

BRIDGE REPORT



Representative Director, President
Executive Officer
Masao Ono

KYB Corporation (7242)



Company Information

Market	TSE 1st Section
Industry	Equipment for transportation
Representative Director, President Executive Officer	Masao Ono
HQ Address	World Trade Center Bldg., 4-1, Hamamatsu-cho 2-chome, Minato-ku, Tokyo
Year-end	End of March
HOME PAGE	http://www.kyb.co.jp/english/

Stock Information

Share Price	Number of shares issued		Total market cap	ROE Act.	Trading Unit
¥3,265	25,748,431 shares		¥84,068million	-15.0%	100shares
DPS Est.	Dividend yield Est.	EPS Est.	PER Est.	BPS Act.	PBR Act.
undecided	-	¥109.62	29.8x	¥5,734.39	0.6x

* Share price as of closing on November 29. Number of shares issued, DPS, EPS, BPS were based on the results of the first half of the term ending March 2020. ROE is from the last year-end.

Earnings Trends

Fiscal Year	Net Sales	Operating Income	Pretax Income	Net Income	EPS	DPS
March 2016 (results)	355,320	4,327	2,825	-3,161	-12.37	11.00
March 2017 (results)	355,316	19,247	18,852	14,544	56.93	12.00
March 2018 (results)	393,743	20,885	20,881	15,202	595.09	150.00
March 2019 (results)	412,214	-28,496	-29,510	-24,757	-969.18	0.00
March 2020 (estimate)	390,000	6,500	6,000	2,800	109.62	未定

* Unit: Million yen or yen

*The forecast is from the company. From the term ended March, 2016, the IFRS has been used. The amounts in the term ended March, 2015 are those after the IFRS adjustment. From the term ended March 2016, net income is profit attributable to owners of the parent.

*The company conducted 1-for-10 reverse share split on October 1, 2017. DPS for the term ending March, 2018 represent the amounts taking the 1-for-10 reverse split into account. EPS and DPS are not adjusted. The dividend of the term ending March 2020 has not been determined yet.

This Bridge Report presents details and analysis of KYB earnings results for the first half of the fiscal year March, 2020.

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Key Points

- The sales for the first half of the term ending March. 2020 were 197.6 billion yen, down 2.5% year on year. The business performance was affected by the yen appreciation and the downturn of the Chinese market caused by the trade friction between the U.S. and China. The AC and HC businesses saw the drop in sales. Segment profit rose 25.9% year on year to 11.9 billion yen. The profit of the AC business increased thanks to the improvement in profitability. The profit of the HC business declined due to the decrease of orders received. Operating profit improved year on year from a loss of 11.3 billion yen to a profit of 4.5 billion yen, mainly because the provision for product warranties, which was posted in the same period of the previous year, decreased and there was no longer the loss related to the U.S. antitrust law in the first half of this term.
- The full-year earnings forecast has been revised downwardly. The sales for the term ending March. 2020 are estimated to be 390 billion yen, down 5.4% year on year. The forecasted trend of the Chinese construction machinery market, etc. were taken into account. There is no revision to the estimated segment profit. Operating profit is projected to drop 66.5% year on year to 6.5 billion yen. The company took into account the possibility of augmentation of cost for product warranties regarding seismic isolation/mitigation oil dampers, etc. Net profit is estimated to go into the black, thanks to the decrease in expenses for seismic isolation/mitigation. The dividends are still to be determined.
- The earnings forecast has been revised downwardly, but segment profit, which indicates the earning from the core business, remains unchanged. Since six-month segment profit has been stable at the level of 10 billion yen since fiscal 2017 and net profit is projected to be positive thanks to the decrease in cost for seismic isolation/mitigation, it seems to be considered in the stock market that the performance of the company has bottomed out.
- However, we need to keep in mind that the business environment is not good and the AC and HC businesses have some problems to be solved. We would like to pay attention to how much the company can proceed in the second half of the year before the next mid-term management plan.

1.Regarding nonconforming acts in the inspection process for seismic isolation/mitigation oil dampers for buildings

(Overview)

In October. 2018, it was revealed that the performance inspection records for seismic isolation/mitigation oil dampers products, which are manufactured and sold by KYB and its subsidiary named Kayaba System Machinery Co., Ltd., were falsified and then the products that do not comply with the criteria approved by the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) or clients' specs were attached to buildings.

(The number of target objects for unknown products and non-conforming products, and the number of products; as of 2019 Sep. 30)

◎ Regarding the seismic isolation/mitigation oil dampers for buildings

As a result of investigation, 991 non-conforming products and 12,113 unknown products are found.

Number of nonconforming and unknown products as well as affected buildings

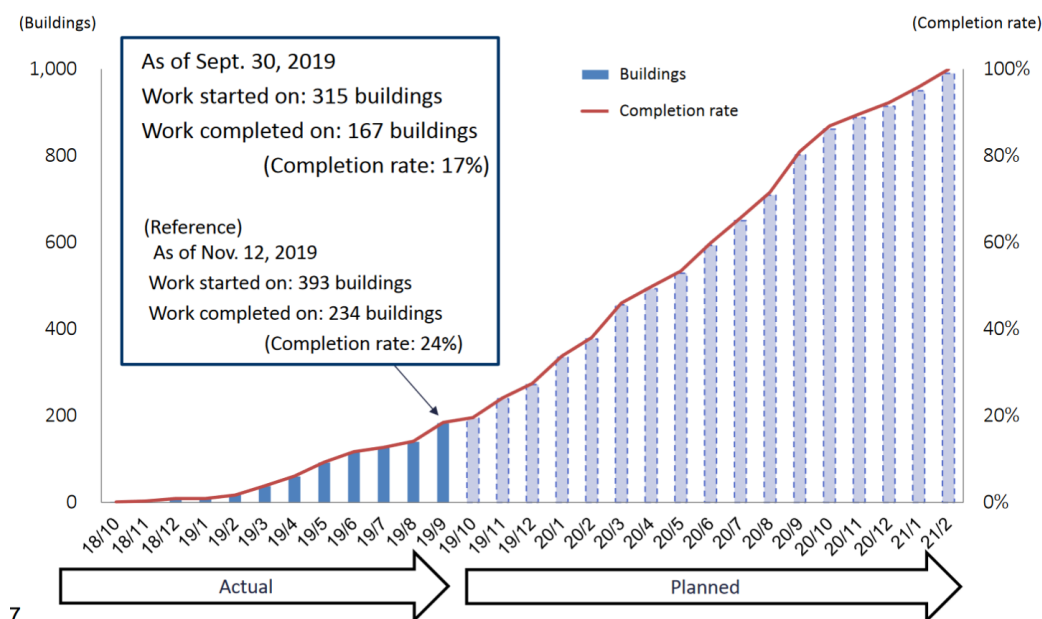
	Nonconforming products *1		(3) Unknown	(1)-(3) Total
	(1) Nonconforming to certification by Ministry	(2) Out of customer standards		
Seismic isolation oil dampers	245 buildings	370 buildings	237 buildings	852 buildings
	1,056 units	3,014 units	3,388 units	7,458 units
Seismic mitigation oil dampers	—	30 buildings	109 buildings	139 buildings
	—	253 units	4,402 units	4,655 units
Total	245 buildings	400 buildings	346 buildings	991 buildings
	1,056 units	3,267 units	7,790 units	12,113 units

*1 There is no Ministry certification system for seismic mitigation oil dampers.

(Taken from the reference material of KYB)

(Correspondence and Progress)

Progress Plan for Bringing Nonconforming Seismic Isolation/Mitigation Dampers up to Conformity



(Taken from the reference material of KYB)

(Measures to prevent recurrence)

In the report, 9 causes including “lack of awareness of the rules,” “corporate culture in which staff avoid facing the truth,” and “factories which are operated assuming that orders are received,” are stated, and “enhancing the awareness of the rules and reforming corporate culture,” “Evaluation of business feasibility and review of business operation and information sharing systems,” “improvement of inspection system and method,” and “fortification of internal audit and control systems” are listed as starting points for the measures to prevent recurrence.

Then, the company started announcing the progress of measures for preventing recurrence every 3 months.

The progress as of Sep. 30, 2019 was disclosed through the second progress announcement on Oct. 16, 2019, and its outline is as follows.

Cause Analysis

Prevention Policies and Progress (As of Oct. 16)

		Number of applicable items	Progress		
			Launch ^{*1}	Underway ^{*2}	Completed
1. Lack of compliance awareness	→	17	3	8	6
2. Corporate culture looks away from inconvenient truths					
3. Management focused on receiving orders	→	22	6	9	7
4. Lack of inspections					
5. Lack of nonconforming act preventions in inspection machines					
6. Incomplete information sharing system	→	12	0	10	2
7. Monopolization of important business					
8. 1) Deficient quality inspections 2) Lack of inspections for similar nonconforming instances related to quality	→	16	4	10	2
9. Problems related to commercialization					

*1. Launch: Determining a concrete plan
 *2. Underway: Preparations complete, operations continuing

(Taken from the reference material of KYB)

(Effects on business performance)

As for a provision for product warranties related to the matter, 35,146 million yen was posted as an expense in fiscal 2018, and the balance of a provision for product warranties regarding the incident as of the end of Sep. 2019 was 30,837 million yen.

