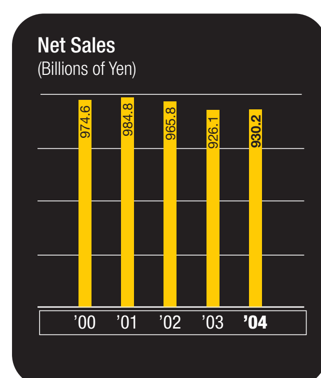
Financial Review

1. SALES AND EARNINGS

General Conditions

During the year ended March 31, 2004, the Japanese economic recovery continued at a gradual pace, supported by a steady growth in private capital expenditure and exports. However, public investment remained weak, resulting in harsh business conditions for the Company. Overseas, in the United States, brisk private consumption continued, housing investment remained favorable, private capital expenditures expanded, and signs of an economic upturn prevailed.

While the domestic market for Internal Combustion Engine and Machinery showed slight improvement, the overseas market, especially the small size tractor market in the United States, was brisk due to increased private consumption and lower interest rates. As for the public works related market, the total amount of orders and order prices remained sluggish due to the reduction of public works spending. The demand for ductile iron pipes, one of the mainstays in the public works related market, showed no signs of increase, although the pace of decrease declined.



Sales

Under such conditions, net sales of the Company during the year under review were ¥930.2 billion ($8,776 million), a 0.4% increase from the prior year. Domestic sales were ¥643.3 billion ($6,069 million), a 6.0% decrease from the prior year, resulting principally from persistently sluggish sales of public works related products, the sale of Kubota Lease Corporation, and the business transfer of the roofing and siding materials operations, which became an affiliated company (the Company has applied the equity method of accounting to the affiliated company). Overseas sales were ¥286.9 billion ($2,707 million), an 18.6% increase from the prior year, mainly due to the strong sales of tractors in North America and brisk export of ductile iron pipes to Middle Eastern countries. As the increase in overseas sales exceeded the decrease in domestic sales, net sales increased. The percentage of overseas sales to net sales was 30.8%, 4.7 percentage points higher than the prior year.

Sales in Internal Combustion Engine and Machinery were ¥501.5 billion ($4,731 million), 12.9% higher than the prior year, comprising 53.9% of consolidated net sales. Sales in Pipes, Valves, and Industrial Castings were ¥175.2 billion ($1,653 million), 1.2% lower than the prior year, comprising 18.8% of consolidated net sales. Sales in Environmental Engineering were ¥115.7 billion ($1,092 million), 15.1% lower than the prior year, comprising 12.4% of consolidated net sales. Sales in Building Materials and Housing were ¥51.8 billion ($489 million), 19.5% lower than the prior year, comprising 5.6% of consolidated net sales. Other sales were ¥86.0 billion ($811 million), 17.4% lower than the prior year, comprising 9.3% of consolidated net sales.

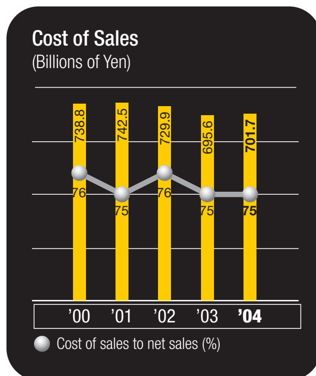
Operating Income

Operating income decreased 26.2% from the prior year, to ¥21.8 billion ($206 million), and as a percentage of net sales decreased to 2.3%, 0.9 percentage point lower than the prior year. The decrease was mainly due to a significant increase in pension costs from the prior year (an increase of ¥43.4 billion) and expenses resulting mainly from the reorganization of the building materials business (¥4.8 billion). As for the increase in pension costs, adversely affected by the unfavorable stock market conditions in Japan, the annual return on plan assets was negative in the prior year. Additionally, the Company reduced the discount rate used in pension plans from 3.0% to 2.5% as of March 31, 2003, resulting in an increase in benefit obligations. Accordingly, the Company amortized a large amount of unrecognized actuarial loss, and pension costs surged in the end. Regarding the expenses from the reorganization of the building materials business, this expense was accompanied by the business transfer of building materials operations.

Operating income or loss in each industry segment (before elimination of intersegment profits and corporate expenses) was as follows: Internal Combustion Engine and Machinery, operating income of ¥54.0 billion ($510 million), a 4.7% decrease; Pipes, Valves, and Industrial Castings, operating loss of ¥5.7 billion ($54 million), as compared to operating income of ¥1.9 billion in the prior year; Environmental Engineering, operating income of ¥0.1 billion ($1 million), a 98.5% decrease; Building

Materials and Housing, operating loss of ¥6.4 billion ($60 million), as compared to operating income of ¥32 million in the prior year; and Other, operating loss of ¥1.4 billion ($13 million), a 91.7% improvement over the prior year.

Profitability in Internal Combustion Engine and Machinery benefited from the brisk sales of lawn mowers, compact and utility tractors in the U.S. market, due to lower interest rates, and strong housing construction, which was consistent with the prior year. However, this benefit was offset by the increase in pension costs and, in the end, operating income declined from the prior year. Profitability in Pipes, Valves, and Industrial Castings benefited from rigorous cost controls and the increased efficiency of the manufacturing process production system. However, these benefits were offset by the surge in the prices of raw materials and the increase in pension costs. In Environmental Engineering, profitability deteriorated because of lower sales to local governments. Building Materials and Housing recorded an operating loss, reflecting various expenses from the reorganization of the building materials business.



