

## Financial Review

### 1. REVENUES AND EARNINGS

#### Revenues

For the year ended March 31, 2007, revenues of the Company increased ¥61.7 billion (5.8%), to ¥1,127.5 billion (\$9,555 million) from the prior year.

In the domestic market, revenues decreased ¥28.6 billion (4.5%), to ¥603.5 billion (\$5,114 million). Revenues in Internal Combustion Engine and Machinery decreased due to lower sales of core farm equipment even though sales of construction machinery and engines increased steadily. Revenues in Pipes, Valves, and Industrial Castings also declined slightly owing to a decrease in sales of industrial castings, while sales of ductile iron pipes and plastic pipes stayed at the same level as in the prior year. Revenues in Environmental Engineering decreased substantially due mainly to severe market conditions. On the contrary, revenues in Other increased chiefly due to sales expansion of vending machines.

On the other hand, revenues in overseas markets increased ¥90.3 billion (20.8%), to ¥524.0 billion (\$4,440 million) from the prior year. In North America, sales of newly introduced mid-size tractors expanded substantially and sales of construction machinery and engines also increased. In Europe, sales of tractors, construction machinery, and engines all increased. In Asia outside Japan, a large increase in sales of farm equipment for rice farming continued. As a consequence, the ratio of overseas revenues to consolidated revenues rose 5.8 percentage points, to 46.5%.

#### Revenues by industry segment

##### 1) Internal Combustion Engine and Machinery

Revenues in Internal Combustion Engine and Machinery were ¥746.8 billion (\$6,329 million), 10.8% higher than the prior year, comprising 66.3% of consolidated revenues. Domestic revenues decreased 4.1%, to ¥258.3 billion (\$2,189 million), and overseas revenues increased 20.7%, to ¥488.5 billion (\$4,140 million). This segment comprises farm equipment, engines, and construction machinery.

In the domestic market, sales of farm equipment declined because of lackluster market conditions. In the domestic market for farm equipment,

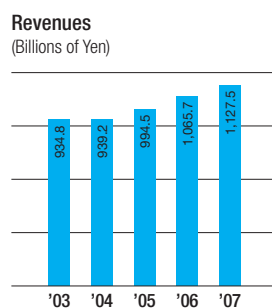
new government agricultural policies have been introduced, and the implementation of these measures is resulting in structural changes within the agricultural sector, leading to a postponement of equipment purchases, principally among medium-sized farms. Within this market environment, to revitalize the operations, the Company implemented sales expansion policies carefully tailored to various customer groups and was able to increase its market share; however, these efforts did not compensate for the market slump. On the other hand, sales of construction machinery rose significantly due to steady demand for construction machinery, the introduction of new models, and the expansion of sales to major machinery rental companies. In addition, sales of engines, mainly to manufacturers of construction and industrial machinery, showed steady expansion.

In overseas markets, sales of tractors, the Company's core product, expanded steadily. In the United States, sales of mid-size tractors showed marked expansion accompanying the introduction of new models, while sales of small-sized tractors weakened along with the slowdown in housing starts. In Europe, sales of tractors showed strong expansion as the Company introduced new products and implemented an active marketing program. Moreover, in Asia outside Japan, sales of tractors sustained a high rate of growth in Thailand, where demand for tractors is expanding rapidly.

Sales of construction machinery reported steady expansion in Europe, the principal overseas market of construction machinery, due to rising demand coupled with the introduction of new products. Sales of construction machinery in North America also increased. In addition, sales of engines in Europe and the United States grew steadily, and sales of combine harvesters in China increased rapidly.

##### 2) Pipes, Valves, and Industrial Castings

Revenues in Pipes, Valves, and Industrial Castings were ¥194.2 billion (\$1,646 million), 2.4% higher than the prior year, comprising 17.2% of consolidated revenues. Domestic revenues decreased 2.2%, to ¥163.4 billion (\$1,385 million), and overseas revenues increased 36.7%, to ¥30.8 billion (\$261 million). This segment comprises pipes, valves, and industrial castings.



In the domestic market, demand for ductile iron pipes and plastic pipes was lackluster, but the Company was able to slightly increase sales of plastic pipes by raising prices, while sales of ductile iron pipes declined marginally. Sales of industrial castings expanded, mainly to the private sector, such as the steel and energy industries, but sales of products to the public sector fell sharply.

