

Kobe Steel Interim Report 2005

*Six Months Ended
September 30*

KOBELCO
 **KOBE STEEL, LTD.**

Message from the President

Japan's economy continued to improve in the first half of fiscal 2005, ended September 30, 2005. Demand in capital investment and personal spending was robust owing to higher corporate profitability. In addition, the U.S. and Asian economies, including China, continued to be strong.

On this background, Kobe Steel's consolidated net sales rose ¥104.8 billion to ¥789.5 billion, in comparison to the same period last year. Operating income increased ¥40.8 billion to ¥108.2 billion, and pretax ordinary income went up ¥40.3 billion to ¥85.4 billion. Kobe Steel took an extraordinary loss on the separation of the real estate business from the parent company, effective October 1. The loss arising from a fire at Kakogawa Works in May was also taken as an extraordinary loss. This led to aftertax net income of ¥36.7 billion.

<Net Sales>	(billions of yen)		
	FY2005 First Half	FY2004 First Half	%
Iron & Steel	366.4	294.0	24.6%
Wholesale Power Supply	31.0	27.5	13.0%
Aluminum & Copper	152.4	145.9	4.4%
Machinery	113.8	91.9	23.8%
Construction Machinery	106.4	106.6	(0.2%)
Real Estate	17.2	16.9	1.9%
Electronic Materials & Other Businesses	28.2	25.3	11.5%
Eliminations	(26.0)	(23.4)	-
Total	789.5	684.7	15.3%

<Operating Income>			
	FY2005 First Half	FY2004 First Half	%
Iron & Steel	69.0	34.9	97.5%
Wholesale Power Supply	8.3	9.6	(13.5%)
Aluminum & Copper	12.2	8.5	44.3%
Machinery	3.1	0.2	1,369.7%
Construction Machinery	3.6	4.4	(17.6%)
Real Estate	1.4	1.7	(17.0%)
Electronic Materials & Other Businesses	8.5	6.5	31.2%
Eliminations	2.0	1.6	-
Total	108.2	67.4	60.6%

Iron & Steel

Domestic steel demand for medium- and high-grade steel products, used mainly in the automotive and shipbuilding industries, was quite strong in the period under review. However, the supply-demand balance worsened as market conditions for general steel products weakened due to China's rising crude steel capacity, leading to a softening in the market. To maintain export prices in this situation, Kobe Steel decreased shipments of steel products, although overall shipments rose over the same period. Kobe Steel was able to steadily increase steel prices owing to the tight supply-demand situation for medium- and high-grade steel products.

Domestic demand for welding consumables was firm mainly in the automotive and shipbuilding industries. Overseas, demand from the automotive and shipbuilding industries and energy projects was strong.

As a result, segment sales increased 24.6% to ¥366.4 billion, and operating income increased by ¥34.1 billion to ¥69.0 billion.

Wholesale Power Supply

Segment sales rose 13.0% to ¥31 billion owing to an increase in the electricity price due to the rise in coal prices. Due to equipment inspection to maintain stable operation, operating income decreased by ¥1.3 billion to ¥8.3 billion.

Aluminum & Copper

Shipments of rolled aluminum products decreased over the same period last year. Domestic sales volume increased owing to higher shipments of aluminum can stock, a major product, due to further use in aluminum bottle cans, but exports fell considerably, which led to a decrease in overall can stock shipments. Due to higher demand in the previous year's summer season for aluminum fin stock used in air conditioners, shipments of fin stock decreased in the half-year period. Demand for aluminum extrusions was also weak.

Demand for rolled copper products was similar to the same period last year. Copper strip for automotive terminals continued to be strong, but strip for semiconductors entered an adjustment phase. Demand for copper tube for air conditioners decreased in the first half of fiscal 2005, a reaction to the hot summer last year, and exports also fell.

Although sales volume decreased, higher ingot prices and an improvement in the product mix enabled segment sales to increase 4.4% to ¥152.4 billion. Operating income increased ¥3.7 billion to ¥12.2 billion.

Machinery

Domestic orders increased 3.6% to ¥68.5 billion due to a rise in standard compressors used in capital investments. Overseas orders rose 32.8% to ¥41.8 billion. Orders were strong for non-standard rotating machinery used in the energy, petroleum and gas industries, as well as for tire machinery. Orders from the energy field for such products as pressure vessels were also robust. As a result, total orders increased 13.0% to ¥110.3 billion, and the backlog of orders was ¥244.7 billion.

