Financial Section

Contents

Consolidated Five-Year Summary

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2004, 2003, 2002, 2001 and 2000

	Millions of yen					Thousands of U.S. dollars (Note)
	2004	2003	2002	2001	2000	2004
Net sales	¥1,219,180	¥1,204,750	¥1,198,014	¥1,373,091	¥1,252,516	$11,535,434
Operating income	100,699	81,054	35,499	106,404	82,708	952,777
Net income (loss)	22,066	1,723	(28,519)	6,504	(53,088)	208,780
Total assets	1,916,338	1,902,642	2,045,303	2,131,123	2,124,795	18,131,687
Total stockholders' equity	330,127	293,138	280,685	263,362	271,462	3,123,541

	Yen					U.S. dollars (Note)
	2004	2003	2002	2001	2000	2004
Amounts per 1,000 shares						
Net income (loss)	¥7,438	¥592	¥(10,068)	¥2,299	¥(18,764)	$70.38
Diluted net income	7,377	—	—	—	—	69.80
Cash dividends applicable to the year	1,500	—	—	—	—	14.19

Note: For convenience only, U.S. dollar amounts in this report have been translated from Japanese yen at the rate of ¥105.69 to US$1, the rate of exchange prevailing on March 31, 2004.

Financial Review

Income Analysis (Consolidated)

With the Consolidated Medium-Term Business Plan for fiscal 2003-05 introduced in June 2003, we have been endeavoring to establish a sound foundation for our operations.

The fiscal year under review is the first year of the Consolidated Medium-Term Business Plan. Based on this plan, we took a number of steps to improve our earnings capacity. With a healthy performance, primarily in the Iron and Steel, Aluminum and Copper, and Construction Machinery segments, we made a good start.

	Billions of yen		Percent change
	2004	2003	2004/2003
Net sales	¥1,219.2	¥1,204.8	1.2%
Operating income....	100.7	81.1	24.2

Net sales climbed ¥14.4 billion from the preceding fiscal year, to ¥1,219.2 billion. Operating income, meanwhile, soared ¥19.6 billion to ¥100.7 billion.

Although the Machinery segment experienced a decline in sales and income, a result of sluggish orders from local governments for solid waste treatment plants, increased shipments and improved prices of steel materials as well as expanding demand for construction machinery in the Japanese and Chinese markets resulted in growing sales and income in the Iron and Steel segment and in the Construction Machinery segment.

Net other expenses totaled ¥65.0 billion and income before income taxes amounted to ¥35.7 billion. After adjustments for income taxes and minority interests, a net income of ¥22.1 billion was recorded.

Business segment information was as follows:

[Iron and Steel Segment]

	Billions of yen		Percent change
	2004	2003	2004/2003
Net sales	¥548.3	¥523.5	4.8%
Operating income....	63.1	48.8	29.4

The Iron and Steel segment attained total sales of ¥548.3 billion, representing an increase of ¥24.8 billion, or 4.8%, from the previous fiscal year. Operating income rose ¥14.3 billion, or 29.4%, to ¥63.1 billion. Domestic steel demand was bullish, especially among manufacturers such as automakers and shipbuilders. Backed by solid demand from East Asia, and particularly China, exports remained robust. Since the summer of 2003, there had been concern about the rise in volume of domestic steel inventories. But inventories have been moving toward appropriate levels since the beginning of 2004. As a result, domestic demand went up and we enjoyed a steady improvement in prices. The export prices of many products increased, given healthy demand for steel and soaring prices of raw materials and semifinished products. Despite the impact of rising raw material prices, we achieved earnings growth thanks to improved sales prices and our cost-cutting initiatives.

[Aluminum and Copper Segment]

	Billions of yen		Percent change
	2004	2003	2004/2003
Net sales	¥243.3	¥248.0	(1.9)%
Operating income....	14.9	12.4	20.4

Total sales in the Aluminum and Copper segment were down ¥4.7 billion, or 1.9%, from the previous year, at ¥243.3 billion. Nonetheless, we recorded a ¥2.5 billion, or 20.4%, increase in operating income, which reached ¥14.9 billion. Beverage can stock enjoyed strong sales, thanks to robust demand for applications in aluminum beverage cans. Demand rose for aluminum sheet as automobiles are using increasing amounts of this light metal, and aluminum plate for LCD manufacturing equipment also increased steadily. Overall, our aluminum business achieved strong performance gains in comparison with the results of the previous fiscal year.

Among rolled copper products, sales of copper strip for electronic materials, such as semiconductor leadframes and automotive terminals, were strong. Imports of finished air conditioners and air conditioner parts manufactured by Japanese manufacturers outside Japan were on a par with the level seen in the previous year. We consequently continued to enjoy solid demand for copper tube for air conditioners. Overall, our copper business performance also outpaced the results recorded in the preceding fiscal year. But despite the rise in the sales of individual products, this segment suffered a fall in overall sales because of our withdrawal from the aluminum ingot business. On the other hand, with growing product sales and overall cost reduction, we registered impressive earnings growth.

[Machinery Segment]

	Billions of yen		Percent change
	2004	2003	2004/2003
Net sales	¥196.3	¥216.2	(9.2)%
Operating income....	1.4	4.2	(66.3)

Total sales of the Machinery segment declined ¥19.9 billion, or 9.2%, to ¥196.3 billion. Operating income also fell from the previous year, dropping ¥2.8 billion, or 66.3% year on year, to ¥1.4 billion. These declines were attributable to a slowdown in orders for solid waste treatment plants from local governments.

Orders in the domestic market jumped ¥35.6 billion, or 31.2%, from the preceding fiscal year, to ¥149.7 billion. Underlying this rise was an increase in orders for industrial machinery, equipment for energy and nuclear applications, and environmental facilities, which offset weak demand from local governments for solid waste treatment plants.

In overseas business, mounting automobile production in East Asia, especially in China, pushed up orders for rubber and tire machinery. This was unfortunately offset by a substantial decline in plant projects, which resulted in a ¥7.4 billion fall in the amount of orders, or 17.9%, to ¥34.0 billion. Total orders received in the Japanese and overseas markets amounted to ¥183.7 billion, a rise of ¥28.2 billion, or 18.1%, from the preceding fiscal year. The balance of orders received at the end of the fiscal year under review was also higher, climbing ¥7.3 billion, or 4.9%, to ¥156.3 billion.

[Construction Machinery Segment]

	Billions of yen		Percent change
	2004	2003	2004/2003
Net sales	¥184.0	¥157.4	16.9%
Operating income....	8.1	4.1	98.3

In our Construction Machinery segment, total sales reached ¥184.0 billion, an improvement of ¥26.6 billion, or 16.9%, from the previous fiscal year. Operating income surged 98.3%, or ¥4.0 billion, to ¥8.1 billion. Despite declining spending on public works in the Japanese market, demand for new machinery rallied as exports of used machinery reduced the number of machines in Japan and customers sought to replace existing equipment. Overseas, the Chinese market posted continued growth, while a turnaround in demand was seen in Europe, North America and Southeast Asia. The Middle East and Russia also witnessed higher demand. Consequently, the Construction Machinery segment posted healthy results in almost all regions.