Cost of Sales

The cost of sales increased 0.9% from the prior year, to ¥701.7 billion ($6,620 million). The cost of sales as a percentage of net sales increased 0.3 percentage point, to 75.4%. In spite of a favorable product mix and continuous cost reduction efforts, the increase in pension costs pushed up the ratio.

SG&A Expenses

Selling, general, and administrative (SG&A) expenses increased 10.2% from the prior year, to ¥199.8 billion ($1,885 million). The ratio of SG&A expenses to net sales increased 1.9 percentage points, to 21.5%. The Company continued to reduce SG&A expenses by reducing staff at the corporate headquarters. These efforts were successful and achieved the goal of reduced costs. However, the surge in pension costs resulted in an overall increase in total SG&A expenses.

Loss from Disposal and Impairment of Businesses and Fixed Assets

Loss from disposal and impairment of businesses and fixed assets dropped 64.8%, to ¥6.9 billion ($65 million). This improvement was due to an impairment loss recorded in the prior year related to a golf course owned by a subsidiary.

Other Income (Expenses)

Other income, net, was ¥5.2 billion ($50 million), an increase of ¥28.7 billion from the prior year. The valuation losses on short-term and other investments decreased ¥23.7 billion from the prior year, to ¥1.1 billion ($10 million), and the gain on sales of securities increased by ¥3.2 billion. Interest expense was ¥4.3 billion ($40 million) and has been decreasing over the past five consecutive years due to the reduction of interest-bearing debt.

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

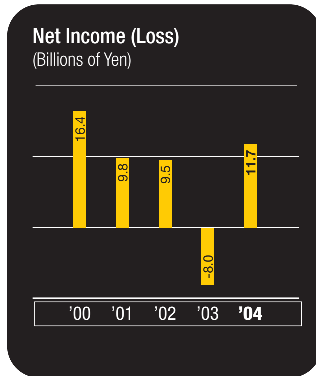
Due to the factors above, income before income taxes, minority interests in earnings of subsidiaries, and equity in net income of affiliated companies increased 340.2%, to ¥27.1 billion ($256 million).

Income Taxes

Income taxes increased 11.4% from the prior year, to ¥13.7 billion ($129 million). The effective tax rate decreased 149.1 percentage points, to 50.6%. The primary reason for the decrease was the non-deductibility of the impairment loss on the golf course in the prior year. The loss was accounted for without recording a related deferred tax asset because it was uncertain whether the subsidiary would achieve profitability to allow for the utilization of the deferred tax asset in the future. Income tax—current was ¥29.3 billion ($276 million), an increase of ¥7.7 billion, and income tax—deferred (benefit) increased ¥6.3 billion, to ¥15.6 billion ($147 million).

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

Minority interests in earnings of subsidiaries increased ¥0.4 billion, to ¥2.5 billion ($23 million). Equity in net income of affiliated companies increased ¥0.5 billion from the prior year, to ¥0.8 billion ($7 million).



Net Income (Loss)

Due to the aforementioned factors, net income was ¥11.7 billion ($110 million), compared with a loss of ¥8.0 billion in the prior year. Return on shareholders' equity improved 5.6 percentage points, to 3.3%, from the prior year.

Income per ADS

Basic net income per ADS (five common shares) was ¥44 ($0.42), as compared to a loss per ADS of ¥29 in the prior year. The number of shares of treasury stock held by the Company was 69.6 million as of March 31, 2004, and these shares were excluded from the calculation of net income per ADS.

Dividends

The Company's basic policy for the allocation of profit is to maintain or raise dividends. To this end, the Company determines the most appropriate use of retained earnings by considering current business operations as well as the future business environment. A year-end cash dividend per ADS at the rate of ¥15 ($0.14) was approved at the general meeting of shareholders, held on June 25, 2004. The Company also paid a ¥15 ($0.14) per ADS interim dividend to each shareholder. Accordingly, the annual cash dividends per ADS were ¥30 ($0.28).

Comprehensive Income

Comprehensive income was ¥85.9 billion ($810 million), ¥142.1 billion improvement from the prior year. This increase was due to the improvement in net income of ¥19.7 billion, an increase in unrealized gains on securities of ¥55.0 billion, and a ¥68.0 billion adjustment to reduce the minimum pension liability from the prior year.

2. FINANCE AND LIQUIDITY MANAGEMENT

Finance and Liquidity Management

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

Annual interest rates of short-term borrowings from financial institutions ranged primarily from 0.29% to 1.68% at March 31, 2004. The weighted average interest rate on such short-term borrowings was 0.90%. As for long-term debt, interest rates were primarily fixed and the weighted average interest rate on such long-term debt at March 31, 2004 was 1.4%.

In North America, the Company maintains an accounts receivable securitization program of trade receivables and finance receivables. The Company may sell both trade and finance receivables through independent revolving-period securitization trusts. Accounts receivable sold under the securitization program are excluded from receivables in the accompanying consolidated balance sheet. The Company sold trade receivables, net of loss reserves of ¥1,056 million

($9,962 thousand) at March 31, 2004, totaling ¥69,218 million ($653,000 thousand), during the year ended March 31, 2004. The Company also sold finance receivables, net of loss reserves of ¥479 million ($4,519 thousand) at March 31, 2004, totaling ¥50,338 million ($474,887 thousand), during the year ended March 31, 2004.