Owing to strong orders, machinery segment sales went up 23.8% to ¥113.8 billion in the half-year period. Operating income increased ¥2.9 billion to ¥3.1 billion.

Construction Machinery

The Japanese market for construction machinery was strong due to the rise in capital investment and reduced inventories in Japan brought about by high exports of used machines. Overseas, Indonesia entered an adjustment phase, but demand in Southeast Asia was firm. Europe and North America were on an expansion trend, and the falling Chinese market had bottomed out. As a result, overall demand for construction machinery was firm.

Although the demand environment was in general favorable, the downturn in the Chinese market had a considerable effect. As a result, construction machinery sales dipped 0.2% to ¥106.4 billion, and operating income went down ¥0.8 billion, versus the same period last year, to ¥3.6 billion.

Real Estate

The number of new condominiums sold in the Tokyo metropolitan area gradually increased owing to the improved economy. However, in the Osaka metropolitan area, the number of units sold was flat.

As the number of housing starts and property handovers were low, segment sales were flat at ¥17.2 billion. Operating income went down ¥0.3 billion to ¥1.4 billion.

Electronic Materials & Other Businesses

Due to continued strong demand for target material used in LCDs, segment sales increased 11.5% to ¥28.2 billion and operating income rose ¥2.0 billion to ¥8.5 billion.

Outlook

In the second half of the fiscal year, Japan's economy is forecast to continue on an expansion trend. Although there is concern over a slowdown in the U.S. economy and rising inflation brought about by rising oil prices, domestic capital investment and personal spending are expected to be strong.

In the Kobe Steel Group's Iron & Steel segment, although the market for general steel products is expected to continue being soft, demand for medium- and high-grade steel products from domestic manufacturers is forecast to be robust. In the Machinery segment, orders for compressors, rubber and tire machinery, and energy-related equipment are also anticipated to be firm. Based on these business conditions, Kobe Steel is growing its "Only One, Number One" distinctive products and implementing strategic capital investments that will enable it to further improve its business competitiveness.

On September 1, 2005, Kobe Steel marked its centennial anniversary. Looking at the next 100 years, we are focusing on manufacturing. With an unquenchable spirit, we will continue to supply high-quality products and services that meet the numerous needs of our customers and aim to further raise our corporate value.

December 2005



Yasuo Inubushi
President and CEO

(* Ordinary income is operating income after adjustments of net financial revenue and net expenses generated on a regular basis, including seconded employees' salaries net of reimbursement.)

Consolidated Interim Balance Sheets

At September 30, 2005 and 2004 (unaudited)

Assets	Thousands of U.S. dollars (Note 1)			Liabilities, Minority Interests and Stockholders' Equity	Thousands of U.S. dollars (Note 1)		
	Millions of yen 2005	2004	2005		Millions of yen 2005	2004	2005
<i>Current assets:</i>				<i>Current liabilities:</i>			
Cash and time deposits	¥ 84,402	¥ 66,334	\$ 745,666	Short-term borrowings	¥ 131,351	¥ 122,555	\$ 1,160,447
Trade notes and accounts receivable				Current portion of long-term debt	143,543	124,145	1,268,160
Unconsolidated subsidiaries and affiliates	68,954	69,419	609,188	Trade notes and accounts payable			
Other	213,208	197,292	1,883,629	Unconsolidated subsidiaries and affiliates	63,327	46,680	559,475
Allowance for doubtful accounts	(1,025)	(1,498)	(9,055)	Other	333,483	288,580	2,946,223
	281,137	265,213	2,483,762		396,810	335,260	3,505,698
Inventories	292,245	251,153	2,581,898	Allowances	16,595	13,444	146,612
Other	78,501	85,465	693,533	Other	197,394	177,063	1,743,917
Total current assets	736,285	668,165	6,504,859	Total current liabilities	885,693	772,467	7,824,834
<i>Investments and other assets:</i>				<i>Long-term liabilities:</i>			
Investments in securities	183,204	115,668	1,618,553	Long-term debt	490,471	615,638	4,333,165
Other	88,219	116,950	779,389	Employees' severance and retirement benefits	51,646	48,060	456,277
Allowance for doubtful accounts	(8,427)	(9,866)	(74,450)	Other	64,663	73,555	571,279
	262,996	222,752	2,323,492		606,780	737,253	5,360,721
<i>Plant and equipment:</i>				<i>Minority interests</i>	35,836	34,867	316,601
Land	196,846	216,791	1,739,076	<i>Contingent liabilities</i> (Note 2)			
Buildings and structures	623,404	617,399	5,507,588	<i>Stockholders' equity:</i>			
Machinery and equipment	1,843,196	1,832,943	16,284,089	Common stock	218,315	218,163	1,928,748
Other	25,397	19,609	224,375	Authorized-6,000,000,000 shares Issued - 2,977,460,202 shares in 2005 and 2,976,070,294 in 2004			
	2,688,843	2,686,742	23,755,129	Capital surplus	68,132	67,975	601,926
Less accumulated depreciation	(1,741,359)	(1,706,392)	(15,384,389)	Retained earnings	109,428	45,996	966,764
	947,484	980,350	8,370,739	Land revaluation	432	966	3,817
<i>Intangible assets</i>	14,721	13,853	130,056	Net unrealized holding gains on securities	48,843	18,092	431,513
	¥ 1,961,486	¥ 1,885,120	\$ 17,329,146	Foreign currency translation adjustments	(10,678)	(9,247)	(94,337)
				Treasury stock, at cost	(1,295)	(1,412)	(11,441)
				Total stockholders' equity	433,177	340,533	3,826,990
					¥ 1,961,486	¥ 1,885,120	\$ 17,329,146