[Real Estate Segment]

	Billions of yen		Percent change
	2004	2003	2004/2003
Net sales	¥43.2	¥42.6	1.3%
Operating income....	3.8	4.3	(13.1)

Total sales in the Real Estate segment increased by ¥0.6 billion, or 1.3%, to ¥43.2 billion. On the other hand, operating income was down ¥0.5 billion, or 13.1%, to ¥3.8 billion. In our mainstay real estate sales business, we enjoyed good results with the sale of large properties, including the Maya Seaside Place East Buildings 4 and 5 (Nada-ku, Kobe), O's Town South 2nd Phase (Akashi, Hyogo Prefecture) and O's Garden 1st Phase (Akashi, Hyogo Prefecture). This translated into higher revenue. Unfortunately, however, earnings declined following a change in the make-up of properties for sale.

[Other Businesses Segment]

	Billions of yen		Percent change
	2004	2003	2004/2003
Net sales	¥45.2	¥56.4	(19.7)%
Operating income....	8.1	5.7	42.0

In our Other Businesses segment, total sales dropped ¥11.2 billion, or 19.7%, from the preceding fiscal year, to ¥45.2 billion. In contrast, operating income surged ¥2.4 billion, or 42.0%, to ¥8.1 billion. During the term, we sold off a substantial portion of our investment in a semiconductor testing subsidiary. As a result, this company is no longer classified as a consolidated subsidiary and our sales in this segment declined. However, earnings benefited from the solid performance of another subsidiary involved in materials testing and the manufacture and sale of high functional materials, such as sputtering target materials for the production of liquid crystal displays.

Analysis of Cash Flow

At the end of the fiscal year under review, cash and cash equivalents stood at ¥68.5 billion, down ¥13.3 billion, or 16.3%, from the end of the preceding fiscal year. We secured cash flows of ¥104.0 billion from operating activities, but the outflow of cash for investing activities reached ¥86.4 billion, while the outflow of cash for financing activities, including the repayment of external liabilities, amounted to ¥35.8 billion.

(Cash flows from operating activities)
Net cash provided by operating activities declined ¥11.7 billion, or 10.1%, to ¥104.0 billion. Despite an increase in income before income taxes, depreciation decreased and sales growth bolstered trade receivables and inventories.

(Cash flows from investing activities)
Net cash used in investing activities came to ¥86.4 billion, compared with a fund inflow of ¥27.0 billion for the previous fiscal year. In addition to the decline in proceeds from the sale of noncurrent assets and from investments in transfers of business, there was an increase in capital investment for the wholesale electric power supply business.

(Cash flows from financing activities)
Net cash used in financing activities amounted to ¥35.8 billion, a decrease of ¥139.2 billion, or 79.6%, due to proceeds from issuance of bonds and a decline in the repayment of bonds.

Analysis of Financial Position

At the end of the fiscal year under review, the total assets of the Kobe Steel Group amounted to ¥1,916.3 billion, representing growth of ¥13.7 billion from the end of the preceding fiscal year. Despite continued efforts to reduce assets by cutting the deposit balance, our investment in the No. 2 Power Plant of our Shinko Kobe Power Inc. produced an increase. Interest-bearing debt totaled ¥797.0 billion at the end of the year, excluding project finance for the wholesale electric power supply business. This figure represents a decline of ¥98.8 billion from a year earlier, when the figure was ¥895.8 billion.

Interest-bearing debt, including project finance for the wholesale electric power supply business was down ¥34.5 billion from the end of the previous year, at ¥931.9 billion. During the term, we made a reversal of our capital surplus to totally eliminate our accumulated deficit.

Shareholders' equity surged ¥37.0 billion to ¥330.1 billion, a result that reflects both our strong net income result as well as an improvement in net unrealized gains on securities following a turnaround in stock prices. As a consequence, the equity-to-assets ratio was 17.2% at the end of the year, up 1.8 percentage points from a year earlier.

Consolidated Balance Sheets

Kobe Steel, Ltd. and Consolidated Subsidiaries
March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
ASSETS	2004	2003	2004
Current assets:			
Cash and cash equivalents (Note 12)	¥ 69,235	¥ 82,419	$ 655,076
Notes and accounts receivable			
Trade	220,518	205,480	2,086,460
Unconsolidated subsidiaries and affiliates	72,902	73,870	689,772
Other	35,908	18,217	339,748
Allowance for doubtful accounts	(1,708)	(687)	(16,160)
	327,620	296,880	3,099,820
Inventories	233,689	221,462	2,211,080
Deferred income taxes (Note 11)	22,781	21,523	215,545
Other	17,094	19,142	161,738
Total current assets	670,419	641,426	6,343,259
Investments and other assets:			
Investments in securities (Note 4)	85,591	47,946	809,831
Investments in and advances to unconsolidated subsidiaries and affiliates	35,370	53,831	334,658
Long-term loans receivable	6,361	7,419	60,185
Other	61,332	80,097	580,301
Allowance for doubtful accounts	(9,514)	(9,156)	(90,018)
	179,140	180,137	1,694,957
Plant and equipment (Note 6):			
Land	223,976	229,249	2,119,179
Buildings and structures	601,805	605,984	5,694,058
Machinery and equipment	1,746,967	1,747,764	16,529,161
Construction in progress	97,600	41,042	923,455
	2,670,348	2,624,039	25,265,853
Less accumulated depreciation	(1,669,182)	(1,630,885)	(15,793,188)
	1,001,166	993,154	9,472,665
Intangible assets	13,615	17,917	128,820
Deferred income taxes (Note 11)	51,998	70,008	491,986
	¥1,916,338	¥1,902,642	$18,131,687

See accompanying notes.

