

Komtrax further raises Komatsu's competitive edge



Merrill Lynch

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Komatsu establishes customer loyalty model for Komtrax

Komatsu held a briefing on its Komtrax wireless equipment monitoring system on 10 December. The briefing left a positive impression, reconfirming that Komtrax will increase the company's competitive edge. We maintain our Buy rating in recognition of three factors. First, growing demand for construction machinery, primarily in developing countries. Second, expanding global market share due to customers' increasingly favorable reaction to the company's introduction of competitive new products as well as Komtrax. Third, the undervaluation of the company's shares.

Komtrax installed in approximately 85,000 units worldwide

Komtrax is a system shared by customers, Komatsu dealers, and Komatsu itself that tracks construction machinery location and travel. The system was introduced in Japan and North America in 2000. Komtrax was initially an option, but is now standard in machinery sold in Japan, North America, Europe, and China. Komtrax is already installed in approximately 85,000 machines worldwide (approximately 8% of all Komatsu machines in operation), and is expected to be installed in the majority of Komatsu machinery in 10 years time.

Customers heap praise on Komtrax

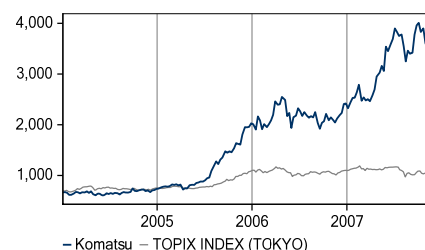
Komtrax provides customers with three distinct advantages. First, theft prevention. Second, reduction of life cycle cost (maintenance, fuel, and operator wages), which is estimated at three times the price of the machine itself. Third, increased value on trade-in (since the system enables a full record of the machine's range of travel and maintenance to be ascertained). By ascertaining the operation of each piece of machinery in their fleet, Komtrax can also help customers develop ideas for fuel efficiency improvement and maintenance. These advantages have won rave reviews from Komatsu's customers and helped the company expand its share of the construction machinery market. In particular, Komtrax's superb fleet management has won top marks from major customers and been key in obtaining purchase orders.

One step ahead of competition

Although its competitors have also rolled out similar services, Komatsu's Komtrax has won the favor of its customers for three main reasons. First, Komatsu developed the system on its own, providing fine-tuned information to its users (whereas European and US manufacturers have outsourced their systems). Second, it is standard equipment in all of Komatsu's machines (whereas corresponding systems are usually options at Komatsu's competitors). Third, it carries no running cost, whereas European and US manufacturers charge fees for communications costs.

Stock Data

Price (Common)	¥3,280
Price Objective	¥4,600
Date Established	1-Aug-2007
Price (ADR)	US\$114.25
Price Objective	US\$164.12
Date Established	1-Aug-2007
Investment Opinion	B-1-7 / B-1-7
Volatility Risk	MEDIUM / MEDIUM
ML Symbol / Exchange	KMTUF / TYO
ML Symbol / Exchange	KMTUY / OTU
Bloomberg / Reuters	6301 JP / 6301.T



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Table 1: Komatsu (6301): Earnings summary

	Sales (¥mn)	YoY (%)	OP (¥mn)	YoY (%)	Pretax-P (¥mn)	YoY (%)	NP (¥mn)	YoY (%)	EPS (¥)	P/E (X)	P/CF (X)	EV/EBITDA (X)
06/3A	1,701,969	18.6	176,453	73.1	168,758	71.0	113,975	93.1	114.7			
07/3A	1,893,343	11.2	244,741	38.7	236,491	40.1	164,638	44.5	165.7			
08/3COE	2,210,000	16.7	325,000	32.8	316,000	33.6	205,000	24.5	206.0	15.9	11.7	8.8
08/3MLE	2,220,000	17.3	335,000	36.9	326,000	37.8	210,000	27.6	211.1	15.5	11.5	8.6
09/3MLE	2,438,000	9.8	380,000	13.4	371,500	14.0	234,000	11.4	235.2	13.9	10.3	7.4
10/3MLE	2,641,000	8.3	429,000	12.9	421,000	13.3	265,000	13.2	266.3	12.3	9.2	6.4

Source: Company data, Merrill Lynch estimates.