Regarding the lines of credit, the Company has established committed lines of credit totaling ¥30.0 billion ($283 million) with some Japanese banks. However, the Company currently does not use these lines as it is focused on the reduction of interest-bearing debt. In the United States, Europe, and Asia, the Company maintains adequate uncommitted lines of credit with financial institutions. The Company also maintains a commercial paper program allowing for the issuance of commercial papers of up to ¥100.0 billion ($943 million).

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

Considering the financing resources mentioned above, the Company believes it will have no difficulty in securing adequate financing resources to fund its operations and investment.

To maintain the strength of its balance sheet and help secure adequate funding resources, the Company is reducing its interest-bearing debt and taking advantage of positive cash flows provided by operations. The Company set a target to reduce its debt to ¥300.0 billion at the end of March 2004. At the end of March 2004, the amount of interest-bearing debt was ¥266.7 billion ($2,516 million), which was under the target. Of the ¥266.7 billion, ¥218.6 billion was borrowings from financial institutions, and the remaining ¥48.1 billion consisted of corporate bonds.

The Company intends to continue further reduction of its interest-bearing debt focusing on debt excluding the effects of reduced cash flow caused by its sales financing program. The Company is providing comprehensive sales financing to support machinery sales in the United States and Japan. The additional debt carried on its books to fund this program is excluded when determining targets. Accordingly, the Company has set a target of reducing debt from ¥183.9 billion to ¥140.0 billion, excluding the debt related to sales financing programs in the United States and Japan by the end of March 2006.

The amount of working capital increased ¥53.7 billion, to ¥266.7 billion ($2,516 million), from the prior year. Additionally, the ratio of current assets to current liabilities jumped 19.9 percentages points, to 164.3%. The Company has kept this ratio at a level of more than 140% for three consecutive years. The ratio in the year under review represents a significant improvement. There is some seasonality to the Company's liquidity and capital resources because a high percentage of the notes and accounts receivable from local governments are collected during April through June every year.

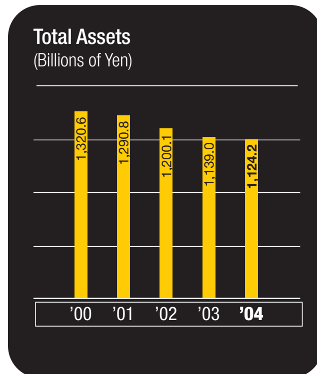
All things considered, the Company believes that it can support its current and anticipated capital and operating expenditures for the foreseeable future.

The currency in which the Company has its debt is mainly Japanese yen. There are no restrictions regarding the manner in which the funds may be used.

Ratings

The Company has obtained a credit rating from Rating and Investment Information, Inc. (R&I), a rating agency in Japan, to facilitate access to funds from the capital market in Japan. The Company's current rating is A+ as of March 2004 and its outlook is stable. The Company's favorable credit rating provides it access to capital markets and investors.

Assets, Liabilities, and Shareholders' Equity

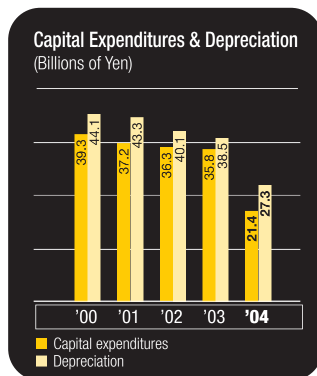


Assets

Total assets at fiscal year-end amounted to ¥1,124.2 billion ($10,606 million), ¥14.8 billion less than at the prior year-end. Cash and cash equivalents increased ¥13.9 billion, to ¥81.2 billion ($766 million). Notes and accounts receivable decreased ¥28.3 billion, to ¥392.1 billion ($3,699 million). These fluctuations are due to a decrease in shipments to the Japanese government and other local governments in Japan. Shipments to the government agencies generally occur during the period from January through March, resulting in an increase in receivables. However, at the year-end under review, the total amounts of such shipments were comparatively small. Accordingly, receivables decreased from the prior year.

Inventories decreased ¥8.3 billion, to ¥143.0 billion ($1,349 million) in accordance with the Company's financial policy of streamlining its balance sheet. As a result, inventory turnover was 6.3 times for the year, 0.3 point higher than at the prior year-end. Total current assets were ¥681.4 billion ($6,428 million), a decrease of ¥10.9 billion.

Investments increased ¥69.4 billion, to ¥161.5 billion ($1,523 million), reflecting a ¥73.5 billion rise in unrealized gains on securities.



Property, plant and equipment decreased ¥29.8 billion, to ¥222.7 billion ($2,101 million). Capital expenditures were ¥21.4 billion ($202 million), a decrease of ¥14.4 billion. The Company managed the amount of capital expenditures so that it would not exceed the amount of depreciation and amortization. The amount of depreciation expense was ¥27.3 billion ($257 million), ¥11.2 billion less than the prior year. This decrease was also owing to the sale of the leasing subsidiary, Kubota Lease Corporation, as well as the transfer of fixed assets related to our building materials business.

Other assets were ¥58.6 billion ($553 million), a decrease of ¥43.4 billion. This fluctuation was mainly due to the decrease in deferred tax assets as a result of the increase in unrealized gains on securities.

Liabilities

Total liabilities amounted to ¥717.5 billion ($6,769 million), a decrease of ¥92.8 billion from the prior year-end. Short-term borrowings decreased ¥9.6 billion, to ¥86.0 billion ($811 million), and the current portion of long-term debt decreased ¥40.0 billion, to ¥35.9 billion ($338 million). This decrease was due to the repayment of the bonds.