The company acknowledges that if additional provisions are posted according to future progress, it may cause a significant impact on performance.

2.Company Overview

The largest manufacturer of independent hydraulic equipment in Japan. Based on hydraulic technology, the company offers products and technologies in a wide range of fields such as "automobiles", "motorcycles", "construction machinery", "industrial vehicles", "aircraft", "railroads" and "special purpose vehicles".

KYB has a high market share with many products. For instance, shock absorbers for automobiles account for 40% of the domestic market and 15% of the global market.

【2-1 Corporate history】

The roots come from "Kayaba Research Center", which was established by Shiro Kayaba, who is an inventor and a founder, in November 1919.

In January 1927, a self-employed enterprise, Kayaba Seisakusho, was established for manufacturing hydraulic dampers, catapults, etc. for aircraft.

In March 1935, Kayaba Manufacturing Co., Ltd. was established.

After the end of World War II, in June 1956, Kayaba Auto Service Co., Ltd. was established for offering products and services.

In October 1959, company's stocks were listed on the Tokyo Stock Exchange.

In July 1974, KYB Corporation of America was established in the United States in order to enter the North American commercial market. Then, the company actively entered foreign markets such as Asia and Europe.

In October 1985, the company name "Kayaba" was changed from kanji (Chinese characters) to katakana (Japanese Characters).

In October 2015, the trade name was changed from Kayaba Manufacturing Co., Ltd. to KYB Corporation in order to further strengthen the brand image.

【2-2 Corporate Philosophy/Management Philosophy】

◎KYB Corporate Symbol

As they changed the corporate name from "Kayaba Manufacturing Co., Ltd." to "KYB Corporation" in 2015, they aim to popularize the KYB brand on a global basis.

Therefore, as shown below, the logo "KYB" has the meaning and spirit



(Taken from KYB's website)

Slanted slits in each letter represent comfortable sunlight cast through the trees and sunbeams illuminating the road ahead. The logo represents an image of unconstrained growth and flexible response to the trends of the era. The right side of the letter "B" represents liquid pressure indicating the origin of KYB. Using italic letters expresses a sense of speedy movement, progressiveness, growth potential, innovativeness.

(What the corporate color means)

The corporate color, red stands for love, enthusiasm and passion, etc. and it gives the image of a sun's warmth, heat and power to grow life that realize an epoch-making society. Red is also a positive color, and represents manufacturing that goes the extra mile.

(Taken from KYB's website)

◎Corporate Statements

Our Precision, Your Advantage

The characteristics of products such as precise quality and reliable technology are expressed with the statement.

It means that not only providing reliable quality to general consumers and business partners leads to stakeholders' "advantage (superiority)", but also the joy of manufacturing, which enables each employee to realize that they can change the world with sure quality, becomes "advantage (merit)."

◎Corporate Spirit

As the KYB Group, which aims to contribute to society by providing technologies and products for making the living of people safe and comfortable, it reflected on the improper act revealed in Oct. 2018, and revised its Corporate Spirit and Corporate Guiding Principles.

(Corporate Spirit)

We shall follow all rules and face all issues with honesty.
We shall build a corporate culture full of vitality, and hold high goals.
We shall value sincerity, cherish nature, care for the environment.
We shall constantly pursue creativity, contribute to the prosperity of customers, shareholders, suppliers and society.

(Management Vision)

Human Resources Development	To cultivate the talent to achieve the objectives with a thorough understanding of the principles and the strategy.
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Technology and product development	To provide products that are impressive, comfortable and reliable to customers throughout the world.
Monozukuri (Manufacturing expertise)	To make our plants enjoyable, dynamic places to work, and at the same time full of discipline based on the field priority doctrine, in order to produce products satisfactory to the customer.
Management	Always keep social responsibilities of the corporation in mind and provide efficient group management.

(Corporate Guiding Principles)

See the following URL:

<https://www.kyb.co.jp/english/company/guidelines.html>

【2-3 Environment Surrounding the Company】**(1) Market Environment**

The automobile market and the construction machinery market have a great effect on KYB's performance.

KYB recognizes the current and future situations of the two markets as follows.

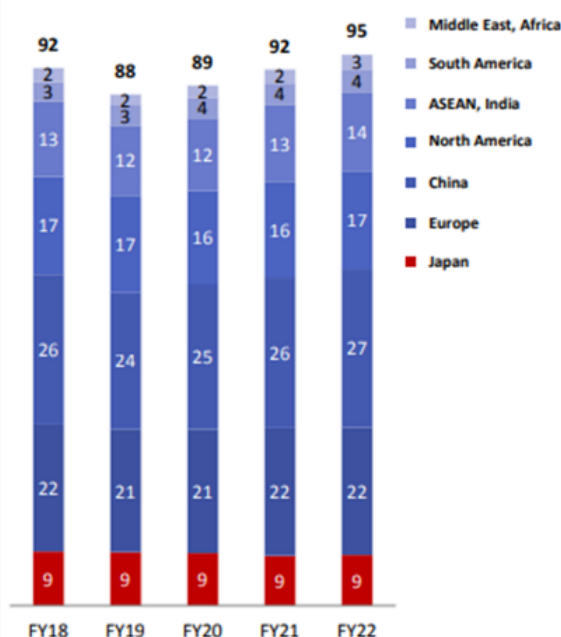
①Automobile Market

- ☆ The global demand for automobiles is expected to increase further, as the global economy is estimated to grow although there are uncertainties because the trade war waged by the U.S. got fierce and there is the negotiation for Brexit.
- ☆ The retail market is projected to expand mainly in emerging countries.

KYB supplies shock absorbers (SA) for new vehicles directly to automobile manufacturers as Tier 1, and also supplies them to auto parts stores, repair shops, etc. through agencies for aftermarket as well. The company calls the former "OEM" and the latter "marketed". Japanese cars are popular in Asia, the Middle East and others, and the commercial market is important for KYB.

Automobile Production Forecast

(Million units)



Source: IHS (the end of Sep. 2019)

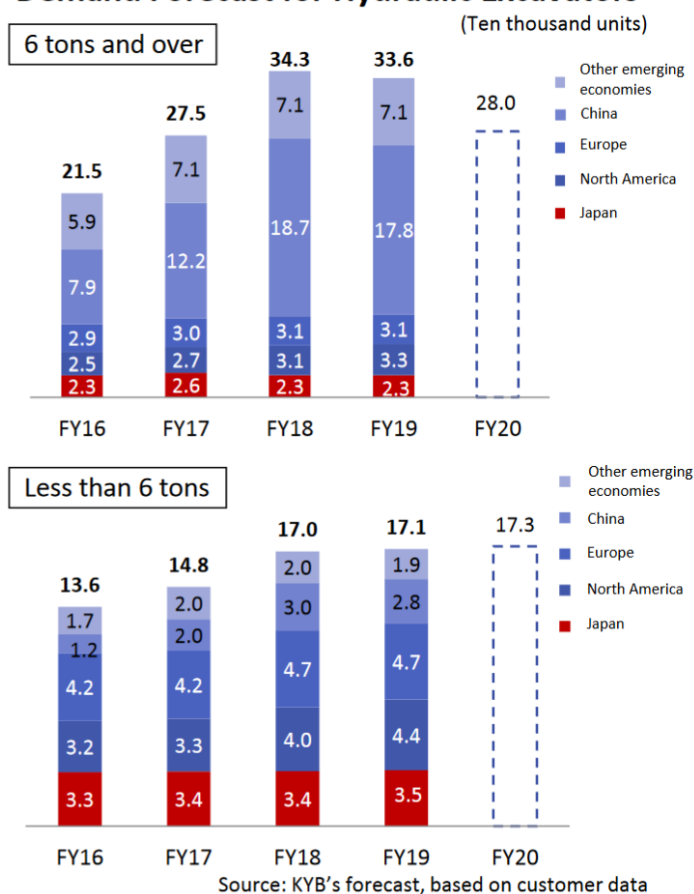
(Taken from the reference material of KYB)

②Construction Machinery Market

- ☆ The Chinese market is estimated to peak out, due to the trade friction between the U.S. and China, etc.
- ☆ In the European and U.S. markets, the demand for small-sized excavators as urban construction machinery is strong.
- ☆ The growth of the Indian market became sluggish.

The company estimates that the demand for excavators weighing 6 tons or over will peak out in some regions while the demand for excavators weighing less than 6 tons will remain high.

