

## **Meeting Material 1H of FY2017 Briefing—Question and Answer Session**

Date: Friday, November 10, 2017

KYB panel: Yasusuke Nakajima, Representative Director, Chief Executive Officer

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### **1. Main causes of profit deterioration in AC Operations**

Q. Excluding the exchange rate, what are the main causes of the deterioration of AC Operations' segment profits compared with the previous term for the first half of fiscal 2017?

A. The causes are an increase in fixed costs related to the start up of our Mexico shock absorber plant, harsh competition in the U.S. market (both for OEM and aftermarket), and rises in steel material prices.

### **2. Declining profitability in HC Operations**

Q. What is the cause of the decline in HC Operations profitability since the second quarter?

A. One cause is an increase in personnel expenses due to increasing shifts to respond to strong demand in the construction machinery market, as well as a labor shortage. Another cause is that cost reductions have not kept pace with demands for the price cuts that are necessary to continue receiving orders.

### **3. AC Operations global share**

Q. In AC Operations, what is the cause of the increase in the share of shock absorbers for new vehicle models in fiscal 2020? Also, why is the share flat in the China market?

A. Our forecast for growth in our global share is based on the increasing use of our shock absorbers, especially by Japanese manufacturers operating overseas, and particularly in the Japan, U.S., and ASEAN/India markets. On the other hand, while we have received inquiries, we have not yet been able to make great progress with the adoption of our products for new cars in the China market. Until now, we have mostly received orders for passenger cars. However, in light of the growth of SUVs in the U.S. and China markets, we plan to change tactics and aim to have our products equipped in SUV models from fiscal 2020 and onward.

#### **4. HC Operations second half plan**

Q. In the second half, it appears challenging to further increase business performance. What is your opinion?

A. We're seeing a rapid upswing in orders received from customers, and have backorders for some products.

Conventional supply methods are not keeping up, so we are using multiple suppliers and new suppliers, and dealing with increasing number of shifts. Also, customer priorities are shifting from pricing to reliable delivery of goods. As such, we have to securely supply goods and continue to negotiate to reflect the sales price.

#### **5. Outlook for HC Operations in the China market**

Q. Do you see the demand outlook for the China market in fiscal 2018 to be largely the same as in fiscal 2017?

A. In the China market in fiscal 2018, we anticipate an increase of about 5% over the current level. The outlook for demand from fiscal 2019 onwards, however, is unclear. Through establishing the optimum production system and conducting sales promotions for growth markets other than hydraulic excavators, we plan to shift to a business constitution that can still achieve profits even if there is a temporary downturn in sales.

#### **6. About the motorcycle business**

Q. How is the profitability of the motorcycle business?

A. About adjustments of surplus capacity to meet demand, we have decided to strengthen or reorganize each plant as necessary, and we are making progress accordingly. Regarding profitability, some plants are performing well while some are not, but with the start of transactions to new customers and increased selling prices to existing customers, the overall trend is toward improvement.

#### **7. Profitability in AC Operations**

Q. How is the profitability in the sub-segments of AC Operations?

A. Automotive shock absorbers in the U.S. market (OEM and aftermarket) and in the Middle East market (aftermarket) are facing severe competition. However, the Middle East market is seeing a recovery trend in the Saudi Arabia market, and we forecast an improvement in the second half. Motorcycles are favorable, particularly in various ASEAN countries. In automotive hydraulics, CVT pump business is favorable, while EPS business remains sluggish.

#### **8. Situation regarding HC Operations component and materials provision**

- Q. We've heard that, amidst current strong demand, components and materials cannot always be supplied on time. When is this situation forecast to end? Has it already been resolved?
- A. We plan to increase our procurement capacity, but demand is exceptionally strong. Our plan involves expanding our suppliers, including those overseas. However, as time is required to evaluate new suppliers, we cannot forecast that the situation will end soon.

#### **9. EPS business profitability**

- Q. We've heard that profitability would be improved through a volume increase (quantity increase). Do you have any forecast for a volume increase?
- A. We do not have a forecast for a volume increase. We are currently considering how we should take measures, both for the domestic and overseas markets.

#### **10. Selling price negotiations in HC Operations**

- Q. With the supply and demand gap in the overall market, are customers asking for cuts in selling prices?
- A. Among all our products, cylinders are facing severe price competition from manufacturers in emerging nations, and we are being asked for drastic price cuts. On the other hand, in the overall market, customer priorities are shifting from pricing to reliable delivery of goods, so it's likely that requests for lower prices will not occur with any regularity.

#### **11. About the closure of Caterpillar Inc.'s Sagami plant**

- Q. Has there been any impact from the closure of Caterpillar Inc.'s Sagami plant, such as changes in suppliers?
- A. We've received orders for some of the hydraulic equipment that had been manufactured in-house.

#### **12. About "Strengthening sales promotions for markets in which KYB was not active"**

- Q. Who are the sales promotion targets for hydraulic products for SSL (skid-steer loaders) and CTL (compact track loaders)? Also, how is the progress with this activity?
- A. We've started receiving orders from Japanese manufacturers, so we are planning to target overseas manufacturers. We'll carry out our sales activities in accordance with next model changes at overseas manufacturers, and increase the likelihood of receiving orders. This sales promotion activity is essential for HC Operations to be able to generate profits during a down cycle in the hydraulic excavator market.