KOBELCO
KOBE STEEL GROUP

Competitiveness through Ingenuity

KOBE STEEL Annual Report 2006
Year Ended March 31, 2006

KOBELCO
KOBE STEEL GROUP

Profile

The Kobe Steel Group is a global enterprise with Kobe Steel, Ltd. at its core. The Group is engaged in the three major business fields of materials, machinery and power supply. Its main businesses in the materials field are iron and steel, welding, and aluminum and copper products. The machinery field covers industrial machinery, construction machinery, environmental solutions, and engineering. The third pillar of the Group is the wholesale power supply business.

Our distinctive, quality products, which cannot be imitated by other companies, are recognized around the world under the KOBELCO brand. We will continue to create outstanding products, develop new technologies, and provide outstanding services to increase our profitability and create greater enterprise value. In this way, we will also make a broad contribution to building a better society.

Reinforcing Group Capabilities

Recognizing the role that the Kobe Steel Group plays in society and the corporate values of management and employees, in 2006 we established a Corporate Philosophy consisting of three principles. Under the KOBELCO brand, we aim to foster the shared values of the Corporate Philosophy. This will further strengthen the Kobe Steel Group's capabilities and enable us to continue growing in the future.

Sharing of Business Principles that Create Unity: Kobe Steel Group Corporate Philosophy

1. We provide reliable and advanced technologies, products and services that satisfy customers.
2. We support each employee in developing his or her abilities, while respecting mutual cooperation within the Kobe Steel Group.
3. Through continuous efforts for innovative change, we aim to enhance our corporate values.

KOBELCO
KOBE STEEL GROUP

KOBELCO is the corporate logo mark of Kobe Steel and its Group companies. KOBELCO is also an international brand for products and is used in the names of Kobe Steel Group companies.

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NOTES

Cautionary Statement

Certain statements in this annual report contain forward-looking statements concerning forecasts, assertions, prospects, intentions and strategies. The decisions and assumptions leading to these statements were based on information currently available to Kobe Steel. Due to possible changes in decisions and assumptions, future business operation, and internal and external conditions, actual results may differ materially from the projected forward-looking statements. Kobe Steel is not obligated to revise the forward-looking contents in this publication.

Uncertain and variable factors include, but are not limited to:

- Changes in economic outlook, demand and market conditions
- Political situation and trade and other regulations
- Changes in currency exchange rates
- Availability and market conditions of raw materials
- Products and services of competing companies, pricing policy, alliances, and business development including M&As
- Strategy changes of alliance partners

Consolidated Financial Highlights

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

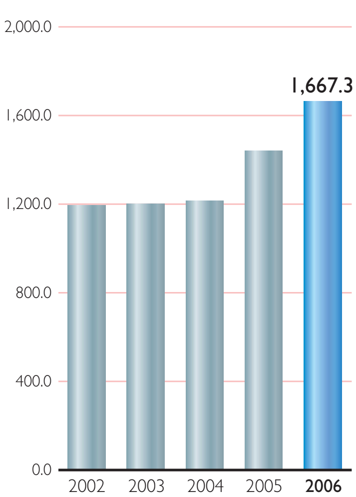
	Millions of yen		Percent change	Thousands of U.S. dollars (Note)
	2006	2005	2006/2005	2006
For the year:				
Net sales	¥1,667,313	¥1,443,772	15.5%	$14,193,522
Operating income	220,395	166,577	32.3	1,876,181
Income before income taxes	152,693	94,687	61.3	1,299,847
Net income	84,559	51,289	64.9	719,835
Capital investment	92,319	66,016	39.8	785,894
Depreciation and amortization	79,507	80,290	(1.0)	676,828
Research and development	24,121	19,700	22.4	205,338
At year end:				
Total assets	2,074,242	1,901,202	9.1	17,657,632
Stockholders' equity	530,000	379,213	39.8	4,511,790
Interest-bearing debt	589,101	669,241	(12.0)	5,014,906
Interest-bearing debt including IPP project finance	720,909	811,572	(11.2)	6,136,963

	Yen		Percent change	U.S. dollars (Note)
	2006	2005	2006/2005	2006
Per share data:				
Net income	¥ 27.94	¥ 17.28	61.7%	$ 0.24
Stockholders' equity	170.65	127.80	33.5	1.45
Cash dividends	6.00	3.00	100.0	0.05

Note: For convenience only, U.S. dollar amounts in this report have been translated from Japanese yen at the rate of ¥117.47 to US$1, the rate of exchange prevailing on March 31, 2006.