Trade notes and accounts payable were ¥193.7 billion ($1,827 million), a decrease of ¥12.1 billion. The principal reason for this decrease was the reduction in orders from the Japanese government and other local governments in Japan and the related decrease in inventory purchases. As a result, total current liabilities decreased ¥64.7 billion, to ¥414.7 billion ($3,912 million).

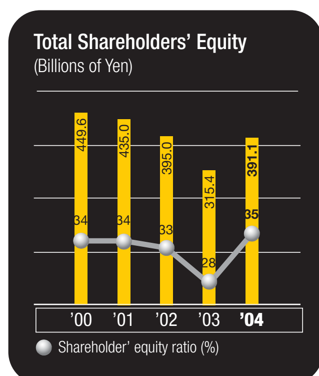
Long-term liabilities decreased ¥28.1 billion, to ¥302.8 billion ($2,857 million). Accrued retirement and pension costs decreased ¥16.1 billion, to ¥143.7 billion ($1,355 million). This decrease reflected the increase in plan assets attributed to higher stock prices.

Minority Interests

Minority interests increased ¥2.4 billion, to ¥15.6 billion ($148 million), due to an increase in the number of subsidiaries that are not 100% owned.

Shareholders' Equity

Total shareholders' equity increased ¥75.6 billion, to ¥391.1 billion ($3,689 million). This increase resulted primarily from a ¥74.2 billion improvement in accumulated other comprehensive income (loss). The ratio of shareholders' equity to total assets improved 7.1 percentage points, to 34.8%. This increase was owing to the growth in shareholders' equity as well as the reduction of interest-bearing debt.



The increase in accumulated other comprehensive income was mainly due to a ¥37.6 billion minimum pension liability adjustment resulting from the price increase of securities and a ¥43.4 billion increase in unrealized gains of securities, partially offset by the foreign currency translation adjustments.

In order to reduce the number of outstanding shares and create more value for shareholders, the Company commenced a program for the purchase of shares of treasury stock in December 2001. The cumulative amount of purchases at March 31, 2004, ¥24.1 billion, was deducted from shareholders' equity, and the number of shares of treasury stock held as of March 31, 2004 was 69.6 million, or 4.9% of total shares issued. For these purchases, the Company used net cash provided by operating activities. As of June 30, 2004, the Company plans to retire 69.0 million shares of treasury stock.

Next fiscal year, the Company plans to continue the purchase of shares of treasury stock. From June 25, 2004, pursuant to the amendment of our articles of incorporation based on the Commercial Code of Japan, the purchase of shares of treasury stock can be authorized at the Board of Directors' Meetings instead of requiring a shareholders' meeting. Accordingly, the Company will now have more flexibility to purchase and retire shares of treasury stock.

The debt-to-equity ratio* was 68.2%, down 35.6 percentage points from the prior year, due to the reduction of interest-bearing debt in accordance with the Company's financial policy and growth in shareholders' equity due to the factors discussed above.

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

Contractual Obligations

The following summarizes contractual obligations at March 31, 2004:

	Millions of Yen				
		Payments Due by Period			
Year Ended March 31, 2004	Total	Less than year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Short-term borrowings	¥ 85,999	¥ 85,999	¥ —	¥ —	¥ —
Capital lease obligations	3,790	2,162	1,628	—	—
Long-term debt	176,913	33,696	81,033	40,260	21,924
Deposits from customers	14,980	3,807	—	—	11,173
Operating lease obligations	1,024	392	197	125	310
Commitments for capital expenditures	562	562	—	—	—
Total	¥283,268	¥126,618	¥82,858	¥40,385	¥33,407

	Thousands of U.S. Dollars				
		Payments Due by Period			
Year Ended March 31, 2004	Total	Less than year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Short-term borrowings	$ 811,311	$ 811,311	$ —	$ —	$ —
Capital lease obligations	35,755	20,396	15,359	—	—
Long-term debt	1,668,990	317,887	764,462	379,811	206,830
Deposits from customers	141,321	35,915	—	—	105,406
Operating lease obligations	9,660	3,698	1,858	1,179	2,925
Commitments for capital expenditures	5,302	5,302	—	—	—
Total	$2,672,339	$1,194,509	$781,679	$380,990	$315,161

3. CASH FLOWS

Net cash provided by operating activities during the year under review was ¥75.7 billion ($714 million), an increase of ¥11.4 billion from the prior year. The Company recorded net income of ¥11.7 billion, which was relatively low due to the increase in pension costs related to the recognition of unrecognized actuarial losses which did not accompany the use of cash. Moreover, both the sale of its leasing business and the transfer of its building materials business during the year under review resulted in material changes in certain account balances, including depreciation, receivables, and payables. However, such changes did not affect the Company's cash position. The increase in net cash provided by operating activities was mainly due to the favorable performance of business operations, especially in the Internal Combustion Engine and Machinery segment.

Net cash used in investing activities was ¥6.5 billion ($61 million), a decrease of ¥21.1 billion from the prior year. Purchases of fixed assets decreased as a result of restrained capital expenditures and the sale of the leasing business. Increases in proceeds from sales of investments and the proceeds from sale of real estate contributed to the reduction of net cash used in investing activities as compared to the prior year. Moreover, advances to subsidiaries decreased, resulting from the reorganization of the Company's business.