Demand Forecast for Hydraulic Excavators



(Taken from the reference material of KYB)

(2) Competitors

①AC Business

KYB's domestic competitors include Showa Corporation (7274, TSE 1st section), 33.4% of whose shares are held by Honda, and Hitachi Automotive Systems, Ltd. (unlisted), a group company of Hitachi.

Its global competitors consist of ZF in Germany, Tenneco in the U.S., and so on. ZF has a long history and intimate relationships with European automobile manufacturers.

The company's share in the commercial product market is slightly less than 20%. Tokico (which was acquired through M&A by Hitachi and is unlisted; today it is one of the brands of Hitachi Automotive Systems) and Monroe (a commercial brand of Tenneco) have earned a large market share in Japan and globally, respectively.

KYB competes with Showa, which is closely related to Honda, in the market of shock absorbers for motorcycles, and with JTEKT Corporation (6473, TSE 1st section) and NSK Ltd. (6471, TSE 1st section) in the steering market.

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②HC Business

In the market of cylinders, which are the parts with the highest sales ratio in KYB, Chinese manufacturers and the like are extending their influences.

KYB's competitors include Nabtesco (6268, TSE 1st section) in the market of control valves for which KYB has the advanced technology, and Nabtesco and Nachi-Fujikoshi (6474, TSE 1st section) in the market of travel motors.

In addition, the largest construction machinery manufacturer in Japan manufactures a number of parts internally.

Code	Corporate name	Sales	Growth rate	Operating income	Growth rate	Operating income rate	ROE	Market cap	PER	PBR
5994	Fine Sinter	40,000	-12%	1,700	+1.0%	4.3%	4.9%	8,968	14.9	0.5
6268	Nabtesco	288,500	-2.1%	24,100	+10.1%	8.4%	12.1%	420,449	24.8	2.3
6471	NSK	860,000	-13.3%	32,000	-59.6%	3.7%	10.4%	583,241	25.8	1.0
6473	JTEKT	1,440,000	-5.3%	45,000	-32.4%	3.1%	4.6%	466,869	25.9	0.9
7212	F-Tech	221,000	-6.1%	5,000	-24.0%	2.3%	6.9%	13,809	12.5	0.3
7242	KYB	390,000	-5.4%	20,600	-6.4%	5.3%	-15.0%	84,068	29.8	0.6
7274	SHOWA	271,000	-5.5%	27,000	-10.4%	10.0%	18.2%	173,173	10.7	1.5

*The sales and growth rates are forecasts for this term estimated by the company with the unit being million yen. ROE is the results from the previous term.

The aggregate market capitals are the closing price on November 29. The unit is million yen. PER (estimates) and PBR (results) are based on the closing price on November 29 with the unit being times.

The operating income of KYB is segment profit (calculated by subtracting cost of sales and SG&A from sales.)

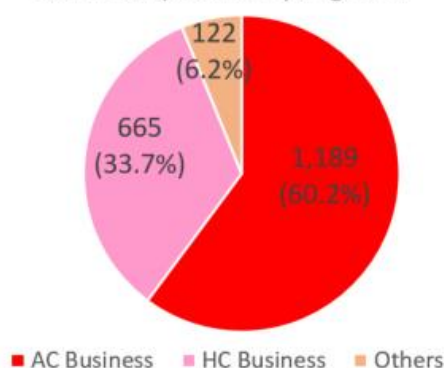
Due to the downturn of markets, mainly the Chinese one, all companies in the list have revised the full-year earnings forecast downwardly.

【2-4 Business contents】

(1) Segments

KYB's business segments are composed of the following three segments: the "AC Business" consisting of hydraulic shock absorbers for automobiles and motorcycles, power steering, etc., the "HC Business" including hydraulic equipment for industrial use mainly for construction machinery, and the "Others" segment which handles special purpose vehicles such as concrete mixer trucks, aircraft components, seismic isolation/mitigation oil dampers for buildings, electronics, and the like.

Sales Composition by Segment



*FY Mar. 2020.

Sales to external customers. Unit: 100 million yen.

①AC(Automotive Component)Business

This segment consists of shock absorbers for automobiles and motorcycles, hydraulic equipment for automobiles, and other products.

Composition ratio for the first half of Fiscal Year March 2020

Product	Sales	Composition ratio	Major products
Shock absorbers for automobiles	860	72.4%	Shock absorbers
Shock absorbers for motorcycles	127	10.7%	Front forks, rear cushion units
Hydraulic equipment for automobiles	175	14.7%	Vane pumps, CVT pumps, EPS
Others	26	2.2%	Shock absorbers for ATVs, Stay dumpers
Total	1,189	100.0%	-

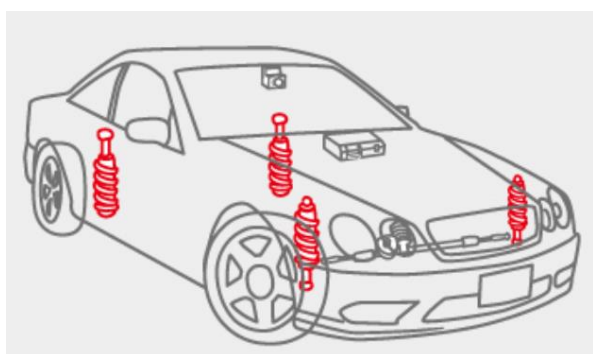
*unit: 100 million yen

<Major Products>

◎Automobiles

(Shock absorbers)

A shock absorber is a device that absorbs vibration of the car body, being mounted between the body and the tires together with a spring.



(Taken from KYB's website)

Each automobile is equipped with a “suspension” which is the system that improves riding comfort and operational stability.

Suspensions have two main functions; one is, as buffers, to prevent transmission of rough road profiles to the car body and another is to set the position of the wheels and axles and press the wheels down on the roads.

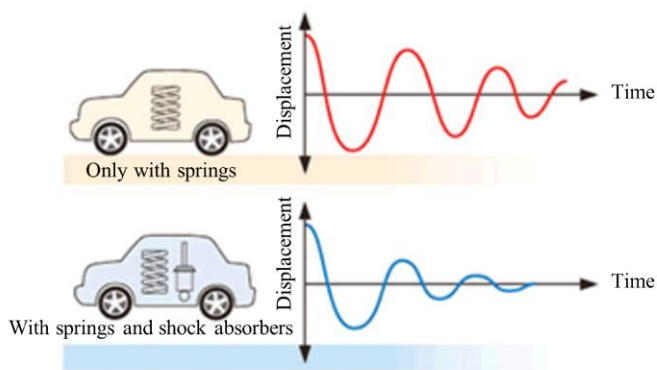
Basically, a suspension is composed of a suspension arm which fixes the wheel position, a spring which supports the car weight and absorbs vibration, and a shock absorber (damper) which dampens vibration of the spring

Automobiles absorb shock caused by uneven road profiles by contracting the springs, but due to their characteristics, the springs rebound to get back to their original position after the contraction.

The top of a spring is connected to the car body and the bottom is coupled with a suspension that includes the heavy tires and brake, which results in, due to inertia, repetition of expansion and contraction of a spring in a range wider than one necessary for returning to its original position.

The role of shock absorbers is to reduce the above-mentioned excess vibration as soon as possible in order to stabilize the car body.

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(Taken from KYB's website)

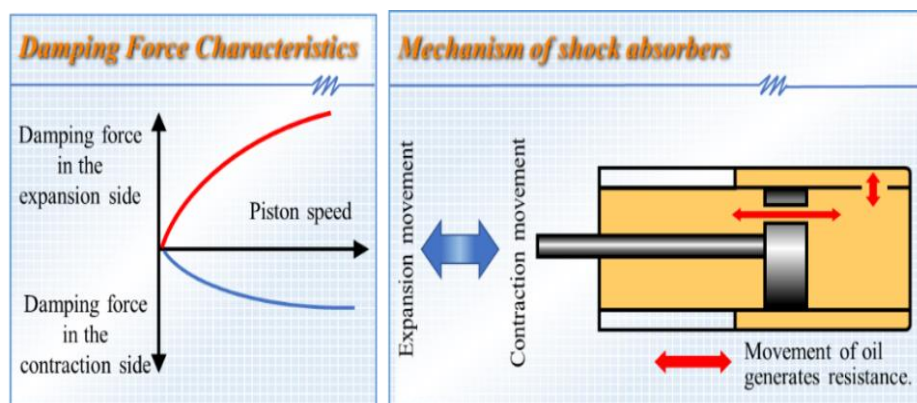
The vehicle in which the shock absorber is functioning properly achieves the following:

- ☆ Reduction in unnecessary movement of springs to secure riding comfort
- ☆ Improvement of the brake performance
- ☆ Smoothness in taking corners

The force that controls expansion and contraction of springs and reduce vibration is called “damping force.” The “hydraulic technology,” which KYB has cultivated and improved since its inauguration, plays a significant role in generating “damping force.”

