Message from CFO

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Director and Senior Executive Officer
CFO

Komatsu was born in Ishikawa Prefecture, Japan in 1921. Over the century that followed, Komatsu has grown into a global company targeting net sales of ¥3 trillion and overseeing a corporate group comprising 254 other companies (212 consolidated subsidiaries and 42 affiliated companies accounted for by the equity method) as of March 31, 2021.

The Company's operating environment has continued to transform over the years, and our accounting and finance department predecessors navigated these changes by building foundations for financial and capital strategies that remain viable even today. Komatsu's resilience to maintain a certain performance in the current challenging operating environment caused by the COVID-19 pandemic is thanks to our predecessors. Let me express the sincere appreciation I feel for the efforts of our predecessors as I explain some of the innovative practices they introduced.

1. Transformation of Business and Response of Accounting and Finance Departments

(1) Business Strategies Leading to Selection and Concentration

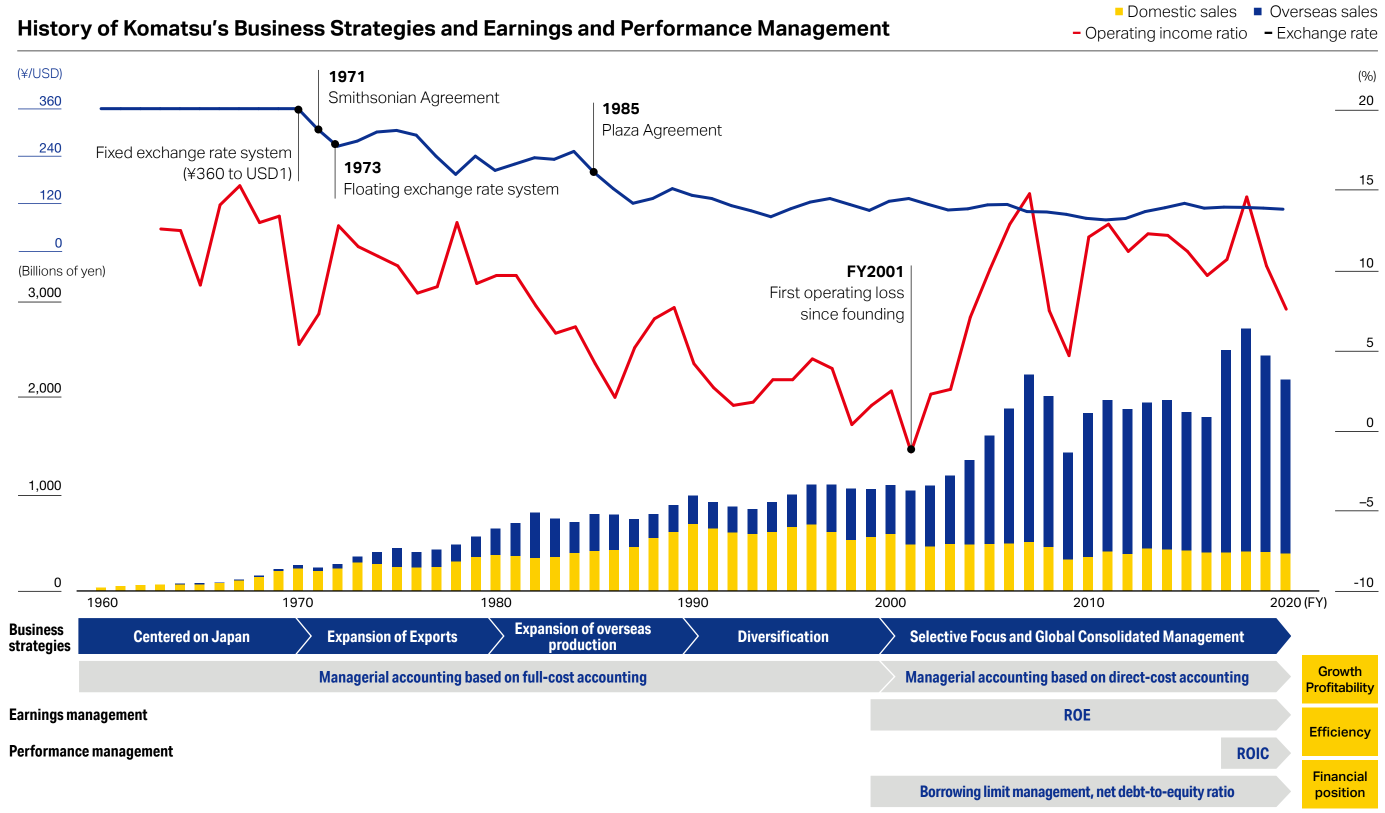
Today, more than 80% of Komatsu's net sales come from overseas. However, this was not always the case; up until the 1960s the majority of sales were generated in Japan. It was in the 1970s that we began our full-fledged expansion into overseas markets. At this time, Komatsu took the approach of engaging in M&A activities while honing its technologies for serving these markets to bolster its product lineup and reinforce the foundations for its export businesses. Initially, overseas sales were mainly composed of exports from Japan. However, we began ramping up local production in overseas markets in the 1980s in order to accommodate the growth of overseas demand and account for the rising value of the yen. In the late 1990s, when we were augmenting our global distributor network, overseas sales completely surpassed domestic sales.