Consolidated Interim Statements of Income

Six months ended September 30, 2005 and 2004 (unaudited)

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
	2005	2004	2005
<i>Net sales</i>	¥ 789,503	¥ 684,743	\$ 6,975,024
<i>Cost of sales</i>	608,011	549,563	5,371,596
Gross profit	181,492	135,180	1,603,428
<i>Selling, general and administrative expenses</i>	73,257	67,783	647,204
Operating income	<u>108,235</u>	<u>67,397</u>	<u>956,224</u>
<i>Other income (expenses):</i>			
Interest and dividend income	2,124	1,555	18,765
Interest expense	(10,639)	(12,316)	(93,992)
Seconded employees' salaries net of reimbursement	(9,208)	(9,094)	(81,350)
Equity in income of unconsolidated subsidiaries and affiliates	5,038	4,182	44,509
Gain on sale of securities	-	2,676	-
Loss on impairment for fixed assets	-	(9,075)	-
Loss on separation of real estate business	(14,101)	-	(124,578)
Casualty loss	(4,540)	-	(40,110)
Effect of applying new accounting standard for retirement benefits	-	(6,368)	-
Amortization of prior service credits of pension plans	-	3,488	-
Other, net	(10,135)	(7,538)	(89,540)
<i>Income before income taxes</i>	<u>66,774</u>	<u>34,907</u>	<u>589,928</u>
<i>Income taxes:</i>			
Current	23,322	6,665	206,043
Deferred	5,236	11,966	46,258
	<u>28,558</u>	<u>18,631</u>	<u>252,301</u>
<i>Minority interests in income of subsidiaries</i>	(1,504)	(586)	(13,287)
<i>Net income</i>	<u>¥ 36,712</u>	<u>¥ 15,690</u>	<u>\$ 324,340</u>
	Yen		U.S. dollars (Note 1)
<i>Per share</i>	2005	2004	2005
<i>Net Income</i>	¥ 12.37	¥ 5.29	\$ 0.11
<i>Diluted net income</i>	11.81	5.04	0.10

See accompanying notes.

Consolidated Interim Statements of Cash Flows

Six months ended September 30, 2005 and 2004 (unaudited)