Price objective basis & risk

Komatsu (6301)

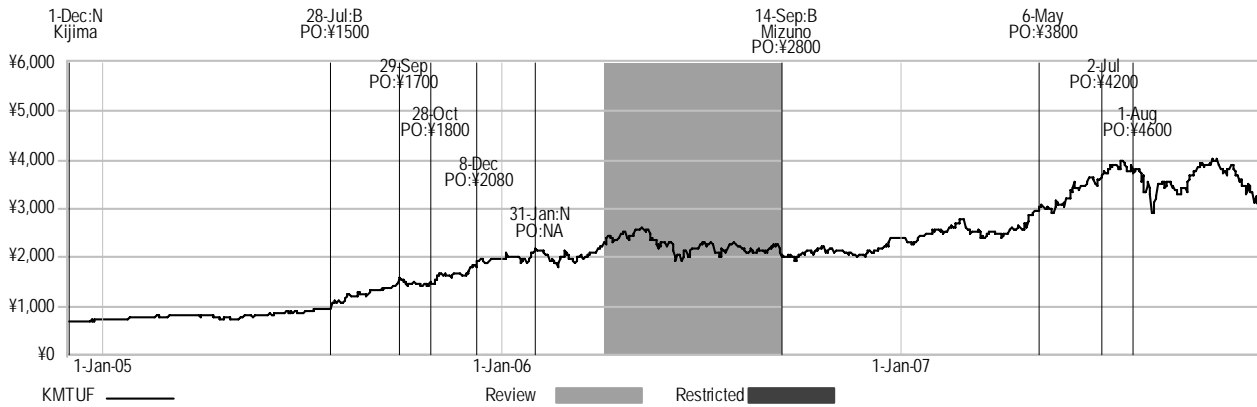
Our share price objective is ¥4,600, equating to a P/E of around 19x FY3/09 and EV/EBITDA of around 10x. We believe a valuation in line with the machinery sector average for FY3/09 is warranted in view of its improved earnings structure and the strong competitiveness of its products. We see the key risks as: (1) forex movements; (2) an unexpectedly sharp drop in North American construction machinery demand; and (3) a sharp fall in materials prices putting the brakes on infrastructure spending in emerging economies.

Analyst Certification

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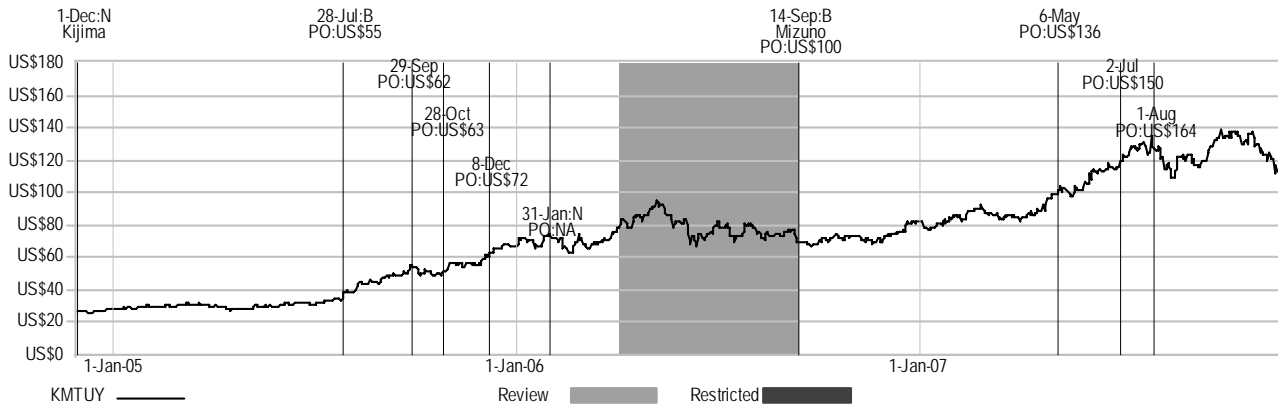
KMTUF Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

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KMTUY Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

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Investment Rating Distribution: Machinery/Diversified Manufacturing Group (as of 01 Oct 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	34	65.38%	Buy	6	20.00%
Neutral	16	30.77%	Neutral	3	21.43%
Sell	2	3.85%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 01 Oct 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1701	47.03%	Buy	437	29.15%
Neutral	1611	44.54%	Neutral	425	29.11%
Sell	305	8.43%	Sell	58	21.09%

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