In the 1990s, demand grew stagnant in our traditional markets of Japan, the United States, and Europe as these markets matured. This trend gave rise to a widespread belief that growth could not be anticipated in the construction equipment market. In fact, there were many within the Company who suggested that we scale back construction equipment operations to the point of half of total net sales. The concept of a conglomerate discount did not exist at the time, and Komatsu was thus driven to develop new businesses and diversify its operations in the same manner as other companies in Japan.

We changed course after the turn of the century, moving away from the diversification of our business to instead practice selective focus. Komatsu thus began concentrating management resources on its construction, mining, and utility equipment business as well as on the industrial machinery and others business that it had continued since its founding and in which it could expect synergies with the aforementioned construction, mining, and utility equipment business. There were three reasons behind this change in strategy. The first was the fact that we recorded the first operating loss in FY2001 since our founding. The second was that the concepts of cost of capital and return on equity (ROE) were starting to become mainstream. The third was that Komatsu's electronics business began to place significant stress on the Company's management in the late 1990s. Maintaining and pursuing growth in the electronics business required massive investments, in amounts that accounted for the majority of capital investments in any given year, despite the business itself not even generating 10% of total net sales. Based on a careful examination, the decision was reached to implement structural reforms that entailed the gradual sale of Komatsu Construction Co.,Ltd, Advanced Silicon Materials LLC, Komatsu Electronic Metal Co., Ltd., and outdoor power equipment business of Komatsu Zenoah Co. and so on.

Throughout this process, Komatsu's accounting and finance departments acted in accordance with the Company's business strategies. For example, the Company began disclosing consolidated financial statements based on generally accepted accounting principles from the United States in 1963 with the goal of procuring funds from overseas markets. Furthermore, we have established the American depositary receipt program for convertible corporate bonds issued in the United States in 1967, and this program continues to contribute to improved convenience for overseas investors and increased recognition for the Company even today. In terms of tax, Komatsu began examining advance pricing agreements (APAs)—ahead-of-time tax payment agreements based on appropriate transfer pricing methodology—in conjunction with an increase in investment in a joint venture company (currently, Komatsu America Corp., a wholly owned subsidiary), established in 1988 with Dresser Industries, Inc., of the United States. We reached our first APA between Japan and the United States in 1996, and then proceeded to expand the scope for which these agreements were used to include countries such as Australia and Belgium. Eventually, these APAs come to account for around half of the Company's overseas sales on a non-consolidated basis.