Net cash used in financing activities was ¥55.1 billion ($520 million), an increase of ¥25.1 billion from the prior year. The Company used net cash provided by operating activities for repayment of interest-bearing debt. The Company spent ¥44.5 billion on the net repayment of short-term borrowings and long-term debt and, additionally, the Company spent ¥2.2 billion on purchases of shares of treasury stock.

As a result, including the effect of exchange rate changes, cash and cash equivalents at the end of March 2004 was ¥81.2 billion ($766 million), an increase of ¥13.9 billion from the prior year.

4. CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The preparation of the consolidated financial statements requires management to make estimates and assumptions on the selection and application of significant accounting policies. The Company reviews these estimates and assumptions periodically. Actual results may differ from estimated results.

The following critical accounting policies that affect financial condition and operations require management to make significant estimates and assumptions:

Inventory Valuation

Completed real estate projects are stated at the lower of acquisition cost or fair value, less estimated costs to sell. The fair values of those assets are estimated based on the appraised values in the market. Land to be developed and projects under development are carried at cost unless those assets are impaired. If carrying amounts of those assets exceed the undiscounted future cash flows expected to be realized from them, those assets are considered impaired and an impairment loss is measured based on the amount by which the carrying value exceeds the fair value of those assets. If the market conditions and demand in the housing business are less favorable than management's projection, additional write-downs may be required.

Impairment of Investments

The Company classifies all its debt securities and marketable equity securities as available for sale. When a decline in the value of the marketable security is deemed to be other than temporary, the Company recognizes an impairment loss to the extent of the decline. In determining if and when such a decline in value is other than temporary, the Company evaluates

market conditions, trends of earnings, the extent to which cost exceeds market value, the duration of market declines, the ability and intent to hold the marketable securities, and other key measures. If equity markets decline or operating results of the issuer of the security become worse, additional impairment losses may be required in the future.

Allowance for Doubtful Receivables

The Company evaluates the collectibility of the notes and accounts receivable, with the estimate based on various judgments, including the customers' financial conditions, historical experience, and the current economic circumstances. If the customers' financial conditions or current economic circumstances become worse, additional allowances may be required in the future.

Deferred Tax Assets

The Company recognizes deferred tax assets with a valuation allowance to adjust the carrying amount when it is more likely than not that the deferred tax assets will not be realized. The valuation of deferred tax assets principally depends on the estimation of future taxable income and tax planning strategies. If future taxable income is lower than expected due to a change in economic circumstances and poor operating results, significant adjustments to deferred tax assets may be required.

Impairment of Long-Lived Assets

When events and circumstances indicate that the carrying amount of long-lived assets to be held and used may not be recoverable and the carrying amounts of those assets exceed the undiscounted future cash flows, an impairment loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived assets. Fair value is determined primarily using anticipated future cash flows discounted at a rate commensurate with the risk involved. If estimates of future cash flows fall below management's projection due to an unexpected change in economic circumstances, additional impairment may be required.

Retirement and Pension Plans

Benefit obligations and periodic benefit cost are valued based on assumptions used by actuaries in calculating such amounts. These assumptions include the discount rate, retirement rate, rate of compensation increase, mortality rate, expected rate of return on plan assets, and other factors. These assumptions are based upon current statistical data and are reviewed every fiscal year. Differences in actual experience or changes in assumptions may affect the benefit obligations and future periodic benefit cost.

The Company recognizes actuarial gains and losses in excess of 20% of the larger of benefit obligations or plan assets in the year subsequent to the year in which such gains and losses were incurred and amortizes actuarial gains and losses between 10% and 20% over the average participants' remaining service period (approximately 15 years). Considerable unrecognized actuarial gains or losses may affect material effect on periodic benefit cost in the next fiscal year.

To determine the discount rate, the Company considers current market interest rates. To reflect declining current market interest rates, the Company reduced the discount rate from 3.0% to 2.5% as of March 31, 2003. In fiscal 2003, this change increased the periodic obligations by approximately ¥21.9 billion. A decrease of 50 basis points in the discount rate would increase the benefit obligations as of March 31, 2004 by approximately ¥23.8 billion ($225 million).

To determine the expected rate of return on plan assets, the Company considers actual returns in the past 5 to 10 years and the current and expected components of plan assets, and it anticipates market trend. Plan assets are managed by asset management companies, trust banks, and insurance companies, and are invested primarily in the fixed income and equity securities of Japanese and foreign issuers. The Company anticipates that investment managers will continue to generate long-term returns of at least 3.5%, based on an asset allocation assumption of 45% on fixed income securities, with an expected rate of return of 1.1%, and 55% on equity securities, with an expected rate of return of 5.5%. The

Company believes that 3.5% is a reasonable long-term rate of return despite an actual return on plan assets in the past 10 years of 2.2%, as significant losses on plan assets were incurred from fiscal 2001 to fiscal 2003, caused by market downturn. A decrease of 50 basis points in the expected rate of return on plan assets would result in an increase of periodic benefit cost in fiscal 2005 of approximately ¥0.5 billion ($5 million).

In June 2001, the Japanese government issued a new law that regulates retirement benefit plans. Under the new law, effective April 1, 2002, the Company can transfer the obligation for the substitutional portion and related plan assets to the government subject to approval by the government. In December 2002, the Company made applications for an exemption from the obligation to pay benefits for future employee service related to the substitutional portion and received approval from the Japanese Ministry of Health, Labour and Welfare on January 30, 2003.