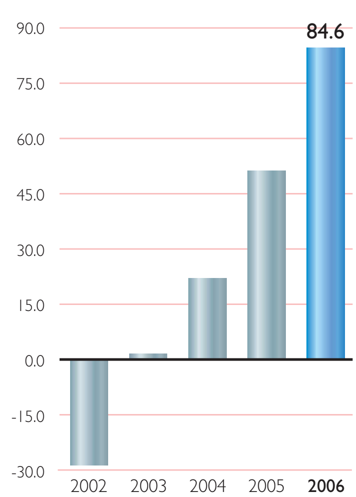
Net Sales

(¥ Billion)



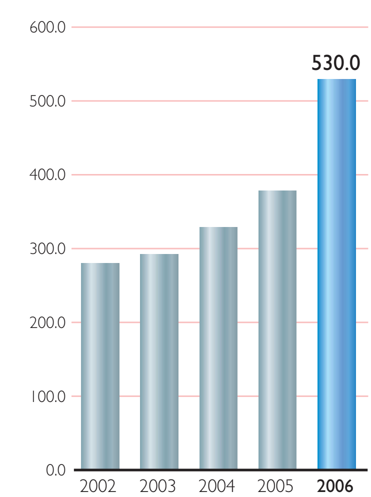
Net Income (Loss)

(¥ Billion)



Stockholders' Equity

(¥ Billion)



Building a strong corporate structure for stability and growth

It gives me great pleasure to present to our shareholders and other stakeholders the Kobe Steel Annual Report 2006. This report includes the Company's business performance on a consolidated basis for fiscal 2005, ended March 31, 2006, and an outline of the Kobe Steel Group's latest medium-term business plan for the fiscal 2006-2008 period, which was launched in April this year.

Yasuo Inubushi
President, CEO &
Representative Director

Target Figures under the Fiscal 2003-2005 Medium-Term Business Plan

(Billions of Yen)

	Fiscal 2005 Plan	Fiscal 2003 Results	Fiscal 2004 Results	Fiscal 2005 Results
Net Sales	1,250.0	1,219.2	1,443.8	1,667.3
Operating Income	125.0	100.7	166.6	220.4
Ordinary Income*	80.0	50.8	116.0	176.9
Net Income	36.0	22.1	51.3	84.6
Total Assets	1,800.0	1,916.3	1,901.2	2,074.2
Debt (Interest-bearing Dept)	640.0	797.0	669.2	589.1
Debt, including IPP Project Finance	(780.0)	(931.9)	(811.6)	(720.9)
Ratio of Ordinary Income to Sales	8.2%	4.2%	8.0%	10.6%
Return on Assets	6.0%	4.0%	7.4%	4.1%
Debt-to-Equity Ratio	1.7	2.5	1.8	1.2
D/E Ratio including IPP Project Finance	(2.1)	(2.9)	(2.2)	(1.5)

(* Operating income after adjustments of net financial revenue and net expenses generated on a regular basis, including labor costs for employees temporarily dispatched.)

Substantial Improvements Achieved in Revenues and Earnings

During fiscal 2005, the Japanese economy continued to be driven by rising capital investments, which were fueled by improved corporate earnings. Exports also maintained their expansionary trend from the previous business term, and the economy as a whole continued on a recovery path.