In overseas markets, exports of ductile iron pipes to the Middle East were robust, and sales of industrial castings continued to increase substantially, owing to high levels of private-sector capital expenditures.

### 3) Environmental Engineering

Revenues in Environmental Engineering were ¥90.6 billion (\$768 million), 17.5% lower than the prior year, comprising 8.0% of consolidated revenues. Domestic revenues decreased 17.6%, to ¥86.5 billion (\$733 million), and overseas revenues decreased 16.8%, to ¥4.1 billion (\$35 million). This segment comprises environmental control plants and pumps.

In the domestic market, the operating environment continued to be extremely challenging because of the decline in public-sector demand and the drop in sales prices due to more intense competition. In addition, suspension of designated pre-approved suppliers due to compliance issues had a major negative impact. As a result, the Water & Sewage Engineering Division and Pumps Division suffered a substantial decline in revenue. Overseas revenues also declined due to a decrease in sales of pumps, which is the main export product in this segment.

### 4) Other

Revenues in Other were ¥95.8 billion (\$812 million), 4.1% higher than the prior year, comprising 8.5% of consolidated revenues. Domestic revenues increased 4.9%, to ¥95.3 billion (\$808 million), and overseas revenues decreased 60.0%, to ¥0.5 billion (\$4 million). This segment comprises vending machines, electronic equipped machinery, air-conditioning equipment, construction, septic tanks, condominiums, and other business. Sales of construction fell sharply because of the Company's realignment measures, including the discontinuance of receiving orders from the

public sector as an original contractor. Sales of vending machines, condominiums, and air-conditioning equipment increased favorably, while sales of electronic equipped machinery and septic tanks declined.

### Cost of Revenues, SG&A Expenses, and Loss from Disposal and Impairment of Business and Fixed Assets

The cost of revenues increased 5.4% from the prior year, to ¥794.7 billion (\$6,735 million). The cost of revenues as a percentage of consolidated revenues decreased 0.2 percentage point, to 70.5%. The decrease in the ratio was attributable to ongoing activities for cost reductions and controls as well as the increased efficiency of the manufacturing process.

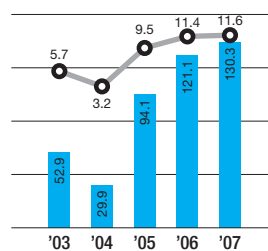
Selling, general, and administrative (SG&A) expenses increased 7.2% from the prior year, to ¥199.4 billion (\$1,689 million). The ratio of SG&A expenses to revenues increased 0.2 percentage point, to 17.7%. This increase was mainly due to increases in overseas subsidiaries' SG&A expenses resulting from sales expansion.

Loss from disposal and impairment of businesses and fixed assets decreased 34.9% from the prior year, to ¥3.1 billion (\$26 million). This loss arose chiefly from the restructuring of construction businesses.

### Operating Income

Operating income climbed ¥9.3 billion (7.7%), to ¥130.3 billion (\$1,105 million) from the prior year, the highest level in the Company's history. By segment, operating income in Internal Combustion Engine and Machinery expanded substantially, supported by the increase in revenues and the positive effect of the weakening of the yen. Pipes, Valves, and Industrial Castings also reported a gain in operating income owing to continued cost-cutting, including reductions in fixed expenses, and higher revenues in overseas markets. Environmental Engineering, however, posted a substantial decline in profitability and reported an operating loss accompanying the decline in sales prices. Operating income in Other, however, showed steady expansion, as a result of increased sales of vending machines and other products.

Operating Income  
(Billions of Yen)



○ The ratio of operating income to revenues (%)

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 ¥124.9 billion (\$1,059 million), a 12.9% increase; Pipes, Valves, and Industrial Castings, operating income of ¥22.0 billion (\$187 million), a 14.3% increase; Environmental Engineering, operating loss of ¥5.6 billion (\$48 million), as compared to operating income of ¥4.3 billion; and Other, operating income of ¥7.1 billion (\$60 million), a 226.9% increase.