The tube of a shock absorber contains oil with a piston moving in it.

A piston has holes through which oil passes when the piston moves following vibration, and the resistance of the oil generates “damping force.” In addition, the moving speed of pistons varies with the degree and velocity of vibration from the car body, and the faster a piston moves, the larger “damping force” becomes. This is called “damping force characteristics.”



(Taken from KYB's website)

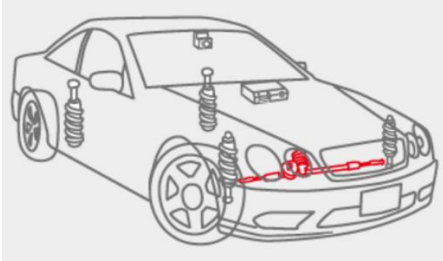
KYB's shock absorbers developed based on its sophisticated technology has earned reputation from a number of automobile manufacturers worldwide, leading to the large market share as mentioned below.

Furthermore, it is said that shock absorbers usually need to be replaced after 5 years from the date of first registration or when the travel distance reached 100,000 km as they deteriorate due to various factors including travel distance and lapse of time and the function decreases.

This replacement demand, which in other words is the commercial product market, is one of the greatest business opportunities for the company.

(Steering)

It is the steering system that provides “the function of taking curves,” one of the three basic functions of automobiles including “driving,” “taking curves,” and “stopping.”



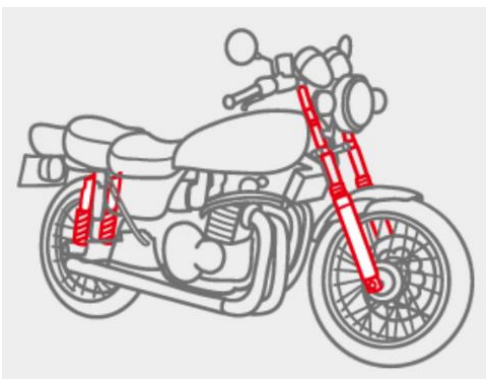
(Taken from KYB's website)

KYB's steering components include the “hydraulic power steering (PS)” that uses the hydraulic power assist unit to support turning of the steering wheel done by drivers and steer the tires, and the “electric power steering (EPS)” that uses the electric power assist unit composed of a motor, a controller, a torque sensor, etc. to support turning of the steering wheel and steer the tires.

The “PS” enables steering operation by a mere movement thanks to hydraulic force and is an indispensable component for safe driving because of its ability to expeditiously avert risks, whereas the “EPS” whose power source is a battery improves fuel efficiency compared to the “PS” whose power source is the engine of a car.

High-performance EPS actuator**Hydraulic power steering vane pump for passenger vehicles****◎ Motorcycles****(Suspensions)**

Suspensions minimize shock to the car body regardless of road surface conditions, pursuing comfort.



(Taken from KYB's website)

*Rear cushion unit (RCU)

The company's RCUs boost riding comfort by maintaining the posture of vehicles and absorbing vibration and shock from the road surfaces.



(Taken from KYB's website)

② HC (Hydraulic Components) Business

The HC Business consists of hydraulic equipment for industrial use and other products.

Composition ratio for the first half of Fiscal Year March 2020

Products	Sales	Composition ratio	Major products
Hydraulic equipment for industrial use	621	93.4%	Cylinders, valves, pumps, motors
Others	44	6.6%	Railroad dampers, railroad brakes
Total	665	100.0%	-

* unit: 100 million yen

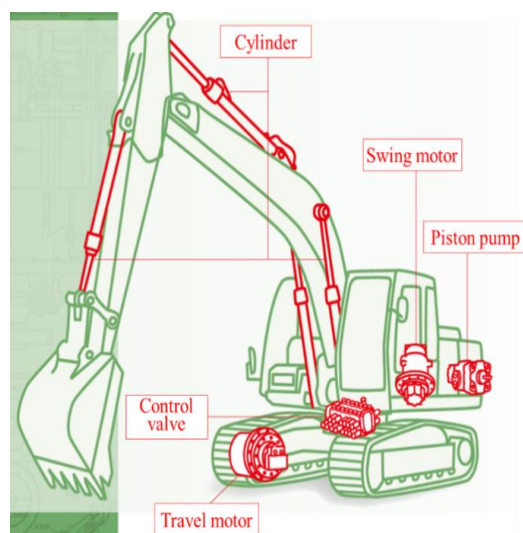
<Major Products>

The mechanism of the drive system of construction machinery such as shovels consists of various parts as shown below, including control valves, piston pumps, travel motors, swing motors, and cylinders; it is the control valve, which is the “brain” of construction machinery, that controls a variety of actuators (a drive unit which converts energy to translational or rotary motion through hydraulic pressure and electric motors) to enable smooth movement of driving, turning, and bending and stretching of the arms.

KYB's control valves have realized more advanced control by combining electric control with its special hydraulic technology.

In addition, KYB is one of the few manufacturers that manufacture all of the above-mentioned parts.

KYB's competitive edge is that it can make suggestion to construction machinery manufacturers because its manufacturers all kinds of parts as just mentioned.



*Control valve for shovels



*Travel motor



*Hydraulic cylinder



(Taken from KYB's website)

③Special purpose system, etc. (System products and others)

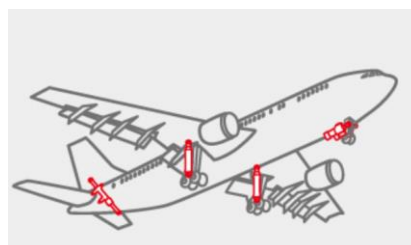
This is composed of special purpose vehicles, hydraulic equipment for aircraft, system products, electronics, and such.

Composition ratio for the first half of Fiscal Year March, 2020

Products	Sales	Composition ratio	Major products
Special purpose vehicles	43	34.7%	Concrete mixer trucks
Hydraulic equipment for aircraft	26	21.0%	Actuators, wheels, brakes
System products and electronic components, etc.	54	44.3%	Oil dampers for seismic isolation and vibration suppression, stage equipment, communication terminals
Total	122	100.0%	-

* unit: 100 million yen

KYB's concrete mixer trucks have high mixing and emission performance, accounting for about 80% of the domestic market share. It offers highly-reliable products for aircraft, including various actuators, weight-saving accumulators, and wheel brakes.



(2) Clients and sales channels

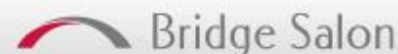
◎Clients

The following is a list of KYB's major clients.

Its shock absorbers are mounted on about 60% of automobiles manufactured by Toyota globally. They are also adopted to about 30% and about 10% of automobiles manufactured by Nissan and Honda, respectively, contributing to KYB's large market share.

	Japanese company	Non-Japanese company
AC Business	Toyota Motor	PSA
	Nissan Motor	Renault
	JATCO	Volkswagen
	Yamaha Motor	Daimler
	Suzuki Motor	Chrysler
	SUBARU	
	Mitsubishi Motors	
	Honda Motor	
	Isuzu Motors	

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	Daihatsu Motor Hino Motors	
HC Business	Hitachi Construction Machinery Sumitomo Construction Machinery Kubota Kobelco Construction Machinery Takeuchi Mfg Yanmar Komatsu Forklift	Caterpillar Trasmital Bonfiglioli Doosan Sany

◎Sales channels

As previously mentioned, KYB supplies its shock absorbers through 2 sales channels including the OEM production system for new vehicles and sale on the market for used vehicles.

Although sales of OEM products are higher, its commercially-available products sold as its private brand show great profitability and thus the company will expand the business to the global markets.

KYB's commercially-available shock absorbers can be mounted on about 90% of Japanese, American, and European automobiles used worldwide today. What is behind such a high coverage rate is the strong relationships KYB has with major automobile manufacturers including Toyota.

(3) Global network

In 24 countries worldwide including Japan, KYB has 48 group companies, establishing strong global networks.

	No. of Countries	No. of group companies
Japan	1	14
Asia	7	18
Europe	12	8
America	3	7
Total	23	47

(As of the end of Sep.2019)



(4) Research and Development

(Structure)

KYB has established a global and optimum research and development (R&D) structure by setting R&D bases in 5 regions including Japan, North America, Europe, China, and Thailand.

While the R&D bases in regions other than Japan basically engage in development of model products and development for enhancing product appeal such as performance improvement and cost reduction, R&D from the long-term perspectives are carried out mainly in Basic Technology R&D Center (Sagamihara-shi, Kanagawa) and Production Technology R&D Center (Kani-shi, Gifu) in Japan and R&D of highly unique prior art, etc are performed.