Against this background, we focused our efforts on meeting market demand from the robust manufacturing sector and on raising selling prices. This was in line with the final-year objectives of the Kobe Steel Group's Fiscal 2003-2005 Consolidated Medium-Term Business Plan, under which our primary focus was on developing new value-added and market-leading products, as well as expanding the sales of such products. As a result of strong demand from the manufacturing sector and sales price increases, we achieved major year-on-year improvements in business performance, particularly in our traditional core business of iron & steel, as well as in electronic materials.

Consolidated net sales rose 15.5% year-on-year, to ¥1,667.3 billion (US$14,193.5 million), operating income was up by a strong 32.3% at ¥220.4 billion (US$1,876.2 million), and ordinary income* climbed sharply by 52.5% to ¥176.9 billion. Net income was affected by a loss resulting from the transfer of our real estate business to a subsidiary, additional expenses for environmental protection measures, and a loss resulting from a fire at our Kakogawa Works. In spite of these negative factors, net income grew 64.9%, year-on-year, to reach ¥84.6 billion (US$719.8 million).

* Ordinary income: Operating income after adjustments for net financial revenue and net expenses generated on a regular basis, including labor costs for employees temporarily dispatched.

Achieving the Targets of the Medium-Term Plan

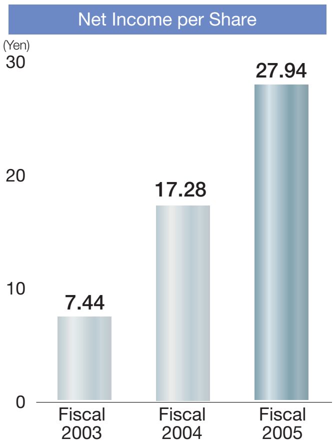
Looking back on the three years of the Company's medium-term plan from April 2003 to March 2006, we not only attained our Group-wide objectives in terms of strengthening our earning power, we were also able to reach all numerical targets under the plan, thanks to the positive turnaround in the business environment and most notably the sharp growth of the Chinese economy.

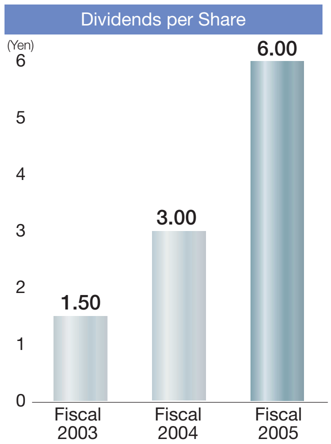
On the other hand, not everything went well. As a result of serious damage from a fire at our Kakogawa Works and other equipment problems, we are faced with the need to take a closer look at our performance in respect to the basic responsibilities as a manufacturer.

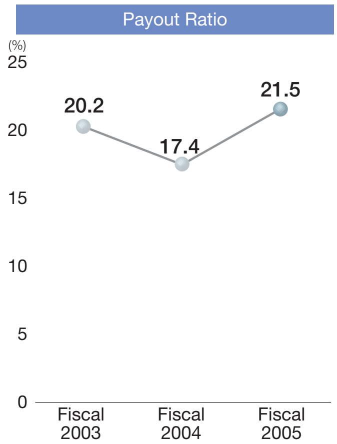
Regarding our efforts to improve the financial position of Kobe Steel on a consolidated basis, we succeeded in reducing interest-bearing debt by ¥306.7 billion over the three years of the plan, but we still cannot go so far as to describe our financial position as totally sound.

Over the three-year period of the plan ended in March this year, the Kobe Steel Group worked to give concrete meaning to our chosen keyword – "distinctive." Our efforts were directed at raising the presence of the Company and increasing the competitiveness of the Group as a whole.

Looking forward, rather than solely pursuing an expansion of scale, we will further enhance our distinctive strengths. At the same time, we will take a closer look at aspects of our business operations that are unsatisfactory and actively work on improving them. To achieve these aims, we have drawn up a new medium-term business plan for the Group that covers April 2006 to March 2008.







