu was able to achieve the objective of the mid-range management plan one year in advance of the prescribed deadline of March 31, 2006, as set forth below.

**Table of Contents****Move The World. KOMATSU 5-800 and Results for the Fiscal Year 2005**

	<b>Results for the Year ended March 31, 2005</b>	<b>Goals for the Fiscal Year ending March 31, 2006</b>
Net Sales	1,434.7 billion yen	1,250 billion yen
Segment Profit	101.9 billion yen	80 billion yen
ROA	7.1%	5.0%
Net DER	0.70	1 or under

## Notes:

- 1) In conformity with Japanese accounting principles, Segment Profit is obtained by subtracting cost of sales and selling, general and administrative expenses, from net sales.
- 2)  $ROA = \text{Pre-tax income} / \{(\text{Total assets at the beginning of the year}) + (\text{Total assets at the end of the year})\} / 2$
- 3)  $\text{Net DER} = \{(\text{Interest-bearing debt}) - (\text{Cash and time deposits})\} / \text{Shareholders' equity}$

Although Komatsu has attained the original objective of the mid-range management plan, Komatsu's management believes the Segment Profit ratio (as a percentage of net sales) of 7% achieved for the fiscal year ended March 31, 2005 to be unsatisfactory. Komatsu's management has set a new goal: Segment Profit ratio of 10%. Starting with the construction and mining equipment business, Komatsu's core operating segment, Komatsu is working on attaining this new goal.

*Business Environment*

The rapid economic growth of BRICs (*i.e.*, Brazil, Russia, India and China), and in particular China, has led to an imbalance of supply and demand for primary commodities such as crude oil and iron ore. This imbalance resulted in an increase in primary commodity prices. Against this backdrop, demand for construction and mining equipment grew sharply as mining sites throughout the world increased excavation activities and resource-rich countries invested the revenue derived from the increase in sale of commodities to build or upgrade their social infrastructure. As a result, the demand for construction and mining equipment increased more than Komatsu's management had anticipated for the fiscal year ended March 31, 2005.

In North America, the largest market for construction and mining equipment, it is estimated that the demand in terms of unit sales for seven major types of construction and mining equipment (crawler-type hydraulic excavators, wheeled-type hydraulic excavators, bulldozers, wheeled loaders, rigid dump trucks, articulated dump trucks and motor graders) increased by approximately 30% as compared to the previous fiscal year, primarily due to an increase in construction investments in the United States.

Demand in Europe remained firm and Komatsu carried out aggressive sales activities and introduced over 20 new or updated models.

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In Japan, construction investments as a whole decreased slightly as the moderate increase in private-sector investments partially offset the continuing decline of public-sector investments.

In China, despite its economic growth, the demand for construction and mining equipment which had been expanding for the last several years declined sharply from May 2004. This decrease in demand was due to the slowdown in construction investments in China, which resulted from the credit-squeeze measures implemented by the Chinese government and the consolidation of industrial parks. Construction and mining equipment sales in China as compared to Komatsu's worldwide sales of such equipment is relatively small (3.8% and 8.7% for the fiscal year ended March 31, 2005 and 2004, respectively). Accordingly, the decrease in demand in China had only a limited impact on Komatsu's results of operations for the fiscal year ended March 31, 2005. By analyzing information collected by KOMTRAX, Komatsu was successful in promptly responding to market changes in China. In addition, Komatsu also completed inventory adjustment at an early stage of the demand decline in China, and worked to secure profits by cutting back fixed costs and implementing strict credit management. To prepare for the future recovery of the Chinese market, Komatsu restructured its distributor network in China and expanded the product range of locally produced equipment.

The demand for industrial machinery, vehicles and others products increased substantially, primarily due to the increase in demand for presses as automobile manufacturers made aggressive capital investments during the fiscal year ended March 31, 2005.

For the fiscal year ended March 31, 2005, demand for silicon wafers increased over the previous year, although the demand for 200mm wafers began to decline during the third quarter of fiscal year ended March 31, 2005. With respect to 200mm wafers, Komatsu focused its efforts on expanding sales of higher-margin products, such as discrete wafers and wafers with specifications meeting the requirements of semiconductor manufacturers in Japan, Taiwan and China. The demand for 300mm wafers has rapidly increased during the past several years. As major semiconductor device manufacturers started establishing production lines compatible with 300mm wafers, silicon wafer manufacturers began to increase their capital investment in this area. Komatsu, through KEM, made capital investments during the fiscal year ended March 31, 2005 to increase its monthly production capacity of 300mm wafers in Japan and also to establish a new production line at Formosa Komatsu Silicon Corporation, KEM's subsidiary in Taiwan, to capture the projected demand increase for 300mm wafers. In addition, the demand for polycrystalline silicon and monosilane gas expanded substantially as compared to previous years as a result of an increase in demand for solar cell materials and LCDs.