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2005	2004	2005
<i>Cash flows from operating activities</i>			
Income before income taxes	¥ 66,774	¥ 34,907	\$ 589,928
Depreciation	39,246	40,583	346,727
Interest and dividend income	(2,124)	(1,555)	(18,765)
Interest expense	10,639	12,316	93,992
Gain on sale of securities	-	(2,676)	-
Equity in income of unconsolidated subsidiaries and affiliates	(5,038)	(4,182)	(44,509)
Loss on separation of real estate business	14,101	-	124,578
Casualty loss	3,271	-	28,898
Loss on impairment of fixed assets	-	9,075	-
Effect of applying new accounting standard for retirement benefits	-	6,368	-
Amortization of prior service credits of pension plans	-	(3,488)	-
Loss on disposal of plant and equipment	1,433	2,472	12,660
Decrease in trade receivables from customers	13,890	22,490	122,714
Increase in inventories	(39,585)	(15,996)	(349,721)
Increase in trade payables to customers	28,857	16,704	254,943
Other	270	(2,030)	2,386
Subtotal	<u>131,734</u>	<u>114,988</u>	<u>1,163,831</u>
Cash received for interest and dividends	3,810	2,314	33,660
Cash paid for interest	(10,988)	(12,812)	(97,076)
Cash paid for income taxes	(19,631)	(4,014)	(173,434)
Net cash provided by operating activities	<u>104,925</u>	<u>100,476</u>	<u>926,981</u>
<i>Cash flows from investing activities</i>			
Purchase of plant, equipment and other assets	(34,415)	(23,374)	(304,046)
Proceeds from sale of plant, equipment and other assets	478	2,225	4,223
Purchase of investments in securities	(5,780)	(1,969)	(51,064)
Proceeds from sale of investments in securities	1,456	3,568	12,863
Decrease (increase) in short-term loans receivable	39	16	345
Long-term loans receivable	(417)	(193)	(3,684)
Proceeds from collection of long-term loans	107	661	945
Other	(87)	(133)	(769)
Net cash used in investing activities	<u>(38,619)</u>	<u>(19,199)</u>	<u>(341,187)</u>
<i>Cash flows from financing activities</i>			
Decrease in short-term borrowings	(5,949)	(39,694)	(52,558)
Proceeds from commercial paper	17,000	10,000	150,190
Proceeds from issuance of long-term debt	2,290	16,970	20,232
Repayment of long-term debt	(46,523)	(52,588)	(411,017)
Proceeds from issuance of bonds	10,000	10,000	88,347
Repayment of bonds	(25,378)	(19,720)	(224,207)
Cash dividends	(8,841)	(4,405)	(78,108)
Other	(8,327)	(5,755)	(73,567)
Net cash used in financing activities	<u>(65,728)</u>	<u>(85,192)</u>	<u>(580,688)</u>
<i>Effect of exchange rate changes on cash and cash equivalents</i>			
	<u>969</u>	<u>56</u>	<u>8,561</u>
<i>Increase (decrease) in cash and cash equivalents</i>	<u>1,547</u>	<u>(3,859)</u>	<u>13,667</u>
<i>Cash and cash equivalents at the beginning of the six months</i>	<u>80,592</u>	<u>68,503</u>	<u>712,007</u>
<i>Cash and cash equivalents of newly consolidated subsidiaries</i>	<u>1,578</u>	<u>912</u>	<u>13,941</u>
<i>Cash and cash equivalents at the end of the six months</i>	<u>¥ 83,717</u>	<u>¥ 65,556</u>	<u>\$ 739,615</u>

See accompanying notes.

Consolidated Interim Statements of Stockholders' Equity

Six months ended September 30, 2005(unaudited)

	Millions of yen							
	Shares of common stock	Common stock	Capital surplus	Retained earnings	Land revaluation	Net unrealized holding gains on securities	Foreign currency transaction adjustments	Treasury stock
Balance at April 1, 2005	2,976,070,294	¥ 218,163	¥ 67,980	¥ 81,634	¥ 409	¥ 25,376	¥(13,150)	¥(1,199)
Net income	—	—	—	36,712	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	2,472	—
Increase in unrealized holding gains on securities	—	—	—	—	—	23,467	—	—
Cash dividends	—	—	—	(8,922)	—	—	—	—
Conversion of convertible bond	1,389,908	152	152	—	—	—	—	—
Bonuses to directors	—	—	—	(23)	—	—	—	—
Increase due to changes in scope of consolidation	—	—	—	41	—	—	—	—
Decrease due to changes in scope of consolidation	—	—	—	(14)	—	—	—	—
Adjustment to revaluation of land	—	—	—	—	23	—	—	—
Treasury stock	—	—	—	—	—	—	—	(96)
Balance at September 30, 2005	2,977,460,202	¥ 218,315	¥ 68,132	¥ 109,428	¥ 432	¥ 48,843	¥ (10,678)	¥ (1,295)

Thousands of U.S. dollars (Note 1)