Goals of the New Medium-Term Business Plan

The Kobe Steel Group's Fiscal 2006-2008 Medium-Term Business Plan is described in detail on pages 6 – 9 of this report, but the main points are as follows:

Targets under the Plan

1. Develop and expand sales of higher-end products by leveraging the Kobe Steel Group's strengths.
2. Improve our "monozukuri" strengths – manufacturing that encompasses comprehensive capabilities in development and production.
3. Build a solid financial position that will enable us to boldly make strategic investments that are essential for long-term success

Through these and the other measures of the Plan, we are confident not only of continuing our present earnings level, but of stabilizing our corporate structure and capabilities at a higher level to attain greater growth.

Under our previous medium-term plan, we followed a fundamental policy of focusing on the development of distinctive and market-leading products, as well as on expanding the sales of these products. In our current medium-term plan, we have redefined our strategic focus to reflect changes in market needs and to respond to the moves of our leading competitors. Our new focus is centered on what we call "Only One" higher-end products. These are products that only the Kobe Steel Group can produce and products containing our own original value.

As a principal means of expanding our lineup of Only One products, we have identified the need to improve our manufacturing capabilities. To attain our goal of sustainable growth and development, two other pillars of the Company consist of building a rock-solid financial position, and finding and training talented employees. They are essential to support our "monozukuri," or manufacturing, strengths so that we can bring our quality, upper-end products to market.

Raising Public Trust

In September of 2005, the Company was found by the Japan Fair Trade Commission (FTC) to be in violation of the Antimonopoly Act with respect to its bidding for orders for bridge construction work from the Ministry of Land, Infrastructure and Transport and the Japan Highway Public Corporation. The Company was ordered by the FTC to change its bidding practices, and it duly complied with the order.

In May of this year, an in-house investigation revealed that our systems for the continuous monitoring of environmental data were faulty, in that emissions into the atmosphere of nitrogen oxide and sulfur oxide at our Kakogawa and Kobe works exceeded the limits imposed under the Air Pollution Control Law.

It is a matter for deep regret that we were unable to prevent such an occurrence, especially given that it is the explicit policy of Kobe Steel to place priority on environmental protection and legal compliance. I would like to apologize to all our stakeholders for the considerable trouble and worry caused by these incidents.

From here onward, we intend to conduct a thorough review of our compliance system and take steps to inculcate a deeper respect for the law among our staff. By these means, the entire Company will work together to build a strong system to prevent the recurrence of such incidents.

Increasing Our Enterprise Value

Ensuring adequate shareholder returns is one of the top management priorities at Kobe Steel. We are working at the Group-wide level to raise our enterprise value, by actively pursuing business activities that look to the medium to long-term future.

We aim to make regular and stable dividend payments to our shareholders. Dividend payments will be determined after careful and comprehensive examination of the Group's business performance, the payout ratio, amount of funds required for strategic investments, and the Company's financial position on a consolidated basis. For the time being, the benchmark payout ratio to be used in deciding on the dividend payment for any particular term, after taking account of that term's business performance, will be between 15% and 25% of net income on a consolidated basis. The dividend payment for the reporting period, ended March 31, 2006, has been set at ¥6 per share, compared with ¥3 per share for the previous business term.

Issues and Tasks Ahead

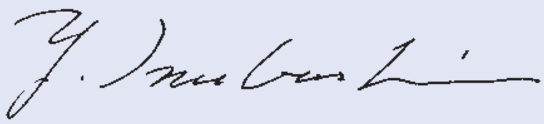
Looking at the business environment in which Kobe Steel and its group companies operate, the Japanese economy is expected to maintain its steady pace of recovery, fueled by vigorous domestic capital investment and strong private-sector demand led by consumer spending. The outlook is not entirely rosy, however. There are fears of further rises in oil prices. In addition, the courses that may be taken by the U.S. and Chinese economies in the near future are a cause of concern.

Over the next three years, we will be focusing our efforts on achieving the goals under our new medium-term business plan. We will boost sales of our Only One products and create more such unique products. We will improve our manufacturing capabilities. Finally, we will strengthen our financial position.

By carrying out these objectives, we will raise our earning power and build a stronger corporate structure, capable of responding effectively to the changing business environment.