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Due to changes in market conditions as noted above, Komatsu received considerably more orders than it had anticipated and its production lines were not well prepared to keep up with these increased orders. In an attempt to complete as many orders as possible, Komatsu tried to increase its production capacity over a short period of time and incurred some additional production and logistics costs for the fiscal year ended March 31, 2005. Komatsu's management believes that to effectively compete in the global market, it is important that Komatsu be able to accurately foresee market changes and enhance its capability to flexibly respond to changes in market trends. Accordingly, Komatsu's management has placed priority on improving its ability to adjust sales and production plans in response to changes in market conditions and the ability to promptly grasp the market conditions around the world by utilizing informational technologies, such as KOMTRAX, and will take such information into consideration when making management decisions.

### *Summary of Operating Results*

Against the backdrop of an increase in demand worldwide for Komatsu's products generally, Komatsu recorded the highest net sales, Segment Profit, income before income taxes, minority interests and equity in earnings of affiliated companies and net income figures to date for the fiscal year ended March 31, 2005. Consolidated net sales increased by 19.9% over the previous fiscal year to ¥1,434,788 million (U.S.\$13,409 million), the second consecutive year in which Komatsu recorded a record-high net sales figures. Segment Profit totaled ¥101,923 million (U.S.\$953 million), up 54.6% as compared to the previous fiscal year, exceeding ¥100 billion for the first time since its incorporation. Income before income taxes, minority interests and equity in earnings of affiliated companies increased 3.7 times over the previous fiscal year, to ¥98,703 million (U.S.\$922 million), as a result of the increase in Segment Profit and improvement in other income, which included a gain of ¥8,538 million from the sale of land for the former Kawasaki Plant. Net income increased 2.2 times as compared to the previous fiscal year, to ¥59,010 million (U.S.\$551 million). For a detailed analysis of the results of operations, please refer to *Item 5.A. Operating Results*.

### *Critical Accounting Policies*

Komatsu prepares its consolidated financial statements in conformity with U.S. generally accepted accounting principles. Komatsu is required to make certain estimates, judgments and assumptions that Komatsu believes are reasonable based upon available information. These estimates and assumptions affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of expenses during the periods presented. By their nature, these estimates and assumptions are subject to an inherent degree of uncertainty, and are based on Komatsu's historical experience, terms of existing contracts, Komatsu's observance of trends in the industry, information provided by its customers and information available from other outside sources, as appropriate. For a summary of Komatsu's significant accounting policies, including the critical accounting policies discussed below, please see Note 1 to the Consolidated Financial Statements. The significant accounting policies Komatsu's management believes are the most critical for the full understanding and evaluation of Komatsu's reported financial results are as follows:



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### **(1) Allowance For Doubtful Receivables**

Komatsu estimates the collectibility of its trade receivables. A considerable amount of judgment is required in assessing the realization of these receivables, including the current financial position of each customer. Komatsu establishes an allowance for expected losses based on individual credit information, past experience and assessment of overdue receivables. While Komatsu believes its reserves to be adequate, it is possible that the accuracy of its estimates could be materially affected due to changes in the overall economic environment, individual customer credit, and the composition of its receivables.

### **(2) Deferred Income Tax Assets**

Komatsu estimates income taxes in each of the jurisdictions in which Komatsu operates. This process involves Komatsu estimating the current income tax exposure and assessing net operating loss carryforwards and temporary differences resulting from differing treatment of items for income tax and financial reporting purposes. These carryforwards and temporary differences result in deferred tax assets and liabilities, which are included within Komatsu's consolidated balance sheet. Komatsu must then assess the likelihood that each company's deferred tax assets will be recovered from future taxable income estimated by each company and available tax planning strategies, and, to the extent Komatsu believes that recovery is not more likely than not, each company must establish a valuation allowance to reduce the amount of assets reflected in the consolidated balance sheet. If the actual results differ from these estimates, Komatsu may need to adjust the valuation allowance which could materially affect Komatsu's financial position and results of operations.

### **(3) Valuation of Long-Lived Assets**

Komatsu's long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of a particular asset to management's best estimate of future undiscounted net cash flows expected to be generated by such asset. If an asset is considered impaired, the impairment loss to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. For assets held for use, the undiscounted cash flow projections used to make assessments of impairment involve significant judgments. Fair value is measured based on the discounted cash flow model or independent appraisal. In the event that there are changes in strategy and market conditions, the assessment of the ability to recover the carrying amount of long-lived assets would change and such changes in assessment could materially affect Komatsu's financial position and results of operations.