History of Komatsu's Business Strategies and Earnings and Performance Management



The retail finance business was separated from the construction, mining, and utility equipment segment in 2016, making for the Company's current three business segments. In the retail finance business, we provide financial products for the users of Komatsu products. This business dates back to 1988, when we established a joint venture with Dresser Industries, Inc. At this time, we also incorporated into the Group a retail finance company under the control of Dresser Industries, Inc. (currently, Komatsu Financial Limited Partnership). We were cautious in expanding our retail finance business up until the early 2000s. However, we began developing this business in countries outside of the United States in 2004 in conjunction with the introduction of the Komtrax construction equipment operation management system as a standard feature on the Komatsu products that serve as collateral for our retail finance products. Today, we work to safekeep our credits by taking advantage of our strengths, Komtrax technologies (location information, operating status information, engine locks etc.), and the retail finance business plays a role of promoting sales of construction and mining equipment.

(2) Improvement of Corporate Value through Structural Reforms

When undertaking business reorganizations and M&A activities in accordance with our policy of selective focus, we have always emphasized creating beneficial situations for sellers and purchasers as well as for the employees who would be relocated as a result of the transaction in question.

Potential M&A transactions are examined by looking at the importance to business strategies and comparing return on investment (ROI) and weighted average cost of capital (WACC) to make a decision of investment. Furthermore, we focus on compatibility with the culture of the acquired company to better integrate processes and facilitate a sense of cohesion. After closing the acquisitions, we regularly monitor their contributions to improving our group-wide corporate value as we compare ROI and WACC of the acquired companies, and check on synergy effects on consolidated business results. Komatsu currently boasts net sales surpassing ¥2 trillion. Organic growth was a major part of this accomplishment, but we cannot deny the significant contributions from M&A activities. As part of post-merger integration, we work to ensure that the anticipated synergies are realized and that a sense of cohesion is achieved. It is therefore not uncommon for the employees not to know the fact of the acquisition after several years.

2. Enhancement of Financial and Capital Strategies

(1) Profitability and Efficiency Policies

Under the current mid-term management plan, Komatsu has defined four consolidated performance targets for growth (sales growth rate), profitability (operating income ratio), efficiency (ROE), and financial position (net debt-to-equity ratio). The process of trial and error that has brought us to where we are today is intrinsically linked to the M&A activities described in the "Transformation of Business and Response of Accounting and Finance Departments" section above.