#### Other Income

Other income, net, was ¥1.2 billion (\$10 million), a decrease of ¥18.2 billion from the prior year. The reason for this substantial decrease was the absence of a gain of ¥15.9 billion from the nonmonetary exchange of securities of UFJ Holdings, Inc., resulting from the merger of Mitsubishi Tokyo Financial Group, Inc., and UFJ Holdings, Inc., in the prior year.

#### Income from Continuing Operations before Income Taxes, Minority Interests in Earnings of Subsidiaries, and Equity in Net Income of Affiliated Companies

Income from continuing operations before income taxes, minority interests in earnings of subsidiaries, and equity in net income of affiliated companies was ¥131.6 billion (\$1,115 million), a decrease of ¥9.0 billion from the prior year.

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

Income taxes decreased 12.7% from the prior year, to ¥49.0 billion (\$415 million). The effective tax rate was 37.2%.

Minority interests in earnings of subsidiaries increased ¥1.3 billion, to ¥6.2 billion (\$53 million). Equity in net income of affiliated companies decreased ¥0.3 billion from the prior year, to ¥1.4 billion (\$11 million). The increase in minority interests in earnings of subsidiaries resulted from the favorable operating performances of overseas subsidiaries.

#### Income from Continuing Operations

Income from continuing operations was ¥77.7 billion (\$659 million), compared with ¥81.1 billion in the prior year.

#### Loss from Discontinued Operations, Net of Taxes

Loss from discontinued operations, net of taxes, was ¥1.3 billion (\$11 million) in the year under review and ¥0.1 billion in the prior year. This loss resulted from the withdrawal from industrial-waste disposal business and the liquidity of a subsidiary engaged with that business.

#### Net Income

Due to the factors described above, net income decreased ¥4.6 billion, to ¥76.5 billion (\$648 million). Return on shareholders' equity decreased 2.8 percentage points, to 12.1%, from the prior year.

#### Income per ADS

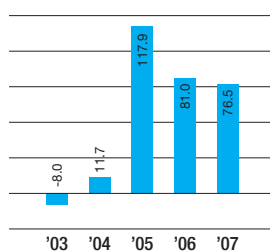
Basic net income per ADS (five common shares) was ¥295 (\$2.50), as compared to ¥311 in the prior year.

#### Dividends

The Company has decided to pay ¥35 per ADS as year-end cash dividends. Accordingly, including the interim dividend of ¥25 per ADS already paid, the total dividends for the entire fiscal year will be ¥60 per ADS, which will be ¥10 per ADS higher than the prior year.

The Company's basic policy for the return of profit to shareholders is to maintain stable dividends or raise dividends together with share buy-backs and the cancellation of treasury stock. For reference's sake, the Company purchased 7.98 million shares outstanding (¥8.5 billion) and retired 7.95 million shares of treasury stock (¥8.5 billion) during the year under review.

Net Income (Loss)  
(Billions of Yen)



## Comprehensive Income

Comprehensive income was ¥67.3 billion (\$570 million), ¥73.0 billion lower from the prior year. This decrease was mainly due to a decrease in unrealized gains on securities.

## 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 receivables, establishing committed lines of credit, and the issuance of bonds and commercial paper (CP) in the capital markets.

Annual interest rates of short-term borrowings ranged primarily from 0.81% to 5.77% at March 31, 2007. The weighted average interest rate on such short-term borrowings was 5.3%. As for long-term debt, interest rates were primarily fixed, and the weighted average interest rate on such long-term debt at March 31, 2007 was 3.6%.

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 securitization trusts. Trade receivables and finance receivables sold under the securitization program are excluded from receivables in the accompanying consolidated balance sheets.

Regarding the lines of credit, the Company has established committed lines of credit totaling ¥20.0 billion (\$169 million) with certain Japanese banks. However, the Company currently does not use these lines. In the United States, Europe, and Asia, the Company maintains adequate

uncommitted lines of credit with financial institutions. The Company also maintains a CP program allowing for the issuance of CP of up to ¥100.0 billion (\$847 million). There was no outstanding issue of CP as of the end of March 2007.