LIABILITIES, MINORITY INTERESTS AND STOCKHOLDERS' EQUITY	Millions of yen 2004	Millions of yen 2003	Thousands of U.S. dollars (Note 1) 2004
Current liabilities:			
Short-term borrowings (Note 6)	¥ 149,378	¥ 164,025	$ 1,413,360
Current portion of long-term debt (Note 6)	123,007	154,775	1,163,847
Notes and accounts payable:			
Trade	264,722	239,908	2,504,702
Construction	26,985	31,152	255,322
Unconsolidated subsidiaries and affiliates	52,473	59,339	496,480
Other	30,587	8,194	289,404
	374,767	338,593	3,545,908
Advances from customers	23,828	18,981	225,452
Customers' and employees' deposits	33,057	21,163	312,773
Income and enterprise taxes payable	6,612	4,907	62,560
Provision for restructuring costs	6,515	6,523	61,643
Deferred income taxes (Note 11)	685	996	6,481
Other	48,424	50,262	458,170
Total current liabilities	766,273	760,225	7,250,194
Long-term liabilities:			
Long-term debt (Note 6)	656,094	639,605	6,207,721
Employees' severance and retirement benefits (Note 14)	46,189	54,206	437,023
Deferred income taxes (Note 11)	6,967	7,605	65,919
Other	77,078	117,976	729,284
	786,328	819,392	7,439,947
Contingent liabilities (Note 7)			
Minority interests	33,610	29,887	318,005
Stockholders' equity:			
Common stock (Note 8)	218,163	218,163	2,064,178
Authorized — 6,000,000,000 shares			
Issued — 2,976,070,294 shares in 2004 and 2,974,549,861 in 2003			
Capital surplus (Note 8)	67,975	140,639	643,156
Retained earnings (Accumulated deficit)	31,633	(61,710)	299,300
Land revaluation	1,905	2,422	18,024
Net unrealized holding gains (losses) on securities	20,994	(939)	198,637
Foreign currency translation adjustments	(9,554)	(4,580)	(90,396)
Treasury stock, at cost:			
8,450,664 shares in 2004 and 12,365,783 shares in 2003	(989)	(857)	(9,358)
Total stockholders' equity	330,127	293,138	3,123,541
	¥1,916,338	¥1,902,642	$18,131,687

Consolidated Statements of Income

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Net sales	¥1,219,180	¥1,204,750	$11,535,434
Cost of sales	993,394	1,001,418	9,399,130
Gross profit	225,786	203,332	2,136,304
Selling, general and administrative expenses (Note 10)	125,087	122,278	1,183,527
Operating income	100,699	81,054	952,777
Other income (expenses):			
Interest and dividend income	2,220	2,871	21,005
Interest expense	(25,897)	(29,726)	(245,028)
Seconded employees' salaries net of reimbursement	(19,807)	(18,009)	(187,407)
Foreign exchange loss	(3,840)	(2,845)	(36,333)
Equity in income of unconsolidated subsidiaries and affiliates	6,022	5,586	56,978
Gain on sale of securities	9,307	5,143	88,059
Loss on write-down of securities, investments and golf memberships	(1,241)	(11,280)	(11,742)
Loss on sale or disposal of plant and equipment	(3,213)	(2,142)	(30,400)
Loss on disposal of inventories of discontinued operations	(1,137)	(2,927)	(10,758)
Loss on write-down of plant and equipment	(7,355)	(3,294)	(69,590)
Effect of applying new accounting standard for retirement benefits	(12,765)	(12,798)	(120,778)
Amortization of prior service costs of pension plans	6,975	6,975	65,995
Gain on securities contributed to employees' retirement benefit trust	3,933	—	37,213
Provision for restructuring costs	(4,334)	(811)	(41,007)
Reversal of allowance for special repairs	—	5,913	—
Business transfer gain	—	2,387	—
Special employees' retirement benefits	—	(988)	—
Other, net	(13,833)	(9,105)	(130,882)
	(64,965)	(65,050)	(614,675)
Income before income taxes	35,734	16,004	338,102
Income taxes (Note 11):			
Current	7,636	6,964	72,249
Deferred	4,146	6,513	39,228
	11,782	13,477	111,477
Minority interests in income of subsidiaries	1,886	804	17,845
Net income	¥ 22,066	¥ 1,723	$ 208,780

	Yen		U.S. dollars (Note 1)
Per 1,000 shares	2004	2003	2004
Net income	¥7,438	¥592	$70.38
Diluted net income	7,377	—	69.80
Cash dividends applicable to the year	1,500	—	14.19

See accompanying notes.

Consolidated Statements of Stockholders' Equity

Kobe Steel, Ltd. and Consolidated Subsidiaries

Years ended March 31, 2004 and 2003

		Millions of yen						
	Shares of common stock	Common stock (Note 8)	Capital surplus (Note 8)	Retained earnings (Accumulated deficit) (Note 8)	Land revaluation	Net unrealized holding gains (losses) on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2002	2,867,549,861	¥215,167	¥137,643	¥(63,068)	¥2,437	¥ (73)	¥(11,293)	¥(128)
Net income	—	—	—	1,723	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	6,713	—
Increase in unrealized holding losses on securities	—	—	—	—	—	(866)	—	—
Issuance of new stock for capital increase	107,000,000	2,996	2,996	—	—	—	—	—
Decrease due to changes in consolidated subsidiaries	—	—	—	(22)	—	—	—	—
Bonuses to directors	—	—	—	(22)	—	—	—	—
Decrease due to changes in investees accounted for by the equity method	—	—	—	(406)	—	—	—	—
Increase due to changes in investees accounted for by the equity method	—	—	—	44	—	—	—	—
Effects adjustment to revaluation of land	—	—	—	41	(15)	—	—	—
Treasury stock	—	—	—	—	—	—	—	(729)
Balance at March 31, 2003	2,974,549,861	218,163	140,639	(61,710)	2,422	(939)	(4,580)	(857)
Net income	—	—	—	22,066	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	(4,974)	—
Unrealized holding gains on securities	—	—	—	—	—	21,933	—	—
Transfer from capital surplus	—	—	(72,728)	72,728	—	—	—	—
Gain on sale of treasury stock	—	—	64	—	—	—	—	—
Bonuses to directors	—	—	—	(19)	—	—	—	—
Increase due to merger of consolidated subsidiaries	—	—	—	7	—	—	—	—
Increase due to changes in scope of consolidation	—	—	—	1,373	—	—	—	—
Decrease due to changes in scope of consolidation	—	—	—	(28)	—	—	—	—
Change due to merger of and with consolidated companies	1,520,433	—	—	(2,655)	—	—	—	—
Adjustment to revaluation of land	—	—	—	(129)	(517)	—	—	—
Treasury stock	—	—	—	—	—	—	—	(132)
Balance at March 31, 2004	2,976,070,294	¥218,163	¥ 67,975	¥ 31,633	¥1,905	¥20,994	¥ (9,554)	¥(989)

	Thousands of U.S. dollars (Note 1)						
	Common stock (Note 8)	Capital surplus (Note 8)	Retained earnings (Accumulated deficit) (Note 8)	Land revaluation	Net unrealized holding gains (losses) on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2003	$2,064,178	$1,330,675	$(583,877)	$22,916	$ (8,885)	$(43,334)	$(8,110)
Net income	—	—	208,780	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	(47,062)	—
Unrealized holding gains on securities	—	—	—	—	207,522	—	—
Transfer from capital surplus	—	(688,125)	688,125	—	—	—	—
Gain on sale of treasury stock	—	606	—	—	—	—	—
Bonuses to directors	—	—	(180)	—	—	—	—
Increase due to merger of consolidated subsidiaries	—	—	66	—	—	—	—
Increase due to changes in scope of consolidation	—	—	12,991	—	—	—	—
Decrease due to changes in scope of consolidation	—	—	(265)	—	—	—	—
Change due to merger of and with consolidated companies	—	—	(25,120)	—	—	—	—
Adjustment to revaluation of land	—	—	(1,220)	(4,892)	—	—	—
Treasury stock	—	—	—	—	—	—	(1,248)
Balance at March 31, 2004	$2,064,178	$ 643,156	$ 299,300	$18,024	$198,637	$(90,396)	$(9,358)

See accompanying notes.