The Company plans to submit another application for the transfer of the substitutional portion related to past services to the Japanese government. After the applications are approved by the government, the remaining benefit obligation of the substitutional portion as well as the related government-specified portion of the plan assets of the contributory defined benefit pension plan will be transferred to the government. The Company will account for the transaction in accordance with EITF No. 03-2, "Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities." The effect of the transfer on the Company's consolidated financial statements has not yet been determined.

The Board of Corporate Auditors and the Company's senior management had proactive discussions about these critical accounting policies, and they agreed that estimates and assumptions were appropriate in light of the current and expected market conditions, the Company's businesses, and numerous other factors.

5. BUSINESS RISKS

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

Industrial and capital goods make up a substantial portion of the Company's products. Accordingly, sales of the Company may be sensitive to declines in general economic conditions, including private sector capital expenditure, construction investment, and domestic public investment. In addition, governmental agricultural policies such as a reduction in rice acreage or change in agricultural basic law may affect domestic sales of agriculture-related products. In overseas markets, especially those of North America and Europe, sales of the Company's products such as utility/compact tractors may also be adversely affected by declines in general economic conditions, including private consumption and residential construction investment.

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

The Company has overseas sales and manufacturing subsidiaries. The financial results of each overseas subsidiary are consolidated into the results of the parent company after translation into Japanese yen. In addition, the parent company exports products to certain subsidiaries and these transactions are generally denominated in the local currencies of the countries in which the subsidiaries are based. As a result, fluctuations in foreign exchange rates will affect the consolidated financial results.

The Company is subject to the risks of international operations.

In some businesses of the Company, substantial overseas operations are conducted. Accordingly, the Company is subject to a number of risks inherent in doing business in those markets, including the following:

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

The major markets with the above risks are markets in the United States, the EU, and Asian countries.

The Company utilizes estimations on some accounts in the consolidated financial statements, which may require additional accruals due to unanticipated changes in the basis of assumptions.

The Company appropriately records its employee benefit obligations, valuation of inventories, valuation allowances for deferred tax assets, probability of collection of notes and accounts receivable, and impairment losses on long-lived assets in the consolidated financial statements. However, these are based on various assumptions about future economic results. If actual results differ from any of these assumptions, unanticipated additional accruals may be required.

Strategic alliances, mergers, acquisitions, and divestitures may not generate successful results as planned.

The Company expects to use strategic alliances, mergers, and acquisitions to seek further growth. The success of these activities depends on such factors as the Company's business environment, the ability of its business counterparts, and whether the Company and its counterparts share common goals. Therefore, the Company is subject to the risk that these activities may not be successful.

The Company may not be able to successfully create new businesses or businesses complementary to the current ones.

As part of its structural renovation, the Company is attempting to cultivate new businesses or businesses that are complementary to the current ones. However, in those markets, there are numerous competitors, and competition will be very harsh. If the Company fails to develop the required personnel or abilities to produce and market appropriate products, these endeavors may not be successful.

Impairment losses on investments in marketable securities may occur as a result of stock market fluctuations.

As of March 31, 2004, the Company owns securities with a fair value of approximately ¥138.8 billion. Most of these securities are equity securities and, accordingly, depending on stock market fluctuations, unrealized losses may occur.

In each of its businesses, Kubota is subject to intensifying competitive pressures. The Company must compete successfully to maintain sales and profits.

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

6. MARKET RISK

Derivatives

To offset currency and interest rate fluctuation risks, the Company uses various types of derivatives, including foreign exchange forward contracts, currency swaps, and interest rate swaps. As a basic policy, the Company conducts its derivatives transactions within the range of its outstanding credit and obligations, and the Company does not engage in speculative derivative transactions. Because the counterparties for derivative transactions are financial institutions with high creditworthiness, the Company does not anticipate any credit losses on such transactions. For more specific details, please refer to Note 12 to the consolidated financial statements.

Countermeasures for the Removal of Government Deposit Guarantees

Effective from April 2002 in Japan, limits were placed on government guarantees of certain short-term deposits held by financial institutions. As a countermeasure, the Company maintains its deposits with a diverse group of financial institutions with high credit ratings. In addition, the Company centralizes its risk management with financial institutions mainly through concentrating cash within the parent company.

7. RESEARCH AND DEVELOPMENT

R&D expense was ¥23.3 billion ($219 million), a decrease of ¥3.1 billion from the prior year, and its ratio to net sales declined 0.35 percentage point, to 2.50%. R&D expenses were primarily related to research in disposition of mixed waste treatment with incinerators, application of the submerged membrane system to large plants, and development of four-wheel vehicles.

8. CAPITAL EXPENDITURES

Capital expenditures amounted to ¥21.4 billion ($202 million), a 40.3% decrease from the prior year. The funding requirements for these capital expenditures were mainly provided by internal operations. The principal capital expenditures as of March 31, 2004, were related to increasing the efficiency of farm equipment production.

9. OUTLOOK FOR THE NEXT FISCAL YEAR

General Conditions

Although the Japanese economy has an opportunity for building sustained growth, public investment will continue to decline, and the appreciation of the yen against the U.S. dollar may have a negative impact on both exports and capital expenditures which have contributed to the recovery of the Japanese economy. Moreover, price increases in raw materials may adversely affect corporate profitability, and there is concern that the U.S. and European economies may slow down. All things considered, the Company expects the difficult economic conditions to continue.