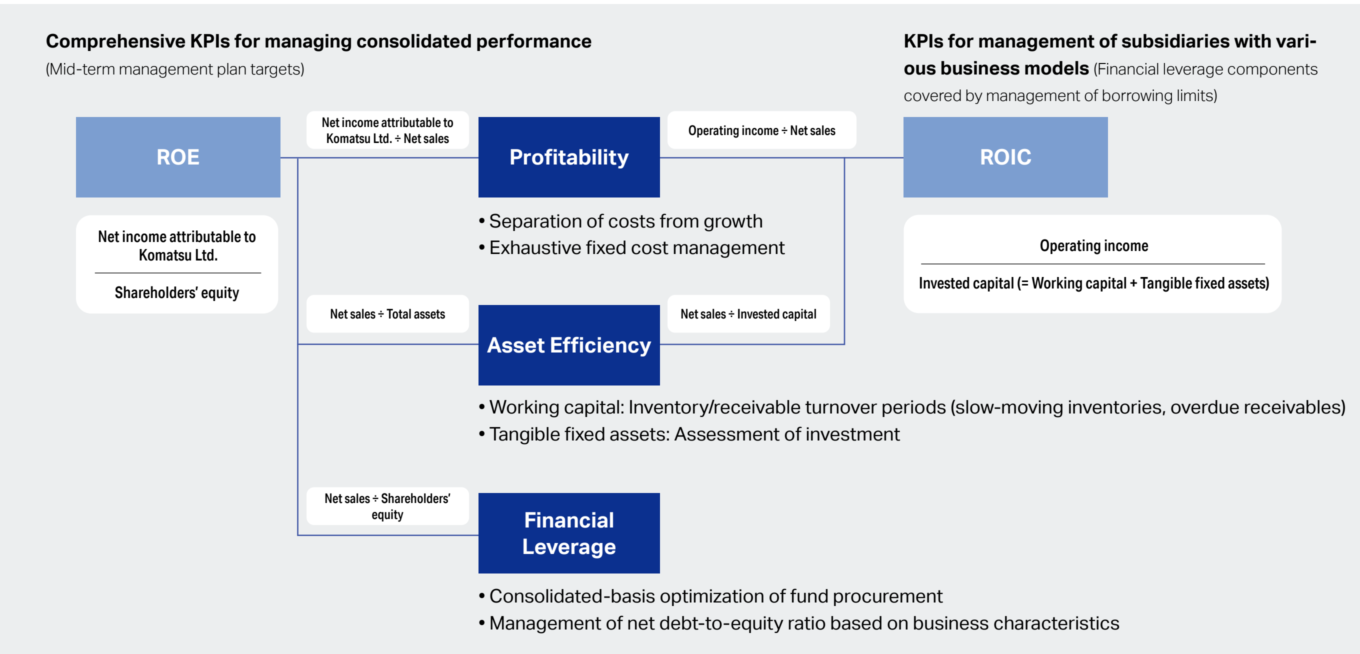
Through the acquisitions of overseas companies conducted after the 1970s, together with technologies and other assets, Komatsu absorbed overseas managerial accounting practices that differed from the full-cost accounting practices traditionally used in Japan. A sharp drop in sales after the 1997 Asian financial crisis made us recognize our weakness, ratio of selling, general and administrative (SG&A) expenses to sales, that was behind our rivals and eventually led to an operating loss in FY2001. This weakness made structural reforms for cutting fixed costs, through means such as reducing the number of subsidiaries, a pressing task. As the Company shifted toward selective focus in its business strategies, we reviewed our traditional full-cost managerial accounting practices, in which unit costs vary by production volume, to incorporate the direct-cost accounting practices used overseas, in which costs are calculated centered on variable costs. Accordingly, new managerial accounting practices were implemented in 2002, in which definition of variable costs and fixed costs have been standardized on a global basis. This change allowed us to respond to fluctuations in demand (sales) through swift action. These standards were also incredibly simple and easy to understand for overseas employees, and, since their introduction, the separation of costs from growth has become the foundation for Komatsu's cost management approach. With these standards, we have been able to entrench throughout the Group a policy of reducing costs while conducting growth investments and thereby curbing increases in fixed costs even as sales rise.

Next, I would like to talk about how we manage the performance of subsidiaries. Komatsu is a manufacturer of construction and mining equipment and industrial machinery, and it thus has a multi-faceted business model encompassing development, manufacturing, sales, and retail finance. Accordingly, ROE, an indicator that comprehensively accounts for profitability, asset efficiency, and financial leverage, is used for consolidated basis management. However, trying to apply ROE as a management indicator for each subsidiary would lead to inequity as capital levels can be different based on factors such as differences in business models and legislative environments in the countries where subsidiaries are located. In addition, the construction and mining equipment business is highly volatile, making effective management of receivables and inventory assets imperative. Based on these considerations, we have been using ROIC for internal management purposes since 2017 to complement prior profitability management practices. Operating income is used as the numerator when calculating ROIC while the total of working capital and tangible fixed assets, which represents how invested capital is utilized, is used as the denominator. Defining ROIC in this manner allows us to provide timely feedback to the divisions responsible for investments with regard to issues and the extent of improvement. Each subsidiary reports graphs indicating changes in ROIC on a monthly basis to track their conditions.