It is my sincere hope that you — the shareholders and market investors of Kobe Steel — will continue to support and encourage us, as we pursue stability and growth for the future.

August 2006



Yasuo Inubushi
President, CEO & Representative Director

Fiscal 2006-2008

Kobe Steel Group Medium-Term Business Plan

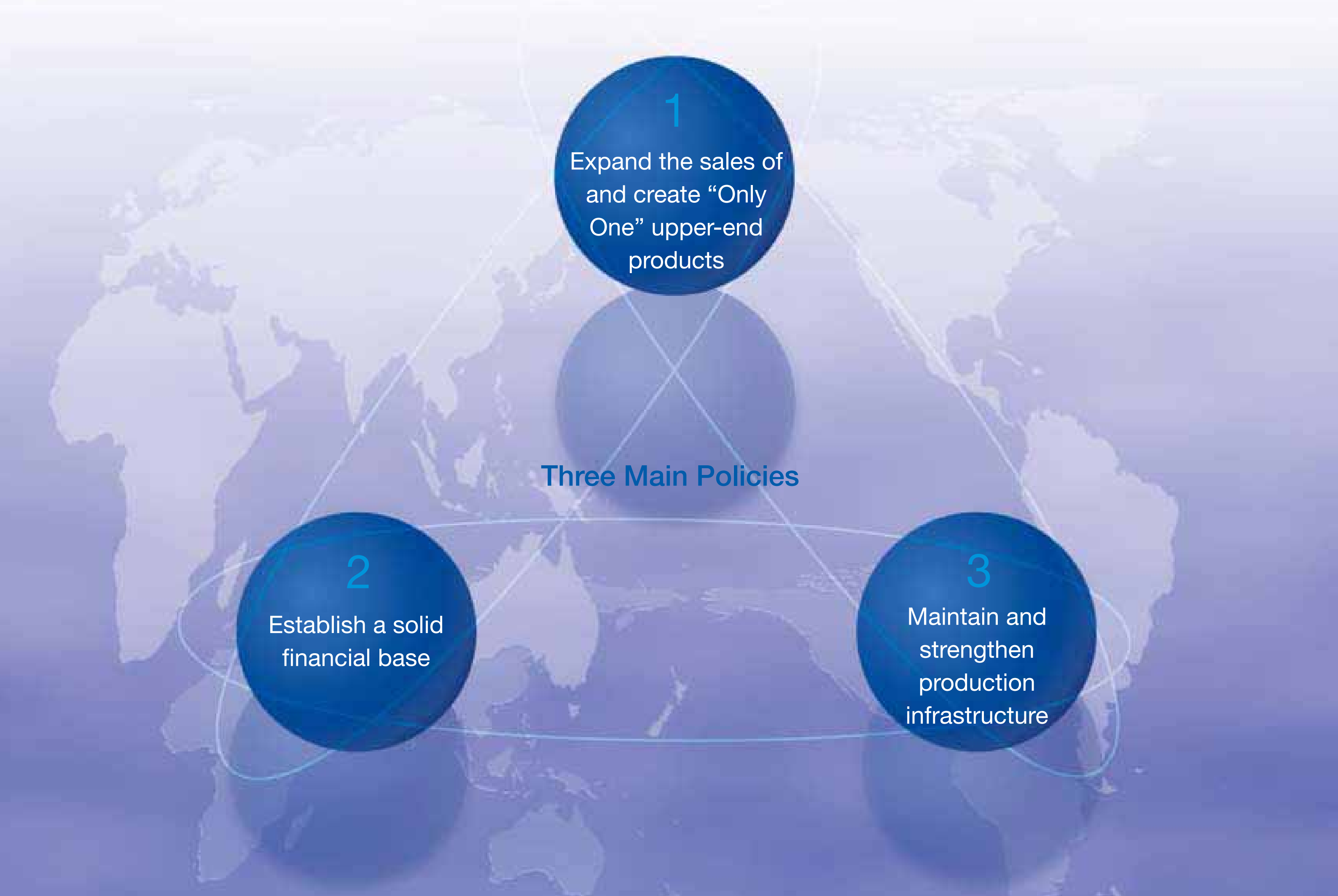
Under the consolidated medium-term business plan from fiscal 2003 through fiscal 2005, substantial efforts had been carried out to make structural changes and improve the business foundation. Consequently, almost all of the management targets set at the start of the plan could be achieved with better results.