Financial Outlook

Under such conditions, the Company will make every effort to overcome the difficult business environment, continue to work hard towards the vigorous and steady implementation of the new version of the Medium-Term Management Strategy, and establish a business structure and profit structure with stability and growth capability. In the public works related business (Pipes, Valves, and Industrial Castings segment and Environmental Engineering segment), the Company will make rigorous efforts for cost reduction and spending control. At the same time, in the overseas businesses of Internal Combustion Engine and Machinery, which is the driving force for the growth of the Company, the Company will implement expansion strategies by taking such measures as continuous new product introductions and the development of peripheral businesses.

Looking ahead, the Company forecasts consolidated net sales for the year ending March 31, 2005 of ¥915.0 billion, down ¥15.2 billion from the prior year. The anticipated sales decrease is mainly due to the transfer of the building materials operation, which will cause a reduction in sales of approximately ¥33.0 billion. This forecast anticipates net sales for business segments “Internal Combustion Engine and Machinery,” “Pipes, Valves, and Industrial Castings,” “Environmental Engineering,” and “Other” of ¥511.0 billion, ¥165.0 billion, ¥122.0 billion, and ¥117.0 billion, respectively.

The Company also forecasts operating income of ¥65.0 billion, an increase of ¥43.2 billion from the year under review. In the year under review, the pension costs jumped ¥43.4 billion from the prior year, but the Company forecasts that the pension costs for the next fiscal year will return to a normal level (a decrease of approximately ¥44.4 billion from the year ended March 31, 2004).

The Company expects income before income taxes, minority interests in earnings of subsidiaries, and equity in net income of affiliated companies for the next fiscal year to be ¥127.0 billion, a substantial increase of ¥99.9 billion from the prior year. The expected increase is due primarily to the significant improvement in other income, net, as a result of a gain related to the transfer of the substitutional portion of the benefit obligation and related plan assets (approximately ¥57.6 billion) to the government and the reduction in pension costs of ¥44.4 billion. Accordingly, net income is forecast to be ¥90.0 billion, up ¥78.3 billion from the prior year. (These forecasts anticipate an exchange rate of ¥105=US$1.)

In accordance with the previously described basic policy related to the Company’s profit allocation to maintain or raise dividends, the Company is considering paying cash dividends per ADS for the next fiscal year of ¥30, including the expected interim cash dividends of ¥15 per ADS.

10. RECENT EVENT

On May 14, 2004, the Company resolved at the Board of Directors Meeting to retire 69.0 million shares of treasury stock on June 30, 2004.

On May 27, 2004, the Company also resolved at the Board of Directors Meeting to establish a joint operation company with C.I. Kasei Company Limited, into which the Company will transfer its PVC pipes business. The new company is expected to be established on April 1, 2005 and be 70%-owned by the Company with the remaining 30% by C.I. Kasei Company, Limited.

SEGMENT INFORMATION

The following segment information for the years ended March 31, 2004 and 2003, which is required under the regulations of the Securities and Exchange Law of Japan, is not consistent with accounting principles generally accepted in the United States of America.

Industry Segments

	Millions of Yen							
Year Ended March 31, 2004	Internal Combustion Engine & Machinery	Pipes, Valves, & Industrial Castings	Environmental Engineering	Building Materials & Housing	Other	Total	Corporate & Eliminations	Consolidated
Net sales:								
Unaffiliated customers	**¥501,551**	**¥175,178**	**¥115,721**	**¥51,823**	**¥ 85,964**	**¥930,237**	**¥ —**	**¥ 930,237**
Intersegment	**32**	**6,923**	**696**	**—**	**19,756**	**27,407**	**(27,407)**	**—**
Total	**501,583**	**182,101**	**116,417**	**51,823**	**105,720**	**957,644**	**(27,407)**	**930,237**
Cost of sales and operating expenses	**447,559**	**187,783**	**116,286**	**58,219**	**107,136**	**916,983**	**(8,595)**	**908,388**
Operating income (loss)	**¥ 54,024**	**¥ (5,682)**	**¥ 131**	**¥(6,396)**	**¥ (1,416)**	**¥ 40,661**	**¥(18,812)**	**¥ 21,849**
Identifiable assets at March 31, 2004	**¥512,885**	**¥204,764**	**¥101,086**	**¥30,576**	**¥ 79,253**	**¥928,564**	**¥195,661**	**¥1,124,225**
Depreciation	**12,713**	**7,440**	**927**	**1,691**	**2,086**	**24,857**	**2,397**	**27,254**
Capital expenditures	**13,096**	**2,504**	**2,711**	**567**	**1,550**	**20,428**	**968**	**21,396**

	Millions of Yen							
Year Ended March 31, 2003	Internal Combustion Engine & Machinery	Pipes, Valves, & Industrial Castings	Environmental Engineering	Building Materials & Housing	Other	Total	Corporate & Eliminations	Consolidated
Net sales:								
Unaffiliated customers	¥444,169	¥177,217	¥136,381	¥64,350	¥104,028	¥ 926,145	¥ —	¥ 926,145
Intersegment	480	7,678	1,053	20	19,983	29,214	(29,214)	—
Total	444,649	184,895	137,434	64,370	124,011	955,359	(29,214)	926,145
Cost of sales and operating expenses	387,953	182,963	128,423	64,338	141,153	904,830	(8,298)	896,532
Operating income (loss)	¥ 56,696	¥ 1,932	¥ 9,011	¥ 32	¥(17,142)	¥ 50,529	¥(20,916)	¥ 29,613
Identifiable assets at March 31, 2003	¥487,841	¥222,708	¥116,136	¥77,515	¥106,027	¥1,010,227	¥128,784	¥1,139,011
Depreciation	13,717	8,032	748	2,820	10,571	35,888	2,606	38,494
Capital expenditures	14,159	5,354	782	1,117	8,582	29,994	5,851	35,845