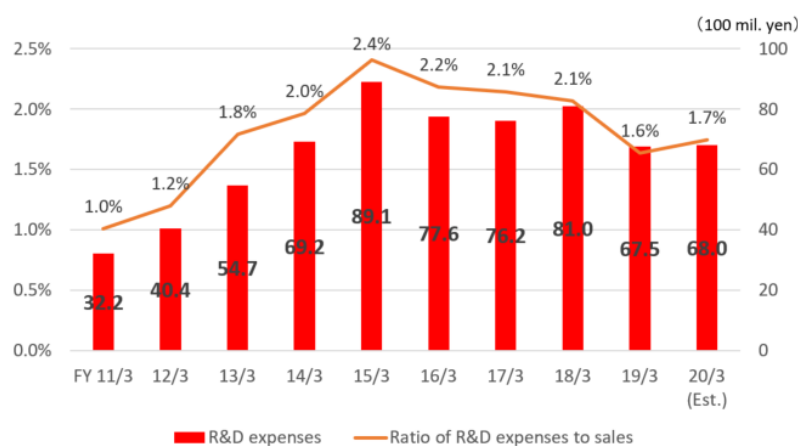
In addition, the know-how about production equipment designing which has been cultivated in Production Technology R&D Center and each plant is gathered in Machine Tools Center (Kani-shi, Gifu) in order to strengthen and propel internal manufacturing of equipment, jigs, and tools for which KYB has strived to boost innovative spirit and reliability.

In Electronics Technology Center (Sagamihara-shi, Kanagawa), a system that collects technologies for designing and evaluating electronics, increases development capabilities, and conducts a series of processes ranging from product development to prototype evaluation and mass production in a smooth and prompt manner has been established.

Regarding high-functionality and systematization of its products, KYB, in addition to independent development, propels joint research and development with its clients or related equipment manufacturers. The company is also endeavoring proactively to developing advanced technology through industry-academia collaboration.

(Variation in R&D expenses)

Since the term ended Mar. 2013, the company has raised its awareness about the ratio of R&D expenses to sales, maintaining the ratio at about 2%.



(Area of focus)

KYB is propelling the development of products by dealing with performance improvement, high functionality, and systematization and considering eco-friendliness with respect to energy and environmental issues through weight saving, energy saving, reduction in environmentally hazardous substances. At the same time, it is striving to strengthen its production technology capabilities.

In addition, following the accelerated globalization, it aims to set up a strategic and global production, sales, and technological structure, including development of human resources with global outlooks and establishment of a standardized management system.

Lately, the company has focused on product development related to autonomous driving systems.

One example is the technology that integrates EPS (electronic steering) and shock absorbers.

KYB considers that the technology, which enables more comfortable and smoother driving in any road surface conditions independently of the drivers' skills and judgment, is definitely indispensable for automobiles with the autonomous driving system.

Furthermore, KYB deems the “steering by wire” system is another technology whose importance will grow in the future.

In the conventional steering operation, movement is transmitted to the steering gear box and tires through the steering shaft, whereas the “steering by wire” system conveys steering movement via electronic signals.

Some of the system’s advantages include the capability of relieving drivers’ fatigue due to less vibration from the tires, and the capability of automatically adjusting sideslips of the car body due to strong winds which conventionally needed to be adjusted through an intentional steering operation by drivers. In addition, thanks to the “steering by wire” system, the steering wheel may not necessarily be mounted on the right front of a car, and therefore, the system’s potential for considerably changing the way automobiles are, including the design and functions, has attracted much attention.

Although several issues still exist, KYB is further brushing up the system as its unique EPS technology.

【2-5 Characteristics and strengths】

◎ Large shares in various product markets

KYB has earned a large market share of multifarious products, with the domestic share of OEM shock absorbers for automobiles being 40% and its global share being 15%, the global share of hydraulic cylinders for construction machinery being 31%, the domestic share of concrete mixer trucks being 79%

◎ Superior core technology

Such large market shares are attributed to the great trust in its products from clients as indicated by the fact that KYB has about 60% share on a global basis in Toyota Motor which vies with Volkswagen and GM for the position of the world’s largest automobile manufacturer. The basis of the clients’ trust is nothing else but the superior “hydraulic” technology that KYB has cultivated and enhanced for the past 100 years since its foundation.

KYB’s two core technologies, the “vibration control technology” represented by its shock absorbers and oil dampers for seismic isolation and vibration suppression and the “power control technology” typified by its control valves for shovels and electric power steering, have gained high reputation from clients and thus are used in diverse circumstances.

【2-6 ROE analysis】

	FY 3/16	FY 3/17	FY 3/18	FY 3/19
ROE [%]	-2.0	9.3	8.8	-15.0
Net income margin [%]	-0.89	4.09	3.87	-6.01
Total asset turnover [times]	0.95	0.96	0.99	0.97
Leverage [times]	2.35	2.37	2.30	2.59

3. The first half of Fiscal Year March 2020 Earnings Results

(1) Overview of consolidated results

	1H of FY3/19	Composition ratio	1H of FY3/20	Composition ratio	YoY
Sales	202,789	100.0%	197,638	100.0%	-2.5%
Gross profit	40,229	19.8%	38,787	19.6%	-3.6%
SG&A expenses	30,761	15.2%	26,868	13.6%	-12.7%
Segment profit	9,468	4.7%	11,919	6.0%	+25.9%
Operating profit	-11,300	-	4,498	2.3%	-
Profit before taxes	-12,369	-	4,205	2.1%	-
Quarterly profit	-11,972	-	1,666	0.8%	-

* unit: million yen

*Segment profit corresponds to the operating income in the Japanese standard. Quarterly profit is the profit attributable to the owner of the parent company.

*The previous forecast was announced in Feb. 2019. From the first quarter of FY3/19, “Loyalty income” and “Income related to compensation for metal molds” which were recorded in “Other incomes” on P/L have been changed to be recorded in “Sales.”

BRIDGE REPORT



Sales dropped due to the yen appreciation, but profitability improved considerably, allowing the company to go into the black.

Sales were 197.6 billion yen, down 2.5% year on year. The business performance was affected by the yen appreciation and the downturn of the Chinese market caused by the trade friction between the U.S. and China. The AC and HC businesses saw the drop in sales.

Segment profit rose 25.9% year on year to 11.9 billion yen. The profit of the AC business increased thanks to the improvement in profitability. The profit of the HC business declined due to the decrease of orders received.

Operating profit improved year on year from a loss of 11.3 billion yen to a profit of 4.5 billion yen, mainly because the provision for product warranties regarding the improper act, which was posted in the same period of the previous year, decreased and there was no longer the loss related to the U.S. antitrust law in the first half of this term.

As rationalization, etc. progressed after the improper act, the company posted the effects of provision for product warranties and its reversal for the cost for producing oil dampers for seismic isolation/mitigation, the expense for replacing oil dampers for seismic isolation, the cost for structural calculation, etc. and the expenses for personnel in the headquarters to deal with the improper act in the section of other expenses. The balance of provision for product warranties as of the end of Sep. 2019 is 30,837 million yen.

◎Trend in each region

Region	Sales	Composition ratio	YoY
Japan	897	45.4%	+0.8%
Europe	334	16.9%	-1.9%
America	177	9.0%	-3.4%
China	161	8.1%	-18.7%
Southeast Asia	142	7.2%	-6.2%
Others	265	13.4%	+0.4%
Total	1,976	100.0%	-2.5%

* unit: 100 million yen

The sales in Europe and the U.S. declined, partially due to exchange rates. The Chinese markets of automobiles and construction machinery were sluggish.

The ratio of overseas sales decreased from 56.1% in the same period of the previous year to 54.6%.

(2) Trend in each segment

Sales	1H of FY3/19	Composition ratio	1H of FY3/20	Composition ratio	YoY
AC business	123,722	61.0%	118,892	60.2%	-3.9%
HC business	67,224	33.1%	66,507	33.7%	-1.1%
Others	11,842	5.8%	12,239	6.2%	+3.4%
Total	202,789	100.0%	197,638	100.0%	-2.5%
Segment profit					
AC business	4,351	3.5%	6,925	5.8%	+59.2%
HC business	5,594	8.3%	4,070	6.1%	-27.2%
Others	-477	-	924	7.5%	-
Total	9,468	4.7%	11,919	6.0%	+25.9%

* unit: million yen

*The composition ratio for income is an income margin.

BRIDGE REPORT



①AC Business

Product	Sales	Composition ratio	YoY
Shock absorbers for automobiles	86,023	72.4%	+1.1%
Shock absorbers for motorcycles	12,726	10.7%	-9.4%
Hydraulic equipment for automobiles	17,512	14.7%	-20.0%
Others	2,632	2.2%	-2.1%
Total	118,892	100.0%	-3.9%

* unit: 100 million yen

Region	Sales	Composition ratio	YoY
Japan	334	28.1%	-6.7%
Europe	293	24.6%	-3.6%
America	142	11.9%	-1.4%
China	81	6.8%	-12.9%
Southeast Asia	130	10.9%	-5.1%
Others	209	17.6%	+3.5%
Total	1,189	100.0%	-3.9%

* unit: 100 million yen

Despite the negative effect of the yen appreciation, the profitability of the shock absorber for four-wheeled vehicles (OEM) improved and fixed costs were reduced, so profit increased while sales decreased.