In the Fiscal 2006–2008 Medium-Term Business Plan, started from April 2006, the Kobe Steel Group intends to build a strong corporate structure that is responsive to changes in the business environment. It aims to achieve stable profitability as well as qualitative and sustainable growth. Everyone at Kobe Steel shares in common the Kobe Steel Group Corporate Philosophy. Together, we will put our full efforts into achieving our goals.

(The business plan was announced on April 13, 2006. Fiscal 2005 financial results were announced on April 27, 2006.)

Themes of the Business Plan

In Pursuit of Stability and Growth



Basic Policies of the Kobe Steel Group's Medium-Term Business Plan

Kobe Steel has begun carrying out the policies outlined below to further strengthen its foundation as a manufacturing company and build a strong corporate structure based on stability and growth for the medium to long-term future.

1 Expanding and Creating "Only One" Upper-End Products

- Further expand sales of "Only One" products, and stabilize and improve profitability.
- Grow and create new "Only One" products that meet the needs of customers and the times.
- Raise the sales ratio of "Only One" products from 35% in Fiscal 2005 to over 40% in Fiscal 2008.

Concept of "Only One" Products:

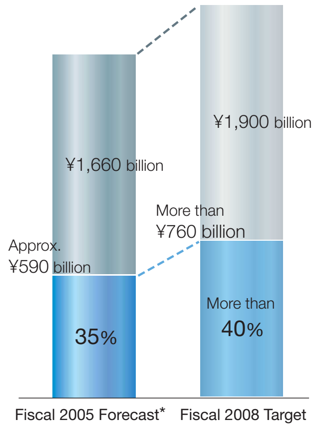
Products that only the Kobe Steel Group can provide.

Products in which we hold a comparative advantage in respect to market share and/or against competing products.

Products that are imbued with the Kobe Steel Group's original value and acknowledged by customers as superlative products, although there may be similar products made by other companies.

Products that set the Kobe Steel Group apart from other manufacturers through originality in functions and technology.

Sales of "Only One" Products



* Fiscal 2005 consolidated forecast announced in business plan on April 13, 2006

2 Strengthening "Monozukuri" Capabilities — Skilled Manufacturing

- Focus on cost reduction and undertake thorough quality control and risk management.
- Implement capital investments for sustainable growth and further improve and add value to products.
- Improve production technologies and the research and development structure to strengthen competitiveness.

3 Strengthening the Financial Base

- Undertake strategic investments for sustained growth.
- Continue focus on improving financial structure to build a solid financial base resistant to changes in the business environment.

4 Promoting Corporate Social Responsibility

- Systematize CSR activities throughout the group.
- Thoroughly carry out compliance activities, as well as focus on improving corporate governance.
- Undertake environmental management through improved operations and equipment utilization.

5 Creating a Positive Work Environment That Instills Pride in Employees' Work

- Establish safer and more comfortable workplaces for all employees of the group.
- Improve the working environment to support diverse employees in developing their abilities.
- Further strengthen skill transference from older to younger workers and human resources development.

6 Strengthening Group Management

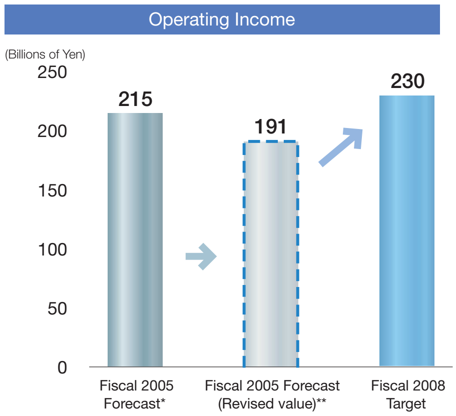
- Integrate systems and information infrastructure and deploy the group brand, KOBELCO, throughout the group.
- Through group management nurture a strong shared unity and enhance the capabilities of the group.