Consolidated Statements of Cash Flows

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Cash flows from operating activities:			
Income before income taxes	¥ 35,734	¥ 16,004	$ 338,102
Depreciation	79,245	85,090	749,787
Interest and dividend income	(2,220)	(2,871)	(21,005)
Interest expense	25,897	29,726	245,028
Gain on sale of securities	(9,307)	(5,143)	(88,059)
Loss on write down of securities, investments and golf memberships	1,241	11,280	11,742
Equity in income of unconsolidated subsidiaries and affiliates	(6,022)	(5,586)	(56,978)
Special employees' retirement benefits	—	988	—
Business transfer gain	—	(2,387)	—
Reversal of allowance for special repairs	—	(5,913)	—
Effect of applying new accounting standard for retirement benefits	12,765	12,798	120,778
Gain on securities contributed to employees' retirement benefit trust	(3,933)	—	(37,213)
Amortization of prior service costs of pension plans	(6,975)	(6,975)	(65,995)
Loss on sale or disposal of plant and equipment	3,213	2,142	30,400
Increase in trade receivables from customers	(14,184)	(7,897)	(134,204)
Increase in inventories	(8,696)	(2,937)	(82,278)
Increase in trade payables to customers	11,194	24,988	105,913
Other	15,525	8,957	146,892
Subtotal	133,477	152,264	1,262,910
Cash received for interest and dividends	3,183	2,895	30,116
Cash paid for interest	(25,689)	(30,126)	(243,060)
Cash paid for special employees' retirement benefits	—	(1,653)	—
Cash paid for income taxes	(6,930)	(7,688)	(65,569)
Net cash provided by operating activities	104,041	115,692	984,397
Cash flows from investing activities:			
Purchase of plant, equipment and other assets	(102,953)	(45,011)	(974,103)
Proceeds from sale of plant, equipment and other assets	8,044	44,376	76,109
Purchase of investments in securities	(5,314)	(13,014)	(50,279)
Proceeds from sale of investments in securities	15,565	10,929	147,270
Decrease (increase) in short-term loans receivable	(1,660)	2,630	(15,706)
Long-term loans receivable	(1,416)	(643)	(13,398)
Proceeds from collection of long-term loans receivable	506	1,038	4,788
Net proceeds from sale of a former consolidated subsidiary	4,153	—	39,294
Proceeds from transfer of business	—	20,188	—
Other	(3,306)	6,528	(31,280)
Net cash provided by (used in) investing activities	(86,381)	27,021	(817,305)
Cash flows from financing activities:			
Decrease in short-term borrowings	(11,096)	(51,122)	(104,986)
Proceeds from issuance of long-term debt	126,685	109,960	1,198,647
Repayment of long-term debt	(175,136)	(137,446)	(1,657,072)
Proceeds from issuance of bonds	95,516	500	903,737
Repayment of bonds	(60,526)	(93,348)	(572,675)
Proceeds from issuance of stock	—	5,992	—
Other	(11,197)	(9,533)	(105,942)
Net cash used in financing activities	(35,754)	(174,997)	(338,291)
Effect of exchange rate changes on cash and cash equivalents	(230)	(1,441)	(2,176)
Decrease in cash and cash equivalents	(18,324)	(33,725)	(173,375)
Cash and cash equivalents at beginning of year	81,809	115,292	774,047
Increase in cash and cash equivalents by merger	4,383	—	41,470
Cash and cash equivalents of newly consolidated subsidiaries	635	242	6,008
Cash and cash equivalents at end of year (Note 12)	¥ 68,503	¥ 81,809	$ 648,150

See accompanying notes.

Notes to Consolidated Financial Statements

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2004 and 2003

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles prevailing in the respective countries of domicile. The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of consolidated statements of shareholders' equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying consolidated financial statements.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2004, which was ¥105.69 to U.S. $1. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

In the year ended March 31, 2004, the Company did not adopt early the new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003). The new accounting standard is required to be adopted by the period beginning on April 1, 2005, but the standard does not prohibit earlier adoption. The Company has not decided when it will adopt the new standard. The Company has not yet estimated the effect of adoption of the new standard.

2. Summary of Accounting Policies

(1) Consolidation

The consolidated financial statements include the accounts of the Company and its significant subsidiaries (the "Group"), the management of which is controlled by the Company. For the year ended March 31, 2004, the accounts of 155 (150 in 2003) subsidiaries have been included in the consolidated financial statements. Intercompany transactions and accounts have been eliminated.

Sixty-two (fifty-five in 2003) consolidated subsidiaries are consolidated using a fiscal period ending December 31, which differs from that of the Company. Any material effects occurring during the January 1 to March 31 period are adjusted in these consolidated financial statements.

In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are evaluated using the fair value at the time the Company acquired the control of the respective subsidiaries.

Investments in unconsolidated subsidiaries and affiliates, over which the Company has significant influence, except for insignificant companies, are accounted for by the equity method.

For the year ended March 31, 2004, 52 (51 in 2003) affiliates were accounted for by the equity method.

The difference, if considered significant, between the cost of investments and the equity in their net assets at their dates of acquisition is amortized over estimated years when its amortization period can be estimated, or over 5 years when it can't. Where the difference is small, it is recognized as expense when incurred.

When the Company's share of the net losses of an affiliate exceeds the adjusted cost of the investments, the Company discontinues applying the equity method and the investment is reduced to zero. Such losses in excess of the amounts due from the investee are recorded in other payables, when the losses are expected to be shared by the Company.

(2) Allowance for Doubtful Accounts

The Group provides for doubtful accounts principally at an amount computed based on the actual ratio of bad debts in the past plus the estimated uncollectible amounts based on the analysis of certain individual receivables.

(3) Securities

The Group has no trading securities. Held-to-maturity debt securities are stated at amortized cost. Equity securities issued by subsidiaries and affiliated companies, which are not consolidated or accounted for using the equity method, are stated at moving-average cost. Available-for-sale securities with available fair market values are stated at fair market value. Unrealized gains and unrealized losses on these securities are reported, net of applicable income taxes, as a separate component of stockholders' equity. Realized gains and losses on sale of such securities are computed using moving-average cost based on carrying value at March 31, 2000 or later date of purchase.

Debt securities with no available fair market value are stated at amortized cost, net of the amount considered not collectible. Other securities with no available fair market value are stated at moving-average cost.