②HC Business

Products	Sales	Composition ratio	YoY
Hydraulic equipment for industrial use	62,130	93.4%	-1.7%
Others	4,377	6.6%	+8.7%
Total	66,507	100.0%	-1.1%

* unit: 100 million yen

Region	Sales	Composition ratio	YoY
Japan	459	69.0%	+4.8%
Europe	41	6.2%	+10.8%
America	30	4.5%	-16.7%
China	80	12.0%	-23.8%
Southeast Asia	12	1.8%	-14.3%
Others	42	6.3%	0.0%
Total	665	100.0%	-1.1%

* unit: 100 million yen

The reduction of fixed costs did not compensate for the decrease of orders from major clients, so sales and profit declined.

BRIDGE REPORT

**(3) Financial standing and cash flows****◎ Major BS**

	End of Mar. 2019	End of Sep. 2019		End of Mar. 2019	End of Sep. 2019
Current assets	235,105	212,375	Current liabilities	206,979	198,878
Cash, etc.	56,092	39,454	Trade payables	87,189	75,541
Trade receivables	107,426	100,331	Debts	54,255	57,081
Inventories	59,591	60,311	Noncurrent liabilities	78,451	87,772
Noncurrent assets	205,969	226,993	Debts	44,046	38,415
Property, plant and equipment	161,368	182,494	Total liabilities	285,430	286,650
Intangible assets	7,532	7,180	Net assets	155,643	152,718
Other financial asset	22,983	21,621	Retained earnings	86,536	87,850
Total assets	441,074	439,368	Total liabilities and net assets	441,074	439,368

* unit: million yen

* “Cash, etc.” means cash and cash equivalents. “Trade receivables” means trade receivables and other receivables. “Trade payables” mean trade payables and other payables

Current assets decreased 22.7 billion yen from the end of the previous term, due to the decline in cash, etc. trade receivables, etc. Noncurrent assets increased 21 billion yen from the end of the previous term, due to the rise in property, plant and equipment, etc., and total assets declined 1.7 billion yen from the end of the previous term to 439.4 billion yen.

Current liabilities dropped 8.1 billion yen from the end of the previous term, due to the decline in trade payables, etc. Noncurrent liabilities rose 9.3 billion yen from the end of the previous term, due to the increase of other financial liabilities, etc., and total liabilities increased 1.2 billion yen from the end of the previous term to 286.7 billion yen. The total capital amount declined 2.9 billion yen from the end of the previous term to 152.7 billion yen.

As a result, the ownership ratio of shareholders of the parent company dropped 0.6 points from 33.9% at the end of the previous term to 33.3%.

◎ Cash Flow

	1H of FY3/19	1H of FY3/20	Increase/decrease
Operating CF	9,313	896	-8,417
Investing CF	-12,554	-11,500	+1,054
Free CF	-3,241	-10,604	-7,363
Financing CF	-4,312	-5,142	-830
Cash and equivalents	35,092	39,454	+4,362

* unit: million yen

The surplus of operating CF shrank, due to the decrease in the provision for product warranties, etc. The deficit of free CF augmented. The deficit of financing CF expanded, due to the augmentation of repayments of lease liabilities, etc. The cash position improved.

4.Fiscal Year March 2020 Earnings Estimates

(1) Full-year earnings forecast

	FY 3/19 Results	Ratio to sales	FY 3/20 Forecast	Ratio to sales	YoY	Difference from initial estimates	Progress rate
Sales	4,122	100.0%	3,900	100.0%	-5.4%	-4.9%	50.7%
Segment profit	220	5.3%	206	5.3%	-6.4%	0.0%	57.9%
Operating profit	-285	-	65	1.7%	-	-66.5%	69.2%
Net income	-248	-	28	0.7%	-	-80.0%	59.5%

* unit: 100 million yen

*The forecast was announced by the company. Segment income corresponds to the operating income in the Japanese standards.

*Net income is profit attributable to owners of the parent.

The earnings forecast revised downwardly. Sales dropped, but a profit earned.

The company has revised the earnings forecast downwardly. Sales are estimated to decline 5.4% year on year to 390 billion yen. The forecasted trend of the Chinese construction machinery market, the effects of the yen appreciation, etc. were taken into account. There is no revision to the estimated segment profit. Operating profit is projected to be 6.5 billion yen. The company took into account the possibility of augmentation of cost for product warranties regarding seismic isolation/mitigation oil dampers, etc. Net profit is estimated to go into the black, thanks to the decrease in expenses for seismic isolation/mitigation.

The assumed (average) exchange rates are 1 US dollar = 105 yen and 1 euro = 115 yen from the third quarter, and 1 US dollar = 106.81 yen and 1 euro = 118.21 yen for the full year (1 US dollar = 110.91 yen and 1 euro = 128.40 yen for the previous fiscal year). The dividend has not been determined.

(2) Trend in each segment

Sales	FY3/19 Results	Composition ratio	FY3/20 Forecast	Composition ratio	YoY	Difference from initial estimates	Progress rate
AC Business	2,458	59.6%	2,329	59.7%	-5.2%	-3.2%	51.0%
HC Business	1,406	34.1%	1,317	33.8%	-6.3%	-7.4%	50.5%
Others	258	6.3%	254	6.5%	-1.6%	-6.6%	48.2%
Total	4,122	100.0%	3,900	100.0%	-5.4%	-4.9%	50.7%
Segment profit							
AC Business	98	4.0%	119	5.1%	+21.4%	+41.7%	58.2%
HC Business	119	8.5%	76	5.8%	-36.1%	-34.5%	53.6%
Others	3	1.2%	11	4.3%	+266.7%	+83.3%	84.0%
Total	220	5.3%	206	5.3%	-6.4%	0.0%	57.9%

* unit: 100 million yen

*The composition ratio for profit is the income margin.

①AC Business

Product	Sales (Ext.)	Composition ratio	YoY	Difference from Initial estimates	Progress rate
Shock absorbers for automobiles	1,679	72.1%	-1.1%	-2.9%	51.2%
Shock absorbers for motorcycles	282	12.1%	-3.1%	-2.1%	45.1%
Hydraulic equipment for automobiles	319	13.7%	-24.2%	-3.0%	54.9%
Others	50	2.1%	0.0%	-15.3%	52.6%
Total	2,329	100.0%	-5.2%	-3.2%	51.0%

* unit: 100 million yen

②HC Business

Product	Sales (Ext.)	Composition ratio	YoY	Difference	Product
Hydraulic equipment for industrial use	1,233	93.6%	-6.8%	-8.1%	50.4%
Others	84	6.4%	+1.2%	+2.4%	52.1%
Total	1,317	100.0%	-6.3%	-7.4%	50.5%

* unit: 100 million yen

The profit of the AC business is expected to rise, thanks to the increase in sales volume of shock absorbers for four-wheeled vehicles. However, the growth of profit rate is estimated to be stagnant, because the automobile market will decline.

The sales and profit of the HC business are projected to decline, due to the sluggish demand for construction machinery in China and Southeast Asia and the drop in the shares of major clients in the Chinese market.

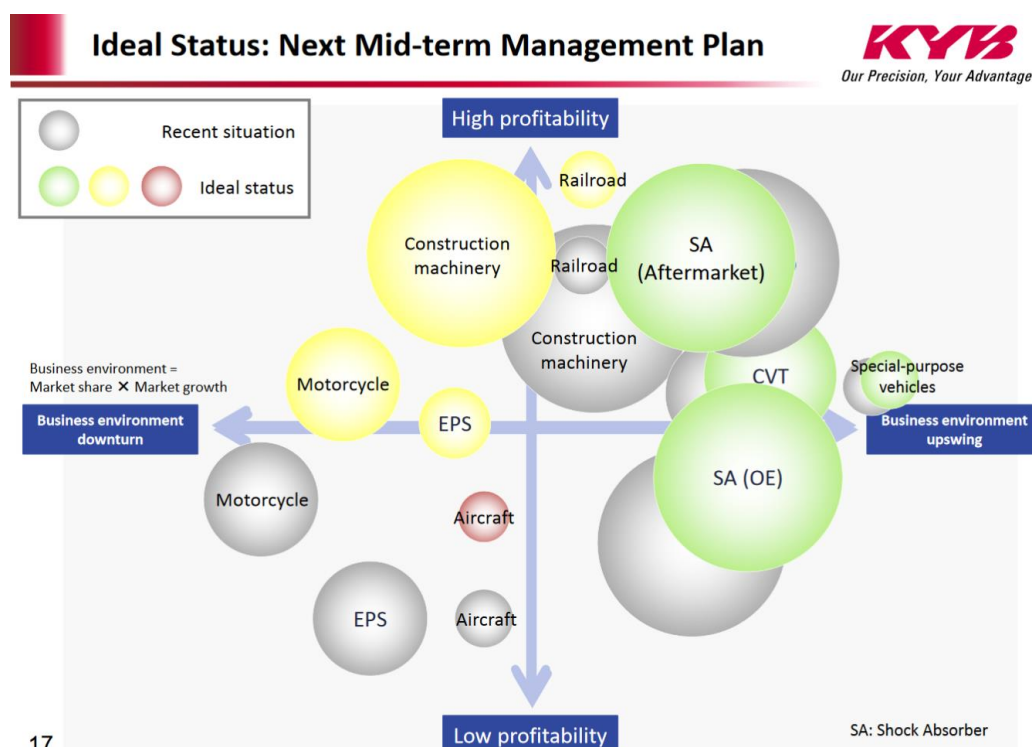
5. Progress in the 2017 mid-term management plan