	Common stock	Capital surplus	Retained earnings	Land revaluation	Net unrealized holding gains on securities	Foreign currency transaction adjustments	Treasury stock
Balance at April 1, 2005	\$ 1,927,405	\$ 600,583	\$ 721,212	\$ 3,613	\$ 224,189	\$ (116,176)	\$ (10,593)
Net income	—	—	324,340	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	21,839	—
Increase in unrealized holding gains on securities	—	—	—	—	207,324	—	—
Cash dividends	—	—	(78,823)	—	—	—	—
Conversion of convertible bond	1,343	1,343	—	—	—	—	—
Bonuses to directors	—	—	(203)	—	—	—	—
Increase due to changes in scope of consolidation	—	—	362	—	—	—	—
Decrease due to changes in scope of consolidation	—	—	(124)	—	—	—	—
Adjustment to revaluation of land	—	—	—	204	—	—	—
Treasury stock	—	—	—	—	—	—	(848)
Balance at September 30, 2005	\$ 1,928,748	\$ 601,926	\$ 966,764	\$ 3,817	\$ 431,513	\$ (94,337)	\$ (11,441)

See accompanying notes.

Notes to Consolidated Interim Financial Statements

September 30, 2005 (Unaudited)

1. Presentation of Financial Statements

Kobe Steel, Ltd. (the "Company") and its consolidated domestic subsidiaries maintain their official accounting records in Japanese yen and in accordance with the provisions set forth in the Japanese Commercial Code and accounting principles generally accepted in Japan ("Japanese GAAP"). 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 interim financial statements should be read in conjunction with the financial statements and related notes included in the Annual Report of the Company to stockholders for the year ended March 31, 2005.

Certain accounting principles generally accepted in Japan are different from International Accounting Standards and standards in other countries in certain respects as to application and disclosure requirements.

The accompanying interim financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of statements of stockholders' equity) from the consolidated interim 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.

The translation of the Japanese yen amounts into U.S. dollars is included solely for the convenience of readers outside Japan, using the prevailing exchange rate at September 30, 2005, which was ¥113.19 to U.S. \$1.00. The convenience translation 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.

Commencing in fiscal 2005, ending March 31, 2006, the company changed the method of evaluating inventories in the Iron and Steel, Wholesale Power Supply, and

Aluminum and Copper segments from the "last-in, first-out method" to the "average method" in order to present the financial position more appropriately.

As the market prices of raw materials such as iron ore, coal, aluminum and copper have changed rapidly, the difference between the value of inventories calculated under the last-in, first-out method and the market prices of the raw materials tend to differ considerably. In this situation, this change has been executed in order to reflect the change of the market prices of the raw materials on the value of inventories on the Balance Sheet.

As a result, both operating income and income before income taxes for the first half of fiscal 2005, ended September 30, 2005 increased by ¥14,587 million (\$128.9 million).

2. Contingent Liabilities

At September 30, 2005, the Company and its consolidated subsidiaries were contingently liable for guarantees of loans of ¥4,821 million (\$42.6 million). This figure includes contingent guarantees and letters of awareness of ¥802 million (\$7.1 million).

3. Subsequent Event

The company issued new shares as all stock acquisition rights of Zero Coupon Convertible bonds due 2006 were exercised from October 1 to November 21, 2005. Details are as follows:

- (1) Number of new shares : Common stock 137,600,898
- (2) Issue price and amount capitalized
Issue price : ¥218 (\$1.93) per share
Amount capitalized : ¥109 (\$0.96) per share
- (3) Aggregate amount issued : ¥29,997 million (\$265.0 million)
- (4) Increase in common stock and capital surplus
Common stock : ¥14,998 million (\$132.5 million)
Capital surplus : ¥14,998 million (\$132.5 million)
- (5) Initial Date in reckoning of dividend : October 1, 2005

Investor Information

Founded: September 1905

Incorporated: June 1911

Fiscal Year: April 1-March 31

Transfer Agent and Office:

Mitsubishi UFJ Trust and Banking Corporation
4-5, Marunouchi 1-chome, Chiyoda-ku,
TOKYO 100-8212, JAPAN

Listings and Quotations:

Kobe Steel is listed on the Tokyo Stock Exchange, the Osaka Securities Exchange and the Nagoya Stock Exchange in Japan. American Depositary Receipts for common stock are traded over the counter in the United States.

Depository for American Depositary Receipts:

The Bank of New York Company, Inc.
101 Barclay Street, New York, NY 10286, U.S.A.
Tel : (212) 815-2042 (U.S. toll free: 888-269-2377)
URL:<http://www.adrbny.com>

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