Inventory assets are accounted for ROIC, and maintaining an appropriate level of inventories requires coordination between sales and production divisions. Komatsu has therefore developed a culture of mutual coordination and check between sales and production divisions, and HANSEI, a coined word from the initials of sales (Hanbai) and production (Sei-san) in Japanese, has long been familiar in Komatsu. As a result of coordinated efforts between sales and production divisions, we have in place global HANSEI operation centers exactly for the purpose of advancing improvement activities targeting both of these areas. Specifically, a center for equipments was established at Osaka Plant in April 2011 and a center for parts was set up at Oyama Plant in July 2015, where we are increasing the accuracy of demand projections and sharing information in an integrated manner to maintain appropriate inventory levels on a global basis while preventing loss in sales opportunities.

In this manner, one of Komatsu's strengths is its ability to create and expand free cash flow from the perspectives of both profitability improvements (separation of costs from growth) and efficiency improvements (inventory management).

Performance Management KPIs



(2) Financial Position and Risk Management Policies

There were cases in which the head office would practice speculative asset management back in the days when production was centered on Japan. However, we later put a stop to speculative financial activities in conjunction with the globalization of our business, instead choosing to focus on improving our financial position and hedging risks on a group-wide basis.

Our basic policy for managing foreign exchange rate and interest rate fluctuation risks is to apply natural hedges through ordinary operations. For example, manufacturing products in locations close to the markets where they will be sold allows us to match sales and costs on a currency basis , and procuring funds on a regional basis allows for such currency matching with regard to assets and liabilities. For risks that cannot be covered through natural hedges, we utilize financial products (derivatives) for mitigating the impacts of foreign exchange rate and interest rate fluctuations.

To address funding risks, we seek to reliably procure funds by securing diverse funding sources and maintaining balanced distributions of direct and indirect, short-term and long-term, and variable interest rate and fixed interest rate borrowings. The Company has also implemented a global cash management system that links Japan and other countries of operation to complement regional-basis funding activities and improve consolidated funding efficiency under normal circumstances while also serving as a safety net by allowing funds to be distributed to overseas subsidiaries from the head office in Japan in emergency circumstances.

