Message from the President

Fiscal 2002, ended March 31, 2003, continued to be a difficult year. Increased exports primarily to Asian countries helped the economy, but a slowdown in the U.S. economy as well as sluggish private-sector capital investment and personal consumption in Japan exerted deflationary pressures.

Nevertheless, we were able to maintain consolidated sales of ¥1,204.7 billion, up 0.6% from the previous year. Lower sales following the transfer of partial equity in an IT systems subsidiary were offset by the start of the wholesale electricity supply business in April 2002. Despite losses incurred in the adoption of new accounting standards for retirement benefits and a write-down of securities due to the weak stock market, we registered a net income of ¥1.7 billion, a vast improvement over a loss last year.

Increasing Collaboration

Last year, we continued and formed new collaborations with other companies – an important aspect of our strategy to remain independent and competitive. In November 2002, we strengthened our existing alliance with Nippon Steel Corporation and formed a new one with Sumitomo Metal Industries, Ltd. To solidify the alliances, we took cross-shareholdings with the two partner companies.

Under our alliance with Nippon Steel, we intend to augment cooperation between affiliates. For example, we will combine two of our companies engaged in the melt-cutting of steel plate. We are seeking steps to increase collaboration between distribution subsidiaries and our steelworks, while cooperating in raw materials procurement.

With Sumitomo Metal Industries, we are stepping up our ties in the titanium business. We increased our equity in Sumitomo Titanium Corporation—a publicly listed titanium sponge subsidiary of Sumitomo Metal Industries—to 24.8%. We and Sumitomo Metal Industries are also working to make more effective use of our product distribution network, undertake the joint procurement of raw materials and equipment, and strengthen the scope of our collaboration.

Overseas, we have continued joint R&D with United States Steel Corporation in automotive steel sheet technologies. In April 2002, we signed a formal cooperation pact with Europe's Lucchini Group to collaborate in specialty steel wire rod and bar for automotive applications. In our alliance with voestalpine Stahl GmbH, we are working on a joint study of auto body structures, high strength steel, and personnel exchanges.

In the machinery business, we and Kawasaki Heavy Industries, Ltd. have merged our two crushing equipment businesses into a 50/50 joint venture, Earth Technica Co., Ltd. The design and marketing portions of the crushing equipment businesses in the parent companies have already been transferred to the joint venture. Manufacturing will be transferred in the latter half of fiscal 2004, giving the joint venture a full range of integrated capabilities.

In May 2003, we decided to shift our environmental business to subsidiary Shinko Pantec Co., Ltd., in October 2003. This will combine the Kobe Steel Group's environmental businesses and lay a foundation for strengthening and expanding the Group's comprehensive environmental solutions business. These consolidations are anticipated to further improve opportunities in the sluggish domestic economy.

Building for the Future

Our vision is to further raise our corporate value and contribute to society through our three principal businesses consisting of materials, wholesale power supply, and machinery.

To reach this vision for the Kobe Steel Group, we launched the Fiscal 2003-2005 Consolidated Medium-Term Business Plan in June this year to set us on course for the next three years. Our financial targets are to achieve a pretax ordinary income of 80 billion yen, increase return on assets to 6%, and reduce debt by 250 billion yen to 640 billion yen.

We have set five basic goals under the medium-term plan. The first goal is to further strengthen our position as a manufacturer of distinctive, value-added products. We produce a wide range of first-class products that are highly regarded by domestic and overseas customers. Our plan is to significantly increase the proportion of these distinctive products to make up 40% of our total menu.

Our second goal is to boost our competitiveness. To be competitive, we need both high-quality products and low-cost operation. Particularly in the steel and other material businesses, we need the right facilities. We will increase capital investment to 100 billion yen to bolster our competitiveness over the coming three years.

Third, we aim to improve our financial position. We realize further improvements are needed under the current financial circumstances. Under the plan, we intend to reduce our debt by 250 billion yen to 640 billion yen and lower our debt-to-equity ratio to 1.7.

The fourth goal is to create cash flow of 250 billion yen through higher profits. As the new plan does not include any major sales of assets, profits will be the source of improved cash flow. We will strive to attain pretax ordinary income of 80 billion yen and return on assets of 6 percent.

Finally, we intend to increase the confidence of the capital market by improving our financial position, increasing profits, and ensuring cash flow.

Corporate Governance

To separate strategy and policy decision-making from business operations, Kobe Steel reduced the number of directors in fiscal 1999. However, as management decision-making and day-to-day operations are closely interrelated, strictly divorcing strategy from execution was not found appropriate. Therefore, we have changed the composition of the Board of Directors to include executives responsible for key head office functions as well as business divisions and internal companies. We believe that responsibility for everyday operations should be borne by directors who have a legal responsibility to carry out the Company's business affairs on behalf of the shareholders and customers. This would be the optimum way for shareholders to relegate this responsibility.

Thus, directors oversee the business segments, while corporate officers execute the business affairs of the segments under their guidance. We have also further strengthened our auditing by appointing an additional outside auditor.

Furthermore, we established the Compliance Committee to serve as an advisory body to the Board of Directors on compliance issues. The majority of the members of this standing committee are from outside Kobe Steel. We intend to create compliance systems for the entire company as well as launch an internal notification system to promote self-governance. In these ways, we are improving our corporate governance and compliance to further gain the confidence of our customers and society.

Outlook

We expect our operating environment will continue to be difficult. Low private-sector capital investment and weak personal consumption are anticipated to persist. Global economic trends are also uncertain.

On this outlook, Kobe Steel is focusing its resources on strategic business fields—areas in which we are particularly strong – and markets that have good growth potential. We are carrying out reforms to create a stronger, more stable profit structure, while endeavoring to improve our financial position and significantly increase our corporate value. We ask for the continued understanding and support of our shareholders, customers and employees as we work toward achieving our goals of building a better company.

August 2003

K. Mizukoshi

Koshi Mizukoshi
President and
Chief Executive Officer