(1) Basic policies for fiscal 2019

Under these circumstances, this term, which is the final fiscal year for the 2017 mid-term management plan, has the following basic policies, and the company considers this term to be a year to “overcome the painful reforms and realize a profitable structure.”

- * Thoroughly diffuse corporate culture that prioritizes compliance and safety
- * Quickly adapt seismic isolation/mitigation oil dampers for buildings
- * Determine unprofitable businesses and bases to discontinue, work on restructuring and integration, specialize in core business
- * Develop new competitive products, and promote innovative manufacturing

As for the next mid-term management plan, the company aims to develop products mainly in fields with high profitability and a favorable business environment (high market share x significant growth) in the AC business, and plans to improve profitability in the HC business.



(2) Activities in each business

①AC business

The company engages in the following activities, under the mid-term policy of “getting on a growth track by integrating and dismantling business footholds according to the change of regions where clients demand products, developing products with high added value, and promoting their sales.”

* Completion of drastic structural reform

The company aims for an optimal layout that matches its strategies for markets, customers, and business.

Restructuring in Europe	For SA, the transfer of products between business establishments is to be completed in fiscal 2021. KSS, a production site for hydraulic pumps in Spain, started the transfer of products, and will be closed in fiscal 2021.
Restructuring of the business for two-wheeled vehicles	The transfer of small-sized products from Thailand to Vietnam is to be completed in fiscal 2020. The transfer of the models of TVS, an Indian two-wheeled vehicle manufacturer, from China to India is to be completed in fiscal 2019.
Restructuring of EPS	The manufacturing of unprofitable models in Japan was discontinued, and the company will concentrate on the manufacturing in China and restructure business operations.
SA retail	As for retail in China, the company completed the integration of distributors into the Chinese production site. The drafting of proposals for the reform of structures for production, sale, and technology (cost reduction and sales channels) is to be completed in fiscal 2019.

* Stabilization of the revenue base

As for the integration of global specs for shock absorbers for mass retailers, the company is preparing standard specs, and it is to be completed in fiscal 2019.

As for the improvement in productivity through innovative manufacturing of SA, the company is designing equipment specs, and will start the production of equipment in fiscal 2020.

* Sustainable growth

The company plans to keep developing products with high added value and expanding sale. As for the order receipt and sales promotion for value-added products, the company has 64 proposals, 9 business inquiries, and 7 mass production projects. The company started a presentation of new technologies for German Premium 3.

As for the increasing order receipt and sales promotion for products for SUVs, EVs, and pickup trucks, the company has received 2 business inquiries and 5 orders, and has 2 mass production projects.

②HC business

Under the mid-term policy of “securing stable sales and profit that are not affected by market fluctuations,” the company will enhance sales promotion in growing markets into which the company has not yet made inroads based on shovels.

* Completion of drastic structural reform

The transfer of control valve lines for medium-sized excavators was delayed a little, but is to be completed by the end of fiscal 2019.

With regard to the integration of motor products in Sagami Factory, the layout for restructuring in China Factory, etc. was determined, and the company started them. The integration and restructuring are scheduled to be finished in Sept. 2020.

Through such transfer and integration, the company plans to reduce the number of production lines without degrading production capacity, and actualize a structure resistant to fluctuations in production volume by making production lines flexible.

* Stabilization of the revenue base

As local and foreign-affiliated companies in the Chinese market are making rapid progress, the company actively promotes sales and receives an increasing number of orders from these manufacturers.

In addition, with regard to compact and large-sized shovels whose demand is expected to remain strong, the company is aiming to

establish a structure which is less susceptible to market fluctuations by improving production capacity to maintain a high market share, etc.

*Sustainable growth

The company is promoting the sales of products in the non-construction machinery market, including valves for loaders, HST (hydraulic static transmission: a continuously variable transmission in which a hydraulic motor is connected with a closed circuit) for farm equipment in the Indian market, and gear pumps for forklifts.

6.Conclusions

The earnings forecast has been revised downwardly, but segment profit, which indicates the earning from the core business, remains unchanged. Since six-month segment profit has been stable at the level of 10 billion yen since fiscal 2017 and net profit is projected to be positive thanks to the decrease in cost for seismic isolation/mitigation, it seems to be considered in the stock market that the performance of the company has bottomed out.

However, we need to keep in mind that the business environment is not good and the AC and HC businesses have some problems to be solved. We would like to pay attention to how much the company can proceed in the second half of the year before the next mid-term management plan

<Reference 1: 2017 Midterm Management Plan>

KYB has formulated a 3-year mid-term management plan with the year 2017 (the term ending Mar. 2018) being the first fiscal year and the year 2019 (the term ending Mar. 2020) being the final fiscal year and the plan is ongoing.

(1) Numerical goals

Under the slogan of “A GLOBAL KYB – CHALLENGE & INNOVATION –,” KYB is striving to “complete drastic structural reform” in FY2017 and will make efforts to realize “sustainable growth,” “stabilization of the earning base,” and “solving managerial issues” in FY2018 and 2019.

(2) Vision for each business

① AC Business

Mid-term policy	Draw a growth path by reorganizing bases to follow shifts of areas of demand by clients and developing and expanding sales of products with high added value Acceleration through introduction of a department system (suspension, steering, and motorcycle departments)
Priority efforts	◇Optimum layout and enhancement of capacities in conformance with the markets and the business strategies of clients Enter emerging markets and review the existing bases. ◇Development and expansion of sales of high-value added products by taking advantage of the electronic technology Expand sales of electronic control suspensions for automobiles, and develop electronic control suspensions for motorcycles. ◇Cost reduction in the existing products by introducing an innovative line

KYB aims to increase the number of shock absorbers sold to 88 million (OEM products and commercially-available products account for 68% and 32%, respectively) for fiscal 2020 from 72 million (OEM products and commercially-available products account for 70% and 30%, respectively) in the previous term.

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Points are as follows:

SA (OEM)	Make profit constantly through sale of shock absorbers, the backbone of the AC business (Policies) <ul style="list-style-type: none"> • Increase the customer satisfaction level by strengthening the 5-region development structure • Enhance capacities in areas of demand • Put high-value added products on the market • Maintain and increase competitiveness mainly through development and introduction of an innovative line
SA (commercially-available)	Certainly fulfill the FY2020 goal of sales of 28 million shock absorbers (Policies) <ul style="list-style-type: none"> • Strengthen capacities in areas with thriving markets by setting up distributors • Develop and introduce new SA apps for popular vehicle models • Develop and introduce apps for peripherals of SAs • Endeavor to attain the goal mainly by hedging exchange rate risks through promotion of local production and consumption of coil springs, etc.
SA Innovative monozukuri(manufacturing)	Accelerate global development of innovative manufacturing With a concept of dealing with the declining birthrate and stabilizing the product quality, endeavor to enhance the overall productivity and automation by 25% and 75%, respectively, through automatic welding, assembly, and inspection, compact coating equipment, etc.
Motorcycles	Optimize excess capacities to realize a business entity that can make profit through development and production innovation Strengthen the businesses in India, Vietnam, and Indonesia, and reorganize the business structures in China and Thailand.
System products	Strengthen development of high-value added system products Strive to meet the needs for electronic control suspensions and autonomous driving system in anticipation of the trend in fiscal 2020 and the subsequent fiscal years.

②HC Business

Mid-term policy	Secure stable sales and profit that are independent of market changes With shovels placed on the core, strengthen sales increase in growing markets where KYB has not yet fully shown its presence
Priority efforts	◇ Establishment of an optimum production system Certainly make profit by developing control valves and reorganizing the production system. ◇ Sales increase in the markets of agricultural machinery, railroad equipment, and other fields Strive to expand sales through product strategies and development that satisfy the demand of each region.