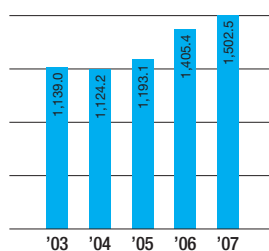
The Company utilizes Group financing. With Group financing, the Company centralizes and pursues the efficiency of cash management domestically through the Kubota Cash Management System, under which the excess or shortage of cash at most of its subsidiaries in Japan is invested or funded, as necessary.

To maintain the strength of its balance sheet and help secure adequate funding resources, the Company carefully monitors its interest-bearing debt excluding debt related to sale financing programs. The Company is providing sale financing programs to support machinery sales in North America, Japan, and Thailand. The Company believes an increase of debt related to sales financing programs is a result of business expansion. At the end of March 2007, the amount of interest-bearing debt was ¥349.9 billion (\$2,965 million). Of the ¥349.9 billion, ¥329.9 billion was borrowings from financial institutions, and the remaining ¥20.0 billion consisted of corporate bonds.

The amount of working capital decreased ¥1.4 billion, to ¥240.4 billion (\$2,037 million), from the prior year-end. Additionally, the ratio of current assets to current liabilities decreased 5.1 percentage points, to 141.7%. The primary reason for this decrease was an increase in the current portion of long-term debt. 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 each year.

All things considered, the Company believes that it can support its current and anticipated capital and operating expenditures for the foreseeable future. The currencies in which the Company has its debt are mainly Japanese yen and U.S. dollars. There are no restrictions regarding the manner in which the funds may be used.

Total Assets  
(Billions of Yen)



## 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 ratings are "A+" for long-term debt and "a-1" for short-term debt as of March 2007 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 the end of March 2007 amounted to ¥1,502.5 billion (\$12,733 million), an increase of ¥97.1 billion (6.9%) from the end of the prior year.

Current assets were ¥817.1 billion (\$6,925 million), an increase of ¥58.9 billion from the prior year-end. Current assets increased substantially due mainly to increases in inventories and short-term finance receivables resulting from business expansion in Internal Combustion Engine and Machinery. Inventory turnover dropped 0.5 point, to 5.9 times.

In addition to the increase in current assets, investments and long-term finance receivables increased ¥24.6 billion, to ¥398.9 billion (\$3,381 million). Long-term finance receivables increased substantially resulting from a sales increase in North America, while other investments decreased owing to a decrease in the unrealized gain on securities. Property, plant, and equipment increased ¥11.3 billion, to ¥237.6 billion (\$2,014 million), due to an increase in capital expenditures. Other assets slightly increased ¥2.3 billion, to ¥48.9 billion (\$414 million).

### Liabilities

Total liabilities amounted to ¥806.8 billion (\$6,837 million), an increase of ¥36.8 billion (4.8%) from the end of the prior year.

Current liabilities were ¥576.7 billion (\$4,887 million), an increase of ¥60.2 billion from the prior year-end. Trade notes and accounts payable

increased due to an increase in inventories, and interest-bearing debt increased due to increases in short- and long-term finance receivables. In addition, income taxes payable also increased.

On the other hand, long-term liabilities decreased ¥23.4 billion, to ¥230.1 billion (\$1,950 million), because accrued retirement and pension costs decreased largely due to an application of a new accounting standard for pensions.

### Minority Interests

Minority interests amounted to ¥36.1 billion (\$306 million), an increase of ¥7.2 billion (24.8%) from the end of the prior year as a result of favorable results of operations of foreign subsidiaries.

### Shareholders' Equity

Total shareholders' equity amounted to ¥659.6 billion (\$5,590 million), an increase of ¥53.2 billion (8.8%) from the end of the prior year.

Retained earnings increased ¥53.7 billion, to ¥376.8 billion (\$3,193 million) from the prior year-end due to the recorded net income. Though the unrealized gains on securities decreased, accumulated other comprehensive income remained at the same level as the prior year-end due mainly to the recorded pension liability adjustment with an application of the new accounting standard for pensions. The Company repurchased ¥8.5 billion (\$72,102 million) of treasury stock and retired ¥8.5 billion (\$71,898 million) during the year under review.

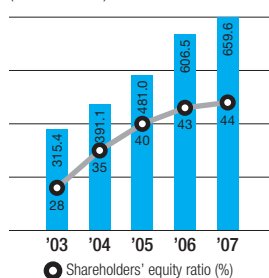
The shareholders' equity ratio\* was 43.9%, 0.7 percentage point higher than at the prior year-end. The debt-to-equity ratio\*\* was 53.0%, 2.1 percentage points lower than at the prior year-end.