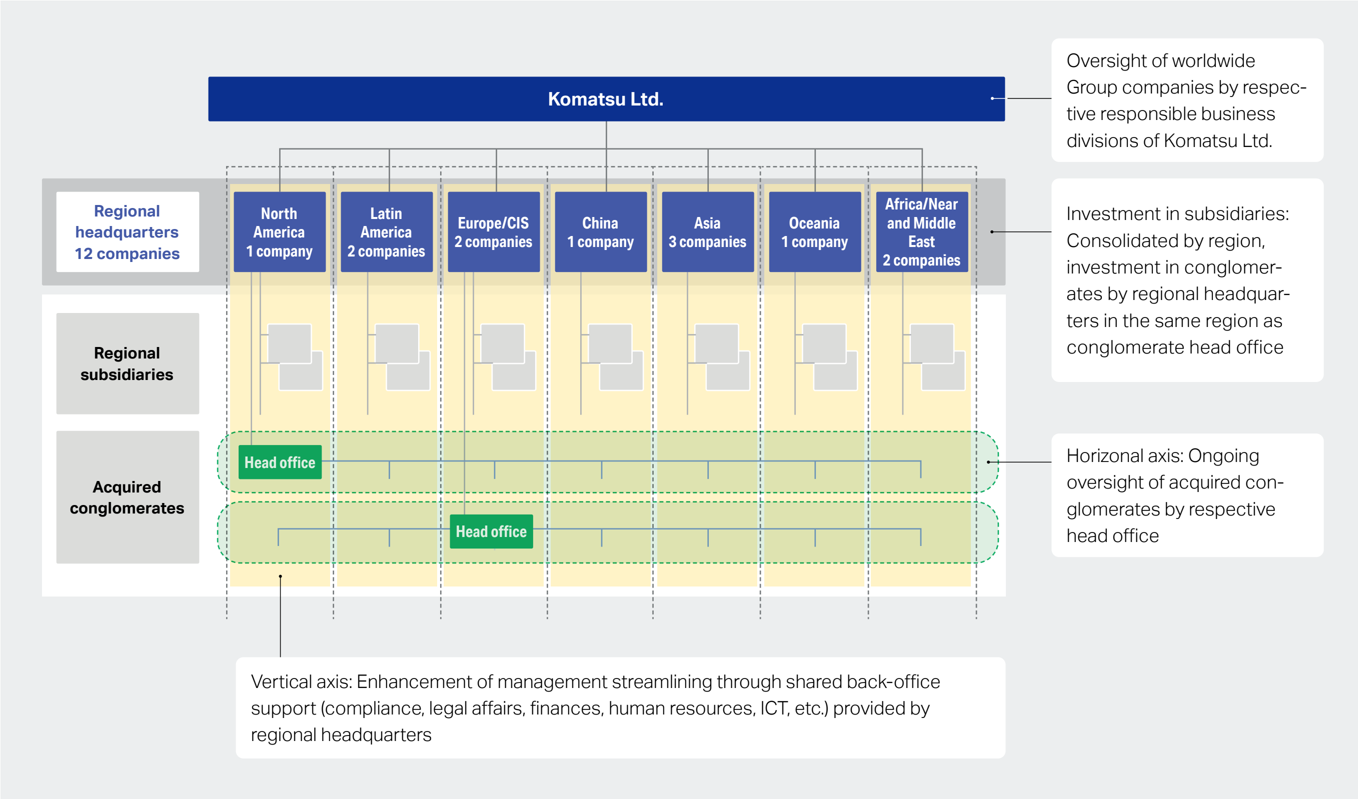
We believe it is important to maintain a sound financial position in order for us to achieve sustainable growth while being free from changes in market demand. The net debt-to-equity ratio is monitored as an indicator of financial soundness on a consolidated basis while borrowing limits and financial benchmarks are set and managed on an individual-subsidiary level. On March 31, 2021, the consolidated net debt-to-equity ratio was 0.35. This ratio is 3.69 when looking at the retail finance business alone, but this level is still within the predetermined acceptable range for leverage. We are working to mitigate foreign exchange rate and interest rate fluctuation risks by matching lending and funding currencies and interest rates and periods. At the same time, we are utilizing the aforementioned Komtrax technologies to safekeep our credits.

Furthermore, the Company thoroughly enforces risk management policies across the Group. We therefore do not utilize schemes only for the purpose of minimizing tax payments in global operations (appropriate taxes are to be paid based on our business), nor do we maintain cash holdings at branches and sites (to eliminate compliance risks) nor holding shares in listed companies (to mitigate stock price fluctuation risks).

(3) Group-Wide Dissemination of Financial and Capital Strategies

Komatsu has proceeded to accelerate its growth through M&A activities. However, we did not initially have a clear policy for shareholding structure. It was therefore not uncommon situation that subsidiaries were investing in companies in respective region where Japanese headquarters also had investments, even as recently as the mid-2000s. This changed in 2007, when we implemented a policy of consolidating investments in overseas Group companies within regional headquarters for the purpose of more efficiently utilizing capital and strengthening governance. At that time, we appointed a total of five regional headquarters, one for the Americas, including Latin America, one for Europe, one for China, one for Indonesia, and one for other parts of Asia. These five companies provided funding and other back-office support in their respective regions while also furnishing a check function backed by investment. In the years that followed, Komatsu went on to acquire various global companies and business, such as Partek Forest AB (currently, Komatsu Forest AB) and Joy Global Inc. (currently, Komatsu Mining Corp., that made it difficult for these five companies to cover the expanded business. This development prompted us to redefine our regional holding

Shareholding Structure and Matrix Management
–Performance management by responsible business division and shard services by regional headquarters–



companies in 2019 to better match the actual circumstances of our business, leading us to have the current 12 regional headquarters. To manage the performance of this expanding scope of companies, the responsible business divisions of Komatsu Ltd. oversee companies belonging to their respective business areas. Meanwhile, the head office of acquired conglomerates are responsible for overseeing the businesses of their worldwide subsidiaries while the 12 regional headquarters manage funding on a regional basis and offer back-office support. This setup makes for a matrix management approach.