	Thousands of U.S. Dollars							
Year Ended March 31, 2004	Internal Combustion Engine & Machinery	Pipes, Valves, & Industrial Castings	Environmental Engineering	Building Materials & Housing	Other	Total	Corporate & Eliminations	Consolidated
Net sales:								
Unaffiliated customers	**$4,731,613**	**$1,652,623**	**$1,091,708**	**$488,896**	**$ 810,981**	**$8,775,821**	**$ —**	**$ 8,775,821**
Intersegment	**302**	**65,311**	**6,566**	**—**	**186,377**	**258,556**	**(258,556)**	**—**
Total	**4,731,915**	**1,717,934**	**1,098,274**	**488,896**	**997,358**	**9,034,377**	**(258,556)**	**8,775,821**
Cost of sales and operating expenses	**4,222,255**	**1,771,538**	**1,097,038**	**549,236**	**1,010,716**	**8,650,783**	**(81,085)**	**8,569,698**
Operating income (loss)	**$ 509,660**	**$ (53,604)**	**$ 1,236**	**$(60,340)**	**$ (13,358)**	**$ 383,594**	**$ (177,471)**	**$ 206,123**
Identifiable assets at March 31, 2004	**$4,838,538**	**$1,931,736**	**$ 953,641**	**$288,453**	**$ 747,670**	**$8,760,038**	**$1,845,858**	**$10,605,896**
Depreciation	**119,934**	**70,189**	**8,745**	**15,953**	**19,679**	**234,500**	**22,613**	**257,113**
Capital expenditures	**123,547**	**23,623**	**25,575**	**5,349**	**14,623**	**192,717**	**9,132**	**201,849**

Geographic Segments

Year Ended March 31, 2004	Millions of Yen					
	Japan	North America	Other Areas	Total	Corporate & Eliminations	Consolidated
Net sales:						
Unaffiliated customers	**¥675,442**	**¥188,767**	**¥66,028**	**¥ 930,237**	**¥ —**	**¥ 930,237**
Intersegment	**154,741**	**2,656**	**1,949**	**159,346**	**(159,346)**	**—**
Total	**830,183**	**191,423**	**67,977**	**1,089,583**	**(159,346)**	**930,237**
Cost of sales and operating expenses	**815,158**	**172,195**	**63,338**	**1,050,691**	**(142,303)**	**908,388**
Operating income	**¥ 15,025**	**¥ 19,228**	**¥ 4,639**	**¥ 38,892**	**¥ (17,043)**	**¥ 21,849**
Identifiable assets at March 31, 2004	**¥752,041**	**¥177,163**	**¥44,290**	**¥ 973,494**	**¥150,731**	**¥1,124,225**

Year Ended March 31, 2003	Millions of Yen					
	Japan	North America	Other Areas	Total	Corporate & Eliminations	Consolidated
Net sales:						
Unaffiliated customers	¥712,964	¥158,051	¥55,130	¥ 926,145	¥ —	¥ 926,145
Intersegment	124,213	2,439	1,268	127,920	(127,920)	—
Total	837,177	160,490	56,398	1,054,065	(127,920)	926,145
Cost of sales and operating expenses	807,122	144,348	52,720	1,004,190	(107,658)	896,532
Operating income	¥ 30,055	¥ 16,142	¥ 3,678	¥ 49,875	¥ (20,262)	¥ 29,613
Identifiable assets at March 31, 2003	¥840,053	¥161,664	¥42,623	¥1,044,340	¥ 94,671	¥1,139,011

Year Ended March 31, 2004	Thousands of U.S. Dollars					
	Japan	North America	Other Areas	Total	Corporate & Eliminations	Consolidated
Net sales:						
Unaffiliated customers	**$6,372,094**	**$1,780,821**	**$622,906**	**$ 8,775,821**	**$ —**	**$ 8,775,821**
Intersegment	**1,459,821**	**25,056**	**18,387**	**1,503,264**	**(1,503,264)**	**—**
Total	**7,831,915**	**1,805,877**	**641,293**	**10,279,085**	**(1,503,264)**	**8,775,821**
Cost of sales and operating expenses	**7,690,170**	**1,624,481**	**597,528**	**9,912,179**	**(1,342,481)**	**8,569,698**
Operating income	**$ 141,745**	**$ 181,396**	**$ 43,765**	**$ 366,906**	**$ (160,783)**	**$ 206,123**
Identifiable assets at March 31, 2004	**$7,094,726**	**$1,671,349**	**$417,830**	**$ 9,183,905**	**$1,421,991**	**$10,605,896**

Sales by Region

Years Ended March 31, 2004 and 2003	Millions of Yen				Thousands of U.S. Dollars
	2004		2003		**2004**
Japan	**¥643,346**	**69.2%**	¥684,254	73.9%	**$6,069,302**
Overseas:					
North America	**189,273**	**20.3**	158,386	17.1	**1,785,594**
Other Areas	**97,618**	**10.5**	83,505	9.0	**920,925**
Subtotal	**286,891**	**30.8**	241,891	26.1	**2,706,519**
Total	**¥930,237**	**100.0%**	¥926,145	100.0%	**$8,775,821**

Sales by region represent sales to unaffiliated customers based on the customers' locations.