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### (4) Fair Value of Financial Instruments

The fair values of derivative financial instruments, consisting principally of foreign currency contracts and interest swap agreements, are estimated by obtaining quotes from brokers.

Fair value estimates are made at a specific point in time, based on relevant market information and information about financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with absolute precision. Change in assumptions could affect these estimates and could have a material impact on Komatsu's financial position and results of operations.

### (5) Pension Liabilities and Expenses

The amounts of Komatsu's pension obligations and net period pension costs are dependent on certain assumptions used to calculate such amounts. These assumptions are described in Note 12 to the consolidated financial statements and include the discount rate, expected rate of return on plan assets and rates of increase in compensation. In accordance with U.S. generally accepted accounting principles, actual results that differ from these assumptions are accumulated and amortized over future service years of employees and therefore generally affect Komatsu's recognized expenses and recorded obligations during such future periods. During the fiscal year ended March 31, 2005, the Company adopted a new discount rate of 2.0% as compared to 2.3% for the fiscal year ended March 31, 2004. The effect of the 0.3 point decrease in the discount rate was to increase projected benefit obligations by approximately ¥2.4 billion. While Komatsu believes that its assumptions are appropriate, in the event that there are significant differences in actual results or significant changes in assumptions, Komatsu's pension obligations and future expenses would be affected.

### (6) Securitization

Komatsu has several accounts receivable securitization programs, and such securitizations are expected to become an important source of funds for Komatsu in the future. The receivables that are securitized are removed from the consolidated balance sheet when they are sold. Komatsu has entered into contractual arrangements with special purpose entities solely for the purpose of securitizing its receivables. For key assumptions used in measuring the fair value of retained interests related to securitization transactions, please refer to Item 5.E. Off-Balance Sheet Arrangements .

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*Recent Accounting Standards Not Yet Adopted*

In March 2004, the Emerging Issue Task Force ( EITF ) reached a consensus on EITF 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. The consensus addresses the meaning of other than temporary impairment and its application to debt and equity securities accounted for under Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Equity Securities, ( SFAS 115 ) and investments accounted for under the cost method. This consensus requires certain quantitative and qualitative disclosures about unrealized losses of debt and equity securities and certain disclosures about cost method investments which are included in the notes to Komatsu s consolidated financial statements to the extent material. The recognition and measurement provisions of EITF 03-1 have been deferred until additional guidance is issued. The effect of this consensus is not expected to have a material effect on Komatsu s consolidated financial position and results of operations.

In November 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4 ( SFAS 151 ). SFAS 151 amends the guidance set forth in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new standard requires that items such as idle facility expense, excessive spoilage, double freight, and re-handling costs be recognized as current-period charges regardless of whether they meet the criterion of so abnormal as stated in ARB No. 43. Additionally, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of applicable production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005 and is required to be adopted by the Company during the fiscal year beginning April 1, 2006. The Company is currently evaluating the effect that the adoption of SFAS 151 will have on its consolidated results of operations and financial condition but does not believe SFAS 151 will have a material impact.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29 ( SFAS 153 ). SFAS 153 eliminates the exception from fair value measurement for non-monetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, Accounting for Nonmonetary Transactions, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange.

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SFAS 153 is effective for the fiscal periods beginning after June 15, 2005, and is required to be adopted by the Company during the fiscal year beginning April 1, 2006. The Company is currently evaluating the effect that the adoption of SFAS 153 will have on its consolidated results of operations and financial condition but expects it will not have a material impact.

In December 2004, the FASB issued SFAS No. 123 (revised 2003) Share-Based Payment ( SFAS 123R ). SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the financial statements and also establishes fair value as the measurement objective in accounting for share-based payment arrangements. The Company will adopt SFAS123R effective for the fiscal year beginning April 1, 2006 using the modified prospective method. The effect of adopting SFAS 123R is not expected to be material to Komatsu s consolidated financial position or results of operations.

**Table of Contents****A. Operating results****Comparison of the Fiscal Years ended March 31, 2005 and 2004**

The following tables set forth selected consolidated financial and operating data, including data expressed as a percentage of total consolidated net sales for the periods indicated, and the change in each consolidated financial line item between the indicated fiscal years. The U.S. dollar amounts represent conversion of Japanese yen amounts at the rate of U.S.\$1=¥107 (the approximate noon buying rate as of March 31, 2005 for Japanese yen in New York City as reported by the Federal Reserve Bank of New York).