If the market value of held-to-maturity debt securities, equity securities issued by unconsolidated subsidiaries and affiliated companies, and available-for-sale securities declines significantly, such securities are stated at fair market value and the difference between fair market value and the carrying amount is recognized as a loss in the period of the decline. If the fair market value of equity securities issued by unconsolidated subsidiaries and affiliated companies, not on the equity method, is not readily available, such securities should be written down to net asset value with a corresponding charge in the statement of operations in the event net asset value declines significantly. In these cases such fair market value or the net asset value will be the carrying amount of the securities at the beginning of the next year.

(4) Inventories

Inventories are valued at cost, as determined principally by the following methods:

The two main works in the Iron and Steel Segment and the three main plants in the Aluminum and Copper Segment:
  Last-in, first-out method
Finished goods and work in process in one plant in the Iron and Steel Segment, the Machinery Segment, the Construction Machinery Segment and the Real Estate Segment:
  Specific identification method
Others:
  Average method

(5) Depreciation

Depreciation of plant and equipment and intangible assets is principally provided using the straight-line method over estimated useful lives.

Useful lives are based mainly on Japanese tax laws. Intangible assets include software for internal use which is amortized over estimated useful lives.

(6) Long-term Construction Contracts
Sales and related costs of certain long-term (over one year) construction contracts of the Company and certain consolidated subsidiaries are recognized by the percentage of completion method.

(7) Bond Issue Expenses and Share Issue Expenses
Bond issue expenses and share issue expenses are charged to expenses as they are incurred by the Company and the domestic consolidated subsidiaries.

(8) Income Taxes
The Company and its domestic consolidated subsidiaries apply deferred tax accounting to recognize tax effects of temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting.

Deferred taxes relating to temporary differences between financial accounting and tax reporting are also recognized by certain foreign consolidated subsidiaries.

(9) Employees' Severance and Retirement Benefits
The Company and its consolidated domestic subsidiaries provide two types of post-employment benefit plans, unfunded lump-sum payment plans and funded non-contributory pension plans.

The Company and its consolidated domestic subsidiaries provide for employees' severance and retirement benefits based on the estimated amounts of projected benefit obligation and the fair value of the plan assets.

The excess of the projected benefit obligation over the total of the fair value of pension assets as of April 1, 2000, the date of adopting a new accounting standard, and the liabilities for severance and retirement benefits recorded as of April 1, 2000 (the "net transition obligation") is being recognized in expenses in equal amounts primarily over 5 years commencing with the year ended March 31, 2001. Prior service costs are recognized in expenses in equal amounts over 4 years. Actuarial gains and losses are recognized in expenses using the straight-line method over mainly 12 years which is within the average of the estimated remaining service lives commencing with the following period.

(10) Land Revaluation
Land used for operations was revaluated by certain consolidated subsidiaries in accordance with the Land Revaluation Law in the years ended March 31, 2002 and 2001. The revaluation amount, net of related taxes, is shown as a separate component of stockholders' equity.

(11) Provision for Restructuring Costs
The provision for restructuring costs is stated at the estimated loss on restructuring of discontinued operations at the end of the fiscal year.

(12) Translation of Foreign Currencies
Receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end rates.

Financial statements of consolidated overseas subsidiaries are translated into Japanese yen at the year-end rate, except stockholders' equity accounts which are translated at historical rates and statement of operations items resulting from transactions with the Company at the rates used by the Company.

The Company and its consolidated domestic subsidiaries report foreign currency translation adjustments in stockholders' equity (and minority interests).

(13) Leases
Finance leases, which do not transfer ownership and do not have bargain purchase provisions, are accounted for in the same manner as operating leases by the Company and consolidated domestic subsidiaries.

(14) Cash and Cash Equivalents
In preparing the consolidated statements of cash flows, cash on hand, readily-available deposits and short-term highly liquid investments with maturities not exceeding three months at the time of purchase are considered to be cash and cash equivalents. See note 12.

(15) Derivatives
The Company and its consolidated domestic subsidiaries state derivative financial instruments at fair value and recognize changes in the fair value as gains or losses unless derivative financial instruments are used for hedging purposes.

If derivative financial instruments are used as hedges and meet certain hedging criteria, the Group defers recognition of gains or losses resulting from changes in fair value of derivative financial instruments until the related losses or gains on the hedged items are recognized.

Also, if interest rate swap contracts are used as hedges and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed.

(16) Consolidated Tax Return
Effective March 31, 2004, the Company files a consolidated tax return with certain domestic subsidiaries.

(17) Accounting Standard for Treasury Stock and Reversal of Statutory Reserves
Effective April 1, 2002, the Company adopted the new accounting standard for treasury stock and reversal of statutory reserves (Accounting Standards Board Statement No. 1, "Accounting Standard for Treasury Stock and Reversal of Statutory Reserves," issued by the Accounting Standards Board of Japan on February 21, 2002).

The effect on net income of the adoption of the new accounting standard was not material.

(18) Net Income per 1,000 Shares
Effective April 1, 2002, the Company adopted the new accounting standard for earnings per share and related guidance (Accounting Standards Board Statement No. 2, "Accounting Standard for Earnings Per Share" and Financial Standards Implementation Guidance No. 4, "Implementation Guidance for Accounting Standard for Earnings Per Share," issued by the Accounting Standards Board of Japan on September 25, 2002).

The effect on earnings per share of the adoption of the new accounting standard was not material.

3. Leases

Original lease obligations as lessee under non-capitalized finance leases at March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Buildings and structures	¥ 474	¥ 264	$ 4,485
Machinery and equipment	60,642	63,222	573,772
	¥61,116	¥63,486	$578,257

Future minimum lease payments as lessee under non-capitalized finance leases at March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Due within one year	¥ 9,280	¥10,481	$ 87,804
Due after one year	17,835	19,219	168,748
	¥27,115	¥29,700	$256,552
Lease expense for the years ended March 31	¥10,555	¥12,148	$ 99,868

Future minimum lease payments as lessee under operating leases at March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Due within one year	¥ 2,847	¥ 2,322	$ 26,937
Due after one year	10,729	8,354	101,514
	¥13,576	¥10,676	$128,451

Leased assets as lessor under finance leases, accounted for as operating leases, at March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Machinery and equipment	¥473	¥584	$4,475
Less accumulated depreciation	(340)	(448)	(3,217)
	¥133	¥136	$1,258

Future minimum lease payments to be received as lessor under finance leases, accounted for as operating leases, at March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Future minimum lease payments receivable:			
Due within one year	¥ 87	¥ 82	$ 823
Due after one year	96	131	908
	¥183	¥213	$1,731
Lease income for the years ended March 31	¥ 90	¥105	$ 852

Future minimum lease payments receivable as lessor under operating leases, at March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Due within one year	¥ 357	¥ 295	$ 3,378
Due after one year	4,679	4,774	44,271
	¥5,036	¥5,069	$47,649

4. Securities

The following tables summarize acquisition costs, book values and fair values of securities with available fair values as of March 31, 2004 and 2003:

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2004			2003			2004
	Book values	Fair values	Difference	Book values	Fair values	Difference	Difference
Held-to-maturity debt securities							
Securities with available fair values exceeding book values:							
Bonds	¥71	¥75	¥4	¥50	¥54	¥ 4	$38
Other securities:							
Bonds	—	—	—	23	23	—	—
	¥71	¥75	¥4	¥73	¥77	¥ 4	$38

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2004			2003			2004
	Acquisition costs	Book (fair) values	Difference	Acquisition costs	Book (fair) values	Difference	Difference
Available-for-sale securities							
Securities with available book values exceeding acquisition costs:							
Equity securities	¥24,949	¥59,099	¥34,150	¥ 7,626	¥10,107	¥2,481	$323,115
Bonds	20	23	3	—	—	—	28
	24,969	59,122	34,153	7,626	10,107	2,481	323,143
Other securities:							
Equity securities	1,331	1,165	(166)	17,886	15,080	(2,806)	(1,571)
Bonds	5	4	(1)	46	33	(13)	(9)
	1,336	1,169	(167)	17,932	15,113	(2,819)	(1,580)
	¥26,305	¥60,291	¥33,986	¥25,558	¥25,220	¥ (337)	$321,563

The following table summarizes book values of securities with no available fair values as of March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Available-for-sale securities:			
Non-listed equity securities	¥20,195	¥17,550	$191,078
Preferred subscription certificate	5,000	5,000	47,308

Available-for-sale securities with maturities and held-to-maturity debt securities mature as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Within one year	¥23	¥ 5	$218
Over one year but within five years	50	73	473

Sales of available-for-sale securities for the years ended March 31, 2004 and 2003 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Sales	¥6,214	¥3,260	$58,795
Gains on sales	3,591	310	33,977
Losses on sales	3	2,028	28

5. Derivative Transactions

The Group enters into forward currency exchange contracts and currency swap agreements to hedge the risk of changes in foreign currency exchange rates associated with transactions denominated in foreign currencies, interest rate swap agreements and cap agreements to hedge the risk related to interest on borrowings, and commodities forward contracts to hedge the risk of movements in market values of aluminum and copper.

The Group does not enter into derivative transactions for speculative purposes. However, the Group may be exposed to losses in case of movements in foreign currency exchange rates, interest rates and commodity market values and is exposed to credit risk in the event of non-performance by counterparties to derivative transactions.

The Company has established policies and controls to manage both market and credit risk, including using only highly-rated banks and trading companies as counterparties, hedging exposed positions, limits on transaction types and amounts, and reporting to management.

Forward currency exchange contracts and swap agreements outstanding at March 31, 2004 and 2003 were as follows:

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2004			2003			2004
	Contracted amount	Fair value	Recognized gain (loss)	Contracted amount	Fair value	Recognized gain (loss)	Recognized gain (loss)
Foreign currency exchange contracts							
To sell foreign currencies U.S. dollars	¥9,042	¥8,797	¥245	¥6,820	¥6,906	¥(86)	$2,318
To buy foreign currencies U.S. dollars	6,831	6,830	(1)	5,073	5,072	(1)	(9)
			¥244			¥(87)	$2,309

Notes: 1. The fair values were estimated by multiplying the contracted foreign currency amount by the forward rate.
2. The above table does not include derivative transactions for which hedge accounting is applied and outstanding foreign exchange contracts which relate to foreign currency receivables and payables that are recorded in the balance sheet by the contracted foreign exchange rates at March 31, 2004 and 2003.

Interest rate swap agreements outstanding at March 31, 2004 and 2003 were as follows:

	Millions of yen				Thousands of U.S. dollars (Note 1)
	2004		2003		2004
	Contracted amount	Recognized gain (loss)	Contracted amount	Recognized gain (loss)	Recognized gain (loss)
Interest rate swap agreements					
To receive floating and pay fixed rates	¥ 2,838	¥ (40)	¥ 3,188	¥ (81)	$ (378)
To receive fixed and pay floating followed by fixed rates	55,300	(2,004)	55,300	(2,317)	(18,961)
		¥(2,044)		¥(2,398)	$(19,339)

Notes: 1. The recognized gains (losses) were estimated by obtaining quotes from counterparty banks.
2. Hedge accounting was not applied to the derivative transactions in the above table at March 31, 2004 and 2003.

6. Short-Term Borrowings and Long-Term Debt

Short-term borrowings at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Bank loans (average rate 1.2% in 2004, and 1.4% in 2003)	¥149,378	¥164,025	$1,413,360

Long-term debt at March 31, 2004 and 2003 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Floating rate (Libor plus 0.95%) notes due 2004	¥ —	¥ 2,139	$ —
Floating rate (20-year swap rate minus 2-year swap rate plus 1.2% per annum subject to minimum interest rate of 0.0% per annum) notes due 2007	10,000	10,000	94,616
1.12% to 3.58% yen bonds, due 2003 through 2012	282,160	272,900	2,669,695
Zero coupon convertible bond, due 2006	30,000	—	283,849
Euro medium-term notes, due 2003 through 2005	3,169	6,147	29,984
Loans, principally from banks and insurance companies	453,772	503,194	4,293,424
	779,101	794,380	7,371,568
Less current portion	123,007	154,775	1,163,847
	¥656,094	¥639,605	$6,207,721

The aggregate annual maturities of long-term debt at March 31, 2004 were as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars (Note 1)
2005	¥123,007	$1,163,847
2006	102,291	967,840
2007	128,731	1,218,005
2008 and thereafter	425,072	4,021,876
	¥779,101	$7,371,568

At March 31, 2004 and 2003, assets pledged as collateral for short-term borrowings and long-term debt were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Assets pledged as collateral			
Plant and equipment-net of accumulated depreciation	¥300,849	¥251,715	$2,846,523
Other assets	15,510	17,512	146,750
	¥316,359	¥269,227	$2,993,273
Secured short-term borrowings and long-term debt			
Bonds (includes due within 1 year)	¥ 3,000	¥ 3,265	$ 28,385
Short-term borrowings	23,880	23,538	225,944
Long-term borrowings (includes due within 1 year)	144,444	98,499	1,366,676
Other debt	10	99	95
	¥171,334	¥125,401	$1,621,100

At March 31, 2004 and 2003, included in the assets pledged as collateral are assets that are promised to be pledged as collateral for short-term borrowings, long-term borrowings and guarantee of loans were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Short-term borrowings	¥ 9,300	¥10,848	$ 87,993
Long-term borrowings	45,492	61,388	430,429
Guarantee of loans	881	—	8,336
	¥55,673	¥72,236	$526,758

7. Contingent Liabilities

At March 31, 2004 and 2003 the Company and its consolidated domestic subsidiaries were contingently liable as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Trade notes discounted	¥ 3,412	¥ 7,977	$ 32,283
Trade notes endorsed	1,943	2,140	18,384
Guarantees of loans			
Related parties	5,459	6,948	51,651
Others	1,744	3,798	16,501
The contingent liability concerning the debt fulfillment underwriting contract of a corporate bond	27,500	25,000	260,195
	¥40,058	¥45,863	$379,014

Guarantees of loans include contingent guarantees and letters of awareness of ¥1,469 million ($13,899 thousand).