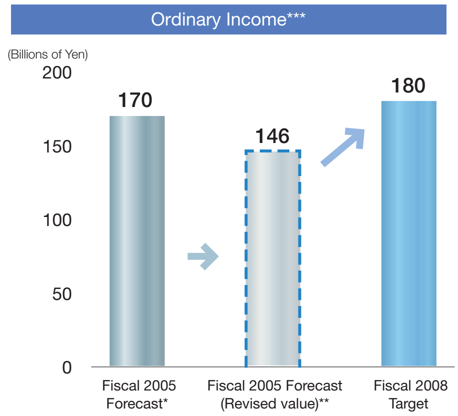
7 Stable Returns to Shareholders

- In allocating the earnings, the Company's financial condition, financial results and future capital needs are taken into consideration. While the basis is to provide stable dividends, dividends are decided based on comprehensive consideration of the financial performance, dividend rate and other factors.
- In consideration of profit distribution based on financial performance, the projected consolidated dividend rate is anticipated to range from 15% to 20% of the consolidated net income.

Targets

- Achieve top-class earning power for a domestic manufacturing company.
- Build a strong corporate structure responsive to changes in the business environment.
- Pursue stable earnings as well as quantitative and sustainable growth.



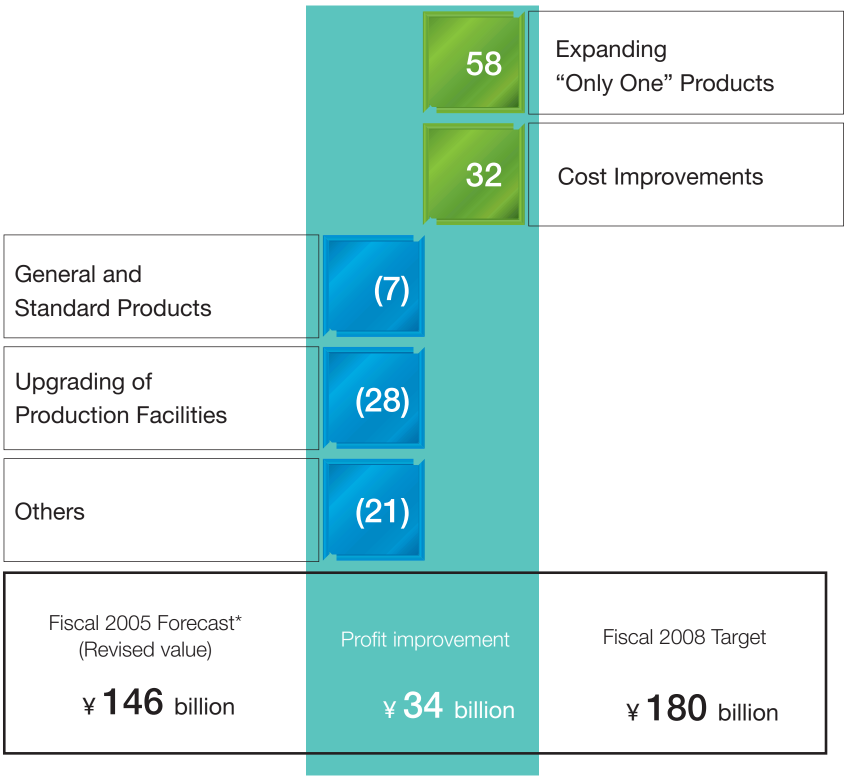


* Fiscal 2005 consolidated forecast announced in business plan on April 13, 2006

** In the fiscal 2005 forecast for the year ended March 2006, the following figures were adjusted: The average method of evaluating inventories pushed up profits by ¥24 billion. Without the inventory valuation, operating income was forecast to be ¥191 billion, with ordinary income of ¥146 million.