\* Shareholders' equity ratio = shareholders' equity / total assets

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

### Total Shareholders' Equity

(Billions of Yen)



### Off-Balance Sheet Arrangements

The Company utilizes accounts receivable securitization programs, which are important for the Company to broaden its funding sources and raise cost-effective funds. In the programs, the Company sells the receivables to wholly owned special-purpose entities ("SPEs"), which in turn transfer the receivables to bankruptcy-remote independent securitization trusts (the "Trusts"). At the time the receivables are sold to the Trusts, the receivables are removed from the consolidated balance sheet of the Company. The Company retains servicing responsibilities and subordinated interests. The purchaser has no recourse to the Company's other assets for failure of debtors to pay when due. The Company's interest in sold receivables is subordinate to the purchaser's interest, and the

Company serves as credit enhancements for the securities issued by the Trusts. The value of the Company's interest in sold receivables is subject to credit, repayment, dilution, and interest rate risks on sold receivables. The Company is obligated to repurchase any receivable if the interest of the administrative agent is materially adversely affected by a breach of representation or warranty made by the SPEs.

The Company provides guarantees to distributors, including affiliated companies, and customers for their borrowing from financial institutions. The Company would have to perform under these guarantees in the event of default on a payment within the guarantee periods. The maximum potential amount of undiscounted future payments of these financial guarantees as of March 31, 2007 was ¥949 million (\$8,042 thousand).

### Contractual Obligations

The following summarizes contractual obligations at March 31, 2007.

Year Ended March 31, 2007	Millions of Yen				
	Total	Payments Due by Period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Short-term borrowings	¥128,365	¥128,365	¥ —	¥ —	¥ —
Capital lease obligations	6,577	3,253	3,028	254	42
Long-term debt	214,957	68,176	114,603	19,046	13,132
Deposits from customers	2,522	2,522	—	—	—
Operating lease obligations	1,785	682	680	178	245
Commitments for capital expenditures	3,819	3,819	—	—	—
Interest payments	13,082	6,269	5,888	744	181
<b>Total</b>	<b>¥371,107</b>	<b>¥213,086</b>	<b>¥124,199</b>	<b>¥20,222</b>	<b>¥13,600</b>

Year Ended March 31, 2007	Thousands of U.S. Dollars				
	Total	Payments Due by Period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Short-term borrowings	\$1,087,839	\$1,087,839	\$ —	\$ —	\$ —
Capital lease obligations	55,737	27,568	25,661	2,152	356
Long-term debt	1,821,670	577,763	971,212	161,407	111,288
Deposits from customers	21,373	21,373	—	—	—
Operating lease obligations	15,127	5,780	5,762	1,509	2,076
Commitments for capital expenditures	32,364	32,364	—	—	—
Interest payments	110,864	53,127	49,898	6,305	1,534
<b>Total</b>	<b>\$3,144,974</b>	<b>\$1,805,814</b>	<b>\$1,052,533</b>	<b>\$171,373</b>	<b>\$115,254</b>

The Company's contributions to pension plans for the year ending March 31, 2008 are expected to be ¥13,562 million (\$114,932 thousand).

### 3. CASH FLOWS

Net cash provided by operating activities during the year under review was ¥96.8 billion (\$821 million), an increase of ¥9.0 billion from the prior year. Although net income decreased from the prior year, the Company's cash position was not affected, because the primary reason for the decrease of net income was the absence of the gain on nonmonetary exchange of securities in the prior year. The increase in net cash provided by operating activities was mainly due to the favorable performance of business operations.

Net cash used in investing activities was ¥90.0 billion (\$763 million), an increase of ¥28.7 billion from the prior year. Purchases of fixed assets increased due to an increase in capital expenditures. In addition, cash provided by proceeds from sales of property, plant, and equipment, proceeds from sales of investments, and proceeds from sales of finance receivables decreased. Accordingly, net cash used in investing activities increased substantially.

Net cash used in financing activities was ¥16.8 billion (\$143 million), an increase of ¥6.6 billion from the prior year. Although purchases of treasury stock decreased, repayment of short-term borrowings and increased cash dividends increased net cash used in financing activities.