8. Stockholders' Equity

(1) Common stock and Capital surplus

Under the Commercial Code of Japan, the entire amount of the issue price of shares is required to be accounted for as capital, although a company may, by resolution of its Board of Directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

(2) Retained earnings

The Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earnings reserve until the total amount of legal earnings reserve and additional paid-in capital equals 25% of common stock.

The total amount of legal earnings reserve and additional paid-in capital of the Company has reached 25% of common stock, and therefore the Company is not required to provide any more legal earnings reserve. The legal earnings reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalized by resolution of the Board of Directors.

On condition that the total amount of legal earnings reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for distribution by the resolution of shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Commercial Code.

9. Research and Development Expenses

Research and development expenses, included in cost of sales and selling, general, and administrative expenses, for the year ended March 31, 2004 were ¥16,929 million ($160,176 thousand) and ¥17,797 million for the year ended March 31, 2003.

10. Selling, General and Administrative Expenses

Selling, general and administrative expenses for the years ended March 31, 2004 and 2003 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Freight	¥ 31,248	¥ 30,321	$ 295,657
Employees' compensation	29,403	29,142	278,200
Research and development	5,898	5,430	55,805
Depreciation	3,102	3,084	29,350
Other	55,436	54,301	524,515
	¥125,087	¥122,278	$1,183,527

11.Income Taxes

Significant components of the Group's deferred income tax assets and liabilities of March 31, 2004 and 2003 were as follows:

	Millions of yen	Thousands of U.S. dollars (Note 1)
	2004	2004
Deferred income tax assets		
Loss carryforwards	¥ 31,316	$ 296,301
Unrealized profit	20,709	195,941
Loss on write down of securities	20,076	189,952
Employees' retirement benefits	19,389	183,452
Other	30,887	292,240
Total deferred income tax assets	122,377	1,157,886
Valuation allowance	(18,786)	(177,746)
Deferred income tax assets	103,591	980,140
Deferred income tax liabilities		
Net unrealized holding gains (losses) on securities	13,023	123,219
Gain on merger	12,002	113,558
Other	11,439	108,232
Total deferred income tax liabilities	36,464	345,009
Net deferred income tax assets	¥ 67,127	$ 635,131

	Millions of yen
	2003
Deferred income tax assets	
Loss carryforwards	¥ 44,554
Unrealized profit	20,486
Loss on write down of securities	12,844
Employees' retirement benefits	19,559
Other	27,059
Total deferred income tax assets	124,502
Valuation allowance	(17,696)
Deferred income tax assets	106,806
Deferred income tax liabilities	
Gain on merger	12,666
Land Revaluation	3,156
Other	8,054
Total deferred income tax liabilities	23,876
Net deferred income tax assets	¥ 82,930

Significant items in the reconciliations of the aggregate statutory income tax rate to the effective income tax rate for the years ended March 31, 2004 and 2003 were as follows:

	2004
Aggregate statutory income tax rate in Japan	42.0%
Non-deductible entertainment expenses	3.9
Loss carryforwards on merger	(8.9)
Equity in income of unconsolidated subsidiaries and affiliates	(7.1)
Other	3.1
Effective income tax rate	33.0%

	Millions of yen
	2003
Aggregate statutory income tax rate in Japan	42.0%
Non-deductible entertainment expenses	20.2
Reduction of carry-forward tax assets due to tax rate changes	18.4
Revision of tax effect due to unrealized gains in fixed assets	17.7
Equity in income of unconsolidated subsidiaries and affiliates	(14.7)
Other	0.6
Effective income tax rate	84.2%

The aggregate statutory income tax rate will be reduced for the years commencing on April 1, 2004 or later due to the revised local tax law. At March 31, 2003, the Company and consolidated domestic subsidiaries applied the reduced aggregate statutory income tax rate of 40.6 % for calculating deferred tax assets and liabilities that are expected to be recovered or settled in the years commencing on April 1, 2004 or later. As a result, deferred taxes assets decreased by ¥2,875 million, provision for deferred income taxes increased by ¥2,949 million, net unrealized holding losses on securities increased by ¥5 million and land revaluation increased by ¥79 million at March 31, 2003 compared with what would be reported using the currently applicable tax rate of 42.0%.

12. Consolidated Statements of Cash Flows

The reconciliations of cash and cash equivalents in the cash flow statements and balance sheets are as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
March 31, 2004 and 2003	2004	2003	2004
Cash and cash equivalents (balance sheets)	¥69,235	¥82,419	$655,076
Time deposits (due over 3 months)	(732)	(610)	(6,926)
Cash and cash equivalents (cash flow statements)	¥68,503	¥81,809	$648,150

Non-cash transactions-Finance leases calling for total payments of ¥23,999 million were entered into for the year ended March 31, 2003.

13. Related Party Transactions

Net sales include sales to Shinsho Corporation, which is an affiliate of the Company, of ¥152,195 million ($1,440,013 thousand) and ¥146,161 million for the years ended March 31, 2004 and 2003, respectively.

14. Employees' Severance and Retirement Benefits

The liability for severance and retirement benefits included in the liability section of the consolidated balance sheets as of March 31, 2004 and 2003 consists of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Projected benefit obligation	¥(217,118)	¥(221,360)	$(2,054,291)
Fair value of pension assets	163,900	118,570	1,550,762
Unrecognized net transition obligation	14,056	26,842	132,993
Unrecognized actuarial differences	14,879	47,754	140,780
Unrecognized prior service costs	(6,975)	(13,950)	(65,995)
Prepaid pension cost	(14,931)	(12,062)	(141,272)
Liability for severance and retirements benefits	¥ (46,189)	¥ (54,206)	$ (437,023)

Included in the consolidated statements of income for the years ended March 31, 2004 and 2003 are severance and retirement benefit expenses comprised of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2004	2003	2004
Service costs – benefits earned during the year	¥ 6,787	¥ 6,758	$ 64,216
Interest cost on projected benefit obligation	5,218	6,130	49,371
Expected return on plan assets	(2,738)	(3,095)	(25,906)
Amortization of net transition obligation	12,873	12,813	121,800
Amortization of actuarial differences	4,110	1,741	38,887
Amortization of prior service costs	(6,975)	(6,975)	(65,995)
Severance and retirement benefit expenses	¥19,275	¥17,372	$182,373

Notes: 1. The estimated amount of all retirement benefits to be paid at future retirement dates is allocated equally to each service year using the estimated number of total service years.
2. The discount rate is mainly 2.5% in 2004 and 2003 and the rate of expected return on plan assets used by the Group is mainly 3.1% in 2004 and 2003.