*** Operating income after adjustments of net financial revenue and net expenses generated on a regular basis, including labor costs for employees temporarily dispatched.

"Only One" Products Drive Growth



* Fiscal 2005 consolidated forecast announced in business plan on April 13, 2006

Financial Targets

(Billions of Yen)

	Fiscal 2008 Plan	Fiscal 2005 Forecast* (Revised values)	Fiscal 2005 Results
Net Sales	1,900	1,660.0	1,667.3
Operating Income	230 or more	191.0**	220.4
Ordinary Income	180 or more	146.0**	176.9
Net Income	100 or more	86.0**	84.6
Net Income per Share (¥)	32 or more	27.6	27.9
Interest-Bearing Debt	550 or less	600.0	589.1
Stockholders' Equity	750 or more	512.5	530.0
Debt/Equity Ratio (Times)***	0.8 or less	1.3	1.2
ROA (net Income after taxes/total assets)	5% or more	4.3%	4.1%

*Fiscal 2005 consolidated forecast announced in business plan on April 13, 2006

***In the D/E ratio, stockholders' equity consists only of common stock, capital surplus and retained earnings.

**Details of Revised Values:

Change in Inventory Valuation
¥24.0 billion

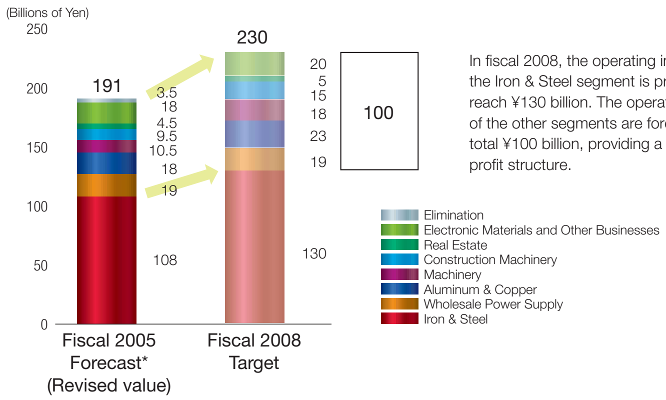
Extraordinary Loss
(¥22.0 billion)

Operating Income
¥215.0 billion → ¥191.0 billion

Ordinary Income
¥170.0 billion → ¥146.0 billion

Net Income
¥80.0 billion → ¥86.0 billion

Operating Income by Segment



In fiscal 2008, the operating income of the Iron & Steel segment is projected to reach ¥130 billion. The operating incomes of the other segments are forecast to total ¥100 billion, providing a balanced profit structure.

* Fiscal 2005 consolidated forecast announced in business plan on April 13, 2006

Plan for Investment in Plant and Machinery

(Billions of Yen)

	Construction Base	Payment Base
Iron & Steel	¥150	¥215
Wholesale Power Supply	2	2
Aluminum & Copper	44	56
Machinery	13	10
Construction Machinery	22	22
Real Estate	12	13
Electronic Materials and Other Businesses	17	22
Total (1)	¥260	¥340
Depreciation Expense (2)	¥280	
(1) / (2)	92.9%	

Cash Flow Plan

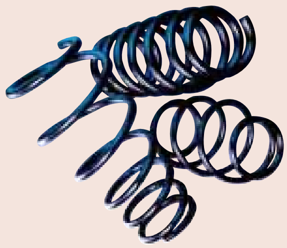
(Billions of Yen)

Resources		Use	
Net Income	¥270	Dividends	¥ 60
Depreciation*	280	Capital Expenditures, Investments & Financing	370
Working Capital, Others	(70)	Repayment of Debt	50
Total	¥480	Total	¥480

* From fiscal 2006, the method used for machinery and equipment depreciation was changed from the straight-line method to the declining-balance method.

Business Segments

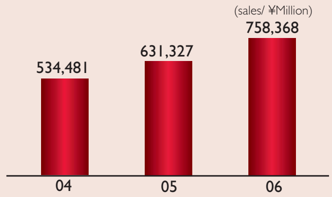
Iron and Steel Segment



[