**Consolidated Statements of Income**

	Millions of Yen				Percentage	Millions
	Year Ended March 31				change	of U.S.
	2005		2004		2005 vs. 2004	dollars
<b>Revenues and other</b>						
Net sales	¥ 1,434,788	100.0%	¥ 1,196,418	100.0%	19.9%	\$ 13,409
Interest and other income	20,047	1.4%	11,945	1.0%	67.8%	188
<b>Total</b>	<b>1,454,835</b>	<b>101.4%</b>	<b>1,208,363</b>	<b>101.0%</b>	<b>20.4%</b>	<b>13,597</b>
<b>Costs and expenses</b>						
Cost of sales	1,066,887	74.4%	881,231	73.7%	21.1%	9,971
Selling, general and administrative	265,978	18.5%	249,261	20.8%	6.7%	2,486
Interest	11,209	0.8%	14,915	1.2%	-24.8%	105
Impairment loss on long-lived assets held for use	4,200		19,051		-78.0%	39
Other	7,858		16,869		-53.4%	73
<b>Total</b>	<b>1,356,132</b>	<b>94.5%</b>	<b>1,181,327</b>	<b>98.7%</b>	<b>14.8%</b>	<b>12,674</b>
<b>Income before income taxes, minority interests and equity in earnings of affiliated companies</b>	<b>98,703</b>	<b>6.9%</b>	<b>27,036</b>	<b>2.3%</b>	<b>265.1%</b>	<b>922</b>
<b>Income taxes</b>	<b>36,044</b>	<b>2.5%</b>	<b>(3,519)</b>	<b>-0.3%</b>		<b>337</b>
<b>Income before minority interests and equity in earnings of affiliated companies</b>	<b>62,659</b>	<b>4.4%</b>	<b>30,555</b>	<b>2.6%</b>	<b>105.1%</b>	<b>585</b>
<b>Minority interests in income of consolidated subsidiaries</b>	<b>(4,588)</b>		<b>(3,839)</b>		<b>19.5%</b>	<b>(43)</b>
<b>Equity in earnings of affiliated companies</b>	<b>939</b>		<b>247</b>		<b>280.2%</b>	<b>9</b>
<b>Net income</b>	<b>¥ 59,010</b>	<b>4.1%</b>	<b>¥ 26,963</b>	<b>2.3%</b>	<b>118.9%</b>	<b>\$ 551</b>



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*Net sales.*

Consolidated net sales for the fiscal year ended March 31, 2005 increased by 19.9% (or ¥238,370 million) from ¥1,196,418 million to ¥1,434,788 million (U.S.\$13,409 million) as compared to the fiscal year ended March 31, 2004, setting record-high figures for the second consecutive year. Komatsu recorded net sales increases for all of its operating segments as compared to the previous fiscal year. Net sales of construction and mining equipment increased by 22.9% (or ¥197,917 million) as compared to the previous fiscal year, which reflected the increase in worldwide demand for such equipment, excluding China. With respect to industrial machinery, vehicles and others, net sales increased by 10.1% (or ¥24,464 million) as compared to the previous fiscal year primarily as a result of the increase in net sales of forklift trucks and industrial machinery, such as presses. Net sales of electronics increased by 17.5% (or ¥15,989 million) as compared to the previous fiscal year primarily due to an increase in demand for silicon wafers, polycrystalline silicon and monosilane gas. Please refer to the segment information provided below for additional information.

*Interest and Other Income.*

Consolidated interest and other income for the fiscal year ended March 31, 2005 increased by 67.8% (or ¥8,102 million) from ¥11,945 million to ¥20,047 million (U.S.\$188 million) as compared to the fiscal year ended March 31, 2004. This increase was primarily due to the increase of other income, including ¥8,538 million of gains realized from the sale of land where the former Kawasaki Plant was situated.

*Total Revenues and Other.*

As a result of the above factors, consolidated total revenue for the fiscal year ended March 31, 2005 increased by 20.4% (or ¥246,472 million) from ¥1,208,363 million to ¥1,454,835 million (U.S.\$13,597 million) as compared to the fiscal year ended March 31, 2004.

*Cost of Sales.*

Consolidated cost of sales for the fiscal year ended March 31, 2005 increased by 21.1% (or ¥185,656 million) from ¥881,231 million to ¥1,066,887 million (U.S.\$9,971 million) as compared to the fiscal year ended March 31, 2004. This increase was primarily due to the increase in net sales and an increase in the price of raw materials, such as steel, as the rapid growth of the Chinese economy resulted in a shortage of raw materials. This increase in cost of sales was partially offset by various cost reduction efforts including Komatsu's Reform of Business Structure project that has been implemented since October 2001. With the goal of reducing capacity costs, Komatsu has streamlined its operations and overlapping services, relocated production lines, implemented restructuring and promoted early retirement. As a result, the cost of sales to net sales ratio for the fiscal year ended March 31, 2005 increased by only 0.7 points to 74.4% as compared to the previous fiscal year.

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*Selling, General and Administrative Expenses.*