As a result, including the effect of exchange rate changes, cash and cash equivalents at the end of March 2007 were ¥82.6 billion (\$700 million), a decrease of ¥9.3 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 ("U.S. 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 conditions 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 the extent to which cost exceeds market value, the duration of market declines, and other key measures. Other non-marketable securities are stated at cost and reviewed periodically for impairment. 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 provides a valuation allowance for 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 developed by the Company and used by actuaries in calculating such amounts. These assumptions include the discount rate, retirement rate, timing of estimated average promotion, 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.

To determine the discount rate, the Company considers current market interest rates. The Company assumed that the discount rate was 2.5% for the years ended March 31, 2007, 2006, and 2005. A further decrease of 50 basis points in the discount rate would increase the benefit obligations as of March 31, 2007 by approximately ¥8.1 billion (\$69 million).

To determine the expected rate of return on plan assets, the Company considers actual returns in the past 5 to 10 years, the current and expected components of plan assets, and anticipated market trends. An actual return on plan assets in the past 10 years at March 31, 2007 was 3.4%, and an asset allocation assumption was 55% on fixed income securities with an expected rate of return of 1.0%, and 45% on equity securities with an expected rate of return of 5.5% for the year ended March 31, 2006 and thereafter. The Company assumed that the long-term rate of return on plan assets was 3.0% for the years ended March 31, 2007 and 2006, and 3.5% for the year ended March 31, 2005. A decrease of 50 basis points in the expected rate of return on plan assets would result in an increase of periodic benefit cost for the year ending March 31, 2008 of approximately ¥0.5 billion (\$4 million).

The Company recognizes actuarial gains and losses in excess of 20% of the larger of the projected benefit obligation or plan assets in the year following 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. Accordingly, significant unrecognized actuarial gains or losses may have a material effect on periodic benefit cost in the next fiscal year.

From the fiscal year ended March 31, 2007, the Company adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132 (R)." The Company recognizes its overfunded or underfunded status of the defined benefit postretirement plan as an asset or liability in the consolidated balance sheets with a corresponding adjustment to pension liability adjustment in accumulated other comprehensive

income, net of tax. The adoption of the statement has no effect on the consolidated statements of income.

### **Revenue Recognition for Long-Term Contracts**

Long-term contracts are accounted for using the percentage of completion method. The Company believes that it is able to develop reasonably dependable estimates of the extent of progress toward completion of individual contracts. Concerning the method of measuring the extent of progress toward completion, the Company uses the cost-to-cost method in measuring the extent of progress toward completion.

Generally, output measures are considered to be the best measures of progress toward completion. But, in the case of the Company, most contracts with customers include the delivery and installation of component units. Accordingly, the extent of progress toward completion cannot be properly measured. The Company deems that the measuring method based on the accrual cost method is the most appropriate. Among the various input measure methods available, the Company believes the cost-to-cost method to be preferable to others, such as labor hours, labor cost, machine hours, or material quantities.

The Company's senior management and the Board of Corporate Auditors 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-sector 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, revenues 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 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 in those regions.

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

The Company has overseas revenues 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 transactions between the parent company and overseas subsidiaries or customers are generally denominated in the local currencies. The payments received in local currencies on such transactions are converted to Japanese yen. 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. Such risks may affect revenues and profitability of the Company or they may hinder growth of the Company in specific countries. The following risks are important concerns for the Company:

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

The major markets with the previously mentioned risks are markets in the United States, the EU, and Asian countries. Among the United States, the EU, and Asian countries, which are major markets for the Company, risks in Asian countries seem to be relatively higher than those of other regions.

**The Company utilizes estimates 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, impairment losses on long-lived assets, and revenue recognition for long-term contracts in the consolidated financial statements based on the information that it has available. 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, and acquisitions 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, if these activities are not successful and returns on related investments are lower than expected, the Company may lose competitiveness in relevant markets. Consequently, the Company's profitability may deteriorate.

**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, subsequent impairment charges may be taken, or there may be a negative impact on the Company's financial position.