Points are as follows:

Establishment of an optimum production system	Change to a corporate structure with greater profitability through the integrated line using the capacity of its corporate group (Policies) <ul style="list-style-type: none"> • Establish an integrated line for control valves. A 15% increase in productivity and discontinuation of transportation between plants are expected as a new line enables establishment of an integrated production system, ranging from casting to machining and assembly. Integration of production and development bases shortens development periods, from which enhancement of product appeal is expected.
Products for agricultural machinery	Increase sales of products for agricultural machinery through product strategies that meet the needs of each region (Policies) <ul style="list-style-type: none"> • Japan: Develop electronic products that can deal with automatic control and unmanned driving and system support.

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	<ul style="list-style-type: none"> • North America: Develop products that satisfy the demand for large capacity. Develop electronic products that can deal with automatic control and driving. • China: Boost the competitiveness of the existing products.
Products for railroads	<p>Endeavor to expand the business through sales increase in overseas markets and new product strategies</p> <p>KYB deems China, India, North America, and Japan as markets to which it must pay attention.</p> <p>(Policies)</p> <ul style="list-style-type: none"> • China: Expand sales of passive dampers and other products for high-speed (250 – 300 km/h) railway and interurban railway (reduce costs through local production) • India and other regions: Boost sales expansion together with Japan. • Japan: Increase sales of active suspension systems for luxury trains, limited express trains, and next-generation shinkansen (bullet train).

③Other

Points are as follows:

Special purpose vehicle business	<p>Increase sales in the special purpose vehicle business through incorporation of domestic demand, and enhancement of the production structure and technical capacities following the thriving Indian market</p> <p>In India, KYB's strengths are not only the technical aspects, including "the high performance of ready-mixed concrete emission" and "the high driving stability with the low center of gravity when ready-mixed concrete is loaded," but also sales aspects of "trust in Japanese companies."</p>
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<Reference 2: Regarding Corporate Governance>

◎ Organization type and the composition of directors and auditors

Organization type	Company with an audit and supervisory board
Directors	6 directors, including 2 outside ones
Auditors	4 auditors, including 2 outside ones

◎ Corporate Governance Report

Last update date: July.16, 2019

<Basic approach>

In order to respond to the expectations of the stakeholders through realization of sustainable growth and corporate value improvement as well as fulfill the corporate social responsibility of contributing to society, it is our basic approach to pursue the development of a rapid and efficient management structure centered on the Board of Directors and establishment of fair and transparent management supervision functions and work on strengthening and enhancing corporate governance based on the following management philosophy and basic policies.

(Management philosophy)

“KYB group contributes to the society, by serving technologies and products that make people’s life safe and comfortable.”

1. We shall build a corporate culture that holds high goals and full of vitality.
2. We shall maintain kindness and sincerity, cherish nature and care for the environment.
3. We shall constantly pursue creativity and contribute to the prosperity of customers, shareholders, business partners and society.

(Basic policies)

1. We shall respect the rights of shareholders and ensure their equality.
2. We shall take the benefits of stakeholders including our shareholders into consideration and endeavor to appropriately collaborate with those stakeholders.
3. We shall disclose not only the information in compliance with the relevant laws and regulations, but also actively provide the important and/or useful information to the stakeholders for their well-informed decision making.
4. The Board of Directors shall be aware of its fiduciary responsibility and accountability to the shareholders and shall appropriately fulfill its roles and responsibilities in order to promote sustainable and stable corporate growth and increase corporate value, profitability and capital efficiency.
5. We shall engage in constructive dialogue with the shareholders and make efforts to obtain their support regarding the company’s business policies and also reflect their opinions in the improvement of management.

To regain trust

Since our company presented our values regarding appropriate cooperation with stakeholders, respect of their interests, ethics for sound business activities, etc., and stipulated the “corporate conduct guidelines” as a code of conduct each of us must observe, we have made continuous efforts to widely diffuse the guidelines in the front lines of our business activities inside and outside Japan for observance (Principle 2-2). As an example, we hold briefings on the corporate conduct guidelines, conduct various compliance education programs, have compliance education as a promotion requirement, conduct one-on-one inspection activities with applied employees, and thoroughly promote the whistleblower system. We have continued fulfilling daily work with a sense of tension and thorough awareness that the products and services we provide to society through our corporate activities and various opportunities including these are related to safety of many people’s lives, bodies, and property, and that slacking of individual work may affect the entire society, as all of us engage in quality management directly and indirectly. In addition, we have continuously worked on enhancing awareness of and observing “Bad News 1st,” which is the policy where we immediately report inconvenient news in all workplaces and try to solve the problem while it is small.

However, as announced in the press release on Oct. 16th, 2018 or later, it was revealed that the performance inspection records for some of seismic isolation/mitigation oil dampers, which are manufactured and sold by our company, were falsified and then the products

which do not comply with the performance evaluation criteria approved by the Ministry of Land, Infrastructure, Transport and Tourism (MILT) or the clients' specs were attached to buildings.

We deeply apologize, for all the concern and inconvenience we have caused, to everyone in society including the property owners, occupants, people related to construction companies and design firms, our shareholders, and people using the buildings.

With determination, our company plans to make every endeavor to diffuse our corporate conduct guidelines among all "individual" employees in the front lines of our business activities inside and outside Japan for observance.

<Reasons for Non-compliance with the Principles of the Corporate Governance Code (Excerpts)>

Principles	Reasons for not implementing the principles
(Supplementary principle 4-1-3 Successive plan for CEO, etc.)	Our company deems successive plans for CEO and the like as an important issue for sustainable growth and medium to long-term improvement of our corporate value. From this year we have established a committee of nomination formed with a representative director and an unaffiliated director so we can improve our transparency in terms of the process of nomination. From now on we will consider requirements and development policy regarding CEO and other positions, taking account of the management environment surrounding our company and the corporate culture. At the same time we will give consideration to the supervision system by the board of directors.
(Principle 4-11 Precondition for ensuring effectiveness of the board of directors and board of corporate auditors)	The Company does not have female directors. However, we appoint people we judge suitable for incorporating diverse values into management as directors, sufficiently considering the balance in knowledge of the whole board of directors, experience (including international experience), abilities, etc., without distinguishing them based on personal attributes such as gender, as stated in 4-11-1.

<Disclosure Based on the Principles of the Corporate Governance Code (Excerpts)>

Principles	Disclosure contents
Principle 1-4【So-called strategically held shares】	<p>(1.)Policy on strategic shareholding</p> <p>From the perspective of medium to long-term improvement of corporate value, our company, when judging as necessary, strategically holds shares through which the relationship of trust and the business relationship are expected to be maintained or strengthened regarding business strategies and operations after comprehensively judging the growth potential and economic rationality of such shares. With regard to strategically held shares, we check the rationality of continued holdings in consideration of whether or not the benefits of holdings are commensurate with the Company's cost of capital, etc., at a meeting of the board of directors every year. We plan to sell shares when we consider that the rationality in holding them has weakened.</p> <p>(2.)Policy on exercise of voting rights</p> <p>Before exercising the voting rights of shares that our company strategically holds, we consider for each case whether the strategic shareholding contributes to medium to long-term improvement of our corporate value and increase in shareholder return and make judgment after giving thorough consideration to the management policies and business strategies of the company that issues relevant shares.</p>
Principle 5-1【 Policy on constructive dialogue with shareholders】	In our company, the global finance executive presides and the IR office of the accounting head department deals with shareholders and investors in order to encourage constructive dialogue with shareholders and the like. The IR office has established a system that allows appropriate response in collaboration with related departments of our company to enrich such dialogue. We hold financial results briefings for analysts and institutional investors, where the president and the global finance executive describe our management strategies and financial conditions, once in every half year. In addition, we

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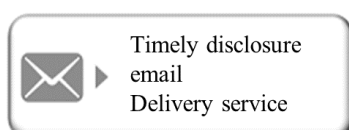


carry out individual interviews as requested, and strive for proactive communication with overseas shareholders and institutional investors through attendance at conferences in and outside Japan and individual IR activities abroad. Opinions and requests obtained from shareholders and investors through our IR activities are conveyed on a regular basis to the board of directors and the management as feedback in order to share information. Our company gives meticulous attention to handling of insider information not to inflict losses on each other in dialogue with shareholders and investors. Accordingly, for a period beginning with the following day of the date of settlement and ending with the day when financial statements are announced, which is called a quiet period, our company refrains from having dialogue with shareholders and investors and endeavors to conduct thorough internal information management.

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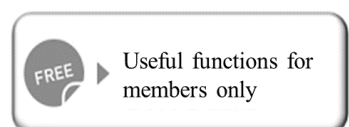
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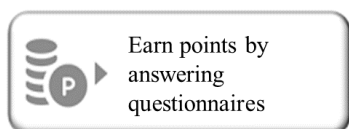
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