15. Segment Information

(1) Industry Segment

The Group's operations are divided into six principal business segments:

Iron and Steel, Aluminum and Copper, Machinery, Construction Machinery, Real Estate, and Other Businesses. Business segment information was as follows:

Years ended March 31, 2004 and 2003		Millions of yen 2004	Millions of yen 2003	Thousands of U.S. dollars (Note 1) 2004
Sales to outside customers:	Iron and Steel	¥ 536,760	¥ 511,750	$ 5,078,626
	Aluminum and Copper	242,532	247,330	2,294,749
	Machinery	186,163	209,280	1,761,406
	Construction Machinery	181,580	156,929	1,718,043
	Real Estate	39,036	38,293	369,344
	Other Businesses	33,109	41,168	313,266
	Consolidated net sales	1,219,180	1,204,750	11,535,434
Inter-segment sales:	Iron and Steel	11,583	11,725	109,594
	Aluminum and Copper	783	710	7,408
	Machinery	10,104	6,936	95,600
	Construction Machinery	2,407	470	22,774
	Real Estate	4,117	4,297	38,954
	Other Businesses	12,128	15,201	114,751
		41,122	39,339	389,081
Total sales:	Iron and Steel	548,342	523,475	5,188,211
	Aluminum and Copper	243,316	248,040	2,302,167
	Machinery	196,267	216,216	1,857,006
	Construction Machinery	183,987	157,399	1,740,817
	Real Estate	43,153	42,590	408,298
	Other Businesses	45,237	56,369	428,016
		1,260,302	1,244,089	11,924,515
Operating costs and expenses:	Iron and Steel	485,232	474,707	4,591,087
	Aluminum and Copper	228,387	235,637	2,160,914
	Machinery	194,841	211,993	1,843,514
	Construction Machinery	175,920	153,330	1,664,490
	Real Estate	39,391	38,261	372,703
	Other Businesses	37,137	50,663	351,377
	Eliminations	(42,427)	(40,895)	(401,428)
	Consolidated operating costs and expenses	1,118,481	1,123,696	10,582,657
Operating income:	Iron and Steel	63,110	48,768	597,124
	Aluminum and Copper	14,929	12,403	141,253
	Machinery	1,425	4,223	13,483
	Construction Machinery	8,067	4,069	76,327
	Real Estate	3,763	4,329	35,604
	Other Businesses	8,100	5,706	76,639
	Eliminations	1,305	1,556	12,347
	Consolidated operating income	100,699	81,054	952,777
Assets:	Iron and Steel	934,659	908,093	8,843,401
	Aluminum and Copper	232,833	241,134	2,202,980
	Machinery	204,521	229,269	1,935,103
	Construction Machinery	195,046	172,521	1,845,454
	Real Estate	114,780	121,370	1,086,006
	Other Businesses	43,132	71,702	408,099
	Corporate and Eliminations	191,367	158,553	1,810,644
	Total	1,916,338	1,902,642	18,131,687
Depreciation:	Iron and Steel	48,672	54,606	460,517
	Aluminum and Copper	12,675	11,920	119,926
	Machinery	9,918	7,941	93,840
	Construction Machinery	2,563	3,001	24,250
	Real Estate	1,765	2,044	16,700
	Other Businesses	1,504	3,308	14,230
	Corporate and Eliminations	2,148	2,270	20,324
	Total	79,245	85,090	749,787
Capital expenditures:	Iron and Steel	85,059	27,410	804,797
	Aluminum and Copper	8,076	7,685	76,412
	Machinery	3,945	3,874	37,326
	Construction Machinery	2,878	1,697	27,231
	Real Estate	2,784	1,532	26,341
	Other Businesses	1,075	1,327	10,171
	Corporate and Eliminations	1,094	446	10,351
	Total	¥ 104,911	¥ 43,971	$ 992,629

Corporate assets of ¥292,039 million ($2,763,166 thousand) and ¥287,352 million at March 31, 2004 and 2003, respectively, are comprised principally of bank and time deposits and assets of administration departments of the Company.

(2) Geographic Area

Year ended March 31, 2003		Millions of yen 2003
Sales to outside customers:	Japan	¥1,115,160
	Asia	38,314
	North America	16,394
	Other areas	34,882
	Total	1,204,750
Inter-segment sales:	Japan	30,559
	Asia	1,111
	North America	2,949
	Other areas	208
	Total	34,827
Total sales:	Japan	1,145,719
	Asia	39,425
	North America	19,343
	Other areas	35,090
	Total	1,239,577
Operating costs and expenses:	Japan	1,069,708
	Asia	36,451
	North America	19,415
	Other areas	33,606
	Eliminations	(35,484)
	Total	1,123,696
Operating income:	Japan	76,011
	Asia	2,974
	North America	(72)
	Other areas	1,484
	Eliminations	657
	Total	81,054
Assets:	Japan	1,534,963
	Asia	36,661
	North America	41,215
	Other areas	42,733
	Corporate and eliminations	247,070
	Total	¥1,902,642

Principal countries in each segment are:

Asia	Singapore, Malaysia, Thailand, China
North America	United States, Canada
Other areas	Netherlands, Australia

Corporate assets of ¥287,352 million at March 31, 2003, are comprised principally of bank and time deposits and assets of administration departments of the Company.

For the year ended March 31, 2004, neither sales nor assets of overseas consolidated subsidiaries are of significant materiality (domestic sales and assets are more than 90% of consolidated sales and consolidated total assets) and therefore, geographic segment information is not presented.

(3) Overseas Sales

Overseas sales for the years ended March 31, 2004 and 2003 were as follows:

		Percentages of 2004 consolidated net sales	Millions of yen		Thousands of U.S. dollars (Note 1)
			2004	2003	2004
Overseas Sales:	Asia	14.7%	¥179,060	¥160,215	$1,694,201
	North America	—	—	33,916	—
	Other areas	7.9	96,887	54,804	916,709
	Total	22.6%	¥275,947	¥248,935	$2,610,910

Overseas sales consisted of export sales of the Company and domestic consolidated subsidiaries, and sales of overseas consolidated subsidiaries excluding sales to Japan.

Principal countries and areas in each segment are:

Asia	China, Taiwan, South Korea, Malaysia, Indonesia
North America	United States, Canada (in 2003)
Other areas	Australia, Italy (and United States and Canada in 2004)

For year ended March 31, 2004, North America area was not of significant materiality and therefore, information on North America is included in Other areas.

Independent Auditors' Report

To the Board of Directors of
Kobe Steel, Ltd.:

We have audited the accompanying consolidated balance sheets of Kobe Steel, Ltd. and consolidated subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity and cash flows for each of the years then ended, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kobe Steel, Ltd. and subsidiaries as of March 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in Japan.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2004 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

AZSA & Co.

Osaka, Japan
June 25, 2004