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

As of March 31, 2007, the Company owns securities with a fair value of approximately ¥203.7 billion (\$1,726 million). Most of these securities are equity securities, and, accordingly, depending on stock market fluctuations, unrealized and realized losses may occur.

**In each of its businesses, Kubota is subject to intensifying competitive pressures. The Company must compete successfully to maintain revenues 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, revenues and/or net income may decrease in the future.

**The Company may be required to incur significant financial expenses if its products and services are alleged to have serious defects.**

If the Company's products and services are alleged to have serious defects, the Company may have liability for significant damages. Such damages and other associated expenses may have a material effect on the Company's consolidated results of operations and financial position. If such claims are asserted, the Company may lose the confidence of the public and suffer a reduction in its brand value, which may result in decreased revenues or demand for its products.

**The Company is subject to various environmental laws and regulations, and may be required to incur considerable expenses in order to comply with such laws and regulations.**

The Company is subject to various environmental laws and regulations that apply to its products and activities. If these environmental laws and regulations, such as those that impose carbon dioxide emission controls, emission controls, and usage restrictions for certain materials which are used in the Company's products, are strengthened or newly established in jurisdictions in which the Company conducts its businesses, the Company may be required to incur considerable expenses in order to comply with such laws and regulations. Such expenses may have a material effect on the Company's consolidated results of operations and financial position. To the extent that the Company determines that it is not economical to continue to comply with such laws and regulations, the Company may have to curtail or discontinue its activities in the affected business areas.

**The Company may be required to incur significant expenses in connection with environmental damage its activities may allegedly cause.**

Claims may arise that the Company's activities have caused environmental contamination, including the release of hazardous materials or air pollution, water pollution, and/or soil contamination. In such an event, the Company may elect or be required to implement costly corrective actions to resolve any issues associated with the release or presence of such hazardous materials or contamination and may face associated litigation. These factors may have a material effect on the Company's consolidated results of operations and financial position.

**The Company may be required to incur significant expenses relevant to asbestos-related issues.**

The Company previously manufactured products containing asbestos from 1954 to 2001. The Company may be required to incur various expenses, including payments to the individual concerned or face lawsuits related to the asbestos-related health hazards of employees (including former employees) who engaged in the manufacturing of products containing asbestos, and residents who lived near the Company's factory at which these products were manufactured. If such expenses become significant or any lawsuits result in judgments unfavorable to the Company, there may be a material adverse effect on the Company's consolidated results of operations, financial position, and its liquidity.

**The Company may experience a material effect on its consolidated results of operations and financial position if it faces issues related to compliance.**

The Company has declared its intention to conduct its corporate activities in compliance with legal regulations and ethical principles, and to exert efforts to cause all management and staff of the Group companies not to act in violation of various legal regulations, ethical standards or internal regulations. However, in the event that compliance issues arise notwithstanding such efforts, there is a possibility that the Company may be subject to disciplinary action by government ministries supervising its activities or to lawsuits, or may suffer a loss of public confidence, that could have a material effect on the Company's consolidated results of operations and financial position.

### **Damage by natural disasters**

Japan is a country with frequent earthquakes. In case of a strong earthquake or related tidal wave, the Company may be affected in the operation of its manufacturing, logistics, and sales activities, and may lose revenues and profits depending on the severity of the earthquake or tidal wave. Japan also is hit by typhoons very frequently. In case major plants are struck by a large and powerful typhoon, the Company's operations may suffer great losses.

## **6. MARKET RISKS**

### **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 derivative transactions within the range of its outstanding credit and obligations, and the Company does not engage in speculative derivative transactions. The counterparties for the Company's derivative transactions are financial institutions with high creditworthiness; therefore, the Company does not anticipate any credit losses on such transactions. For more specific details, please refer to Note 15 to the consolidated financial statements.

## **7. RESEARCH AND DEVELOPMENT**

R&D expenses were ¥22.9 billion (\$194 million), an increase of ¥0.2 billion from the prior year, and its ratio to revenues declined 0.13 percentage point, to 2.03%. R&D expenses were mainly spent on R&D activities of the Internal Combustion Engine and Machinery segment.