Today, approximately 70% of Komatsu Group employees are working overseas. We have thus adopted globally standardized rules and simplified management procedures for core financial and capital strategies, and these practices have been entrenched throughout the Group via the aforementioned matrix. This approach is taken to make our practices easier to understand for employees in operating divisions worldwide and to facilitate the integration and cohesion of acquired companies and businesses.

(4) Pursuit of Further Growth

Komatsu has not established numerical targets for growth, profitability, and financial position in its mid-term management plan. We had set such targets in the past. However, demand is incredibly volatile in our business; in the mining equipment business, for example, demand can fluctuate by nearly 30%. As a result, past numerical targets have lost their meaning in the first year of the respective three-year plan. Instead of numerical targets, we have therefore chosen to set the more abstract targets of achieving a growth rate above the industry's average for growth and the industry's top level for profitability and financial position.

The decision to set a target for growth (net sales growth rate) in the mid-term management plan is based on our strong commitment to continue growing through a combination of organic growth and inorganic growth by means of M&A activities. Growth rates are also indicators for measuring our position within the industry. Our growth target is aggressive and significant pressure on Komatsu's management team, but this pressure is necessary to prevent us from falling into a state of overall decline.

The operating income ratio is also an important indicator for demonstrating the meaningfulness of a company. We have set a target for this indicator based on our responsibility as the industry leader. In the late 1980s, Komatsu caused damage to its own market by becoming involved in excessive price wars due to an overemphasis on its share in the domestic market. Based on this experience, we made the difficult decision to raise prices as we focused on our core business after recording an operating loss in FY2001. Combined with the aforementioned cost management practices, this approach has enabled us to improve our operating income ratio. Today, we emphasize profitability when developing marketing strategies, whether these be for our traditional markets or for strategic markets.

In our integrated reports, we have disclosed key performance indicators (KPIs) linked to environmental, social, and governance (ESG) issues for the various projects for advancing the growth strategies of the mid-term management plan (please see pages 38 and 39). These KPIs are a very viable tool for directly confirming the progress and benefits of these projects. In addition, the accounting and finance departments began aiding in the accomplishment of the targets for these KPIs through the issuance of Komatsu's first green bonds in July 2020. The rising global concern for ESG factors is impacting the financial market, specifically through stricter regulations for sustainability-related disclosure by financial institutions and the need to implement and popularize ESG scoring frameworks. Amid this trend, the issuance of green bonds served as a new opportunity for stakeholders to develop an understanding of Komatsu and thus helped expand our investor base. Going forward, we will continue to examine the possibility of issuing green bonds and other ESG-related bonds in conjunction with Companywide initiatives for achieving carbon neutrality and electrifying equipment. We will also track financial indicators along with ESG and other KPIs to achieve sustainable growth through a positive cycle of improving and stabilizing earnings and solving ESG issues.

Use of Funds Procured through Green Bonds

Use of funds

Item	Amount (millions of yen)
Procurement amount (July 2020)	10,000
Use in FY2020	▲6,854
Investment in rental equipment assets for popularizing ICT-intensive model	(▲4,137)
Of which, refinancing	0
Construction of energy-saving facilities and installation of biomass generation facilities at domestic factories	(▲2,717)
Of which, refinancing	0
Balance as of March 31, 2021	3,146

Two of allocated eligible projects have been in operation, technical center at Ibaraki Plant since October 2020 and test laboratory No.3 at Oyama Plant since January 2021.

Allocation of ¥10.0 billion worth of funds procured through green bonds to be completed within FY2021.


Technical center (at Ibaraki Plant)


Test laboratory No.3 (at Oyama Plant)

Web
Details on green bonds are available on Komatsu's corporate website.
https://komatsu.disclosure.site/en/themes/191