

Message from the President

In the first half of fiscal 2003, Japan's exports to China, other Asian countries and the United States increased and private-sector capital investment showed signs of improvement. Although there were indications that business activity was picking up, the economy did not achieve full recovery.

Under these conditions, Kobe Steel, Ltd. continued to place its full efforts into reducing costs and increasing profitability. For the half-year period ended September 30, 2003, orders fell for municipal solid waste treatment plants due to sluggish demand. However, steel exports to Asia were high and demand was strong for construction equipment in China. As a result, consolidated net sales at Kobe Steel rose 1.7% to ¥587 billion. Operating income went up 21.8% to ¥42 billion, and net income rose 72.1% to ¥9.0 billion.

Iron and Steel

Domestic steel demand was firm in the first half of the fiscal year. Although the construction industry was sluggish, export demand from the automotive and other manufacturing markets was strong and private-sector capital investment showed improvement. With steel exports mainly to Asia at a high level, Japan's crude steel production increased over the same period last year. Market conditions continued to improve for steel, as demand tightened both in Japan and overseas.

With this background, vigorous marketing and the stable operations of the No. 1 Power Plant in our wholesale electric power supply business contributed to a 5.0% increase in segment sales to ¥265.1 billion. Operating income went up 30.6% to ¥27.9 billion, owing to an increase in the shipments of steel products and improvement in sales prices.

In our wholesale electricity supply business, trial operation of the No. 2 Power Plant began in July 2003 and the start-up of commercial operations is slated for April 2004. Together with the No. 1 Power Plant, we will have a total generation capacity of 1.4 million kilowatts of electricity when both plants are in operation in April.

Aluminum and Copper

Although the cool summer and higher taxes on *happoshu*, a low-malt beer, reduced demand for beverage containers, the growth in aluminum bottle cans led to a small increase in the shipments of rolled aluminum products in the half-year period. Demand for automotive sheet, plate for semiconductor and liquid crystal fabrication equipment, blanks for disk drives, and automotive extrusions was firm, leading to higher overall aluminum shipments over the same period last year.

Shipments of rolled copper products were up over the same period last year. Demand for copper strip used in electronic applications was flat in comparison to the same period last year, but demand for copper tube for air conditioners increased in Japan.

Although product sales increased, our withdrawal from overseas aluminum ingot projects led to a 4.1% decrease in segment sales to ¥122.8 billion. Operating income increased 13.0% to ¥7.2 billion owing to higher product shipments and overall cost reductions.

Machinery

Domestic orders increased 21.8% to ¥63.4 billion due to higher

private-sector capital investments that supported orders for rotating machinery, tire machinery and environmental equipment. Overseas orders rose 6.5% to ¥15.9 billion owing to strong demand for rotating machinery and tire machinery to China. As a result, total orders for the Machinery segment increased 18.4% to ¥79.3 billion and the backlog of orders for the half year was ¥147.7 billion.

Machinery segment sales decreased 15.1% to ¥83.5 billion due to low orders for municipal solid waste treatment plants. Operating income went down ¥2.6 billion, resulting in an operating loss of ¥2.4 billion.

Construction Machinery

The domestic construction machinery market began showing signs of recovery as replacement purchases increased. In China, demand for construction equipment was strong due to the large push in infrastructure projects. Demand in Southeast Asia was also strong, while the North American market gradually started to recover.

Owing to robust demand in China and improvement in the domestic market, segment sales increased 27.2% to ¥93.3 billion. Operating income rose 134.5% to ¥3.5 billion.

Real Estate

A tax break on housing loans stimulated demand in the real estate market, leading to a slight increase in housing starts - the first increase in four years. Owing to strong marketing efforts, segment sales increased 30.8% to ¥20.6 billion. Operating income rose 34.8% to ¥2.6 billion.

Other Businesses

The transfer of equity shares in a semiconductor testing subsidiary led to an 18.8% decline in segment sales to ¥20.7 billion. Operating income increased 20.9% to ¥2.7 billion owing to the improved performance of a subsidiary engaged in materials testing and the manufacture of target material for liquid crystal displays.

Outlook

Japan's economy is not expected to achieve a full recovery in the second half of the fiscal year. While private-sector capital investment is showing signs of improvement, the severe employment situation and low incomes are putting downward pressure on personal spending.

Under these conditions, we are carrying out our Fiscal 2003-2005 Consolidated Medium-Term Business Plan to improve the profitability, performance and business foundation of the Company.

Our financial targets are to achieve a pretax ordinary income of ¥80 billion, increase return on assets to 6%, and reduce debt by ¥250 billion to ¥640 billion. Over the next three years, we intend to create and expand sales of distinctive, value-added products; further advance our alliances; respond to the global market; reduce costs and undertake investments to improve competitiveness; and improve corporate governance.

Moving forward to meet these goals, we ask for your continued understanding and support.

December 2003

Koshi Mizukoshi
President and Chief Executive Officer