## **8. CAPITAL EXPENDITURES**

Capital expenditures amounted to ¥44.7 billion (\$379 million), a 32.3% increase from the prior year. Capital expenditures were spent primarily on expanding production capacity, including building a new factory, and acquiring land. The amount of depreciation expense was ¥25.1 billion (\$213 million), ¥0.1 billion less than the prior year. The funds for these capital expenditures were mainly provided by internal operations. The principal capital expenditures as of March 31, 2007 were related to expansion of capacity for engine manufacturing.

## **9. MATTERS RELATED TO THE HEALTH HAZARD OF ASBESTOS**

### **Background**

Until 1995, the Company's plant in Amagasaki, Hyogo Prefecture, which is now a Company office, had produced products containing asbestos. In April 2005, the Company was advised that some residents who lived near the former plant suffered from mesothelioma, a form of cancer that is said to be mainly caused by the aspiration of asbestos. After discussing this issue with those patients and their private support groups, and deliberating internally and consulting with outside advisers, the Company announced its intention in June 2005 to act seriously and faithfully concerning various issues of the health hazard of asbestos from the viewpoint of corporate social responsibility (CSR) as a company that had once manufactured products containing asbestos for a long time.

According to the Company's basic policy, the Company started the program of consolation payments to patients with mesothelioma who lived near the former plant and to the families of residents who died from mesothelioma. In April 2006, the Company decided to establish the relief payment system in place of the consolation payment system and make additional payment to the residents to whom consolation payment or condolence payment were eligible to be paid or payable.

With regard to current and former employees of the Company who are suffering from, or died of, asbestos-related diseases, the Company has paid, or is paying, compensation in accordance with policies that were established in the early 1990s, which include compensation for medical expenses, special health checkups for retired employees, and certain additional payments to workers' compensation that are not required by law but are voluntarily made by the Company.

As a result of the asbestos issue becoming an object of public concern, the Japanese government newly established the Law for the Relief of Patients Suffering from Asbestos-Related Diseases ("New Asbestos Law") in March 2006. Based on the New Asbestos Law, a Fund for the Relief of Patients Suffering from Asbestos-Related Diseases (the "Fund") was established, and the Fund, from which the relief aid is paid, is funded by the national government, municipal governments, and business entities. The payment of contribution to the Fund by each business entity shall commence from the year ending March 31, 2008.

### **Contingencies Regarding Asbestos-Related Matters**

The Company expenses the payments for the health hazard of asbestos based on the Company's policies and procedures. The amounts of these expenses during the year under review were approximately ¥4.0 billion. The Company believes it is not possible to reasonably estimate the amount of its ultimate liability relating to asbestos issues. However, the Company believes asbestos-related issues contain potentially material risks for the Company's consolidated results of operations, financial position, and its liquidity.

## **10. OUTLOOK FOR THE NEXT FISCAL YEAR**

### **Financial Outlook**

The Company forecasts consolidated revenues for the year ending March 31, 2008 will slightly increase from the year under review. In the domestic market, revenues in Pipes, Valves, and Industrial Castings are expected to increase. However, revenues in Internal Combustion Engine and Machinery are forecast to decrease slightly and revenues in Environmental Engineering and Other are forecast to decrease substantially. As a result, total domestic revenues are estimated to decrease from those of the year under review. As for overseas revenues, the Company expects higher revenues than in the year under review due to steady expansion of revenues in Internal Combustion Engine and Machinery.

The Company forecasts that operating income will almost be at the same level as in the year under review. Although a favorable swing of exchange rates mainly against the euro as well as corporate-wide cost reductions will have a favorable effect on profitability, the price increases in raw materials will cause downward pressure on operating income. The Company expects income from continuing operations before income taxes, minority interests in earnings of subsidiaries, and equity in net income of affiliated companies, and net income for the next fiscal year to be also almost at the same level as in the year under review.

### **Cautionary Statements with Respect to Forward-Looking Statements**

This document may contain forward-looking statements that are based on management's expectations, estimates, projections, and assumptions. These statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Therefore, actual future results may differ materially from what is forecast in the forward-looking statements due to a variety of factors, including, and without limitation, general economic conditions in the Company's markets, particularly government agricultural policies; levels of capital expenditures, both in the public and private sectors; foreign currency exchange rates; continued competitive pricing pressures in the marketplace; as well as the Company's ability to continue to gain acceptance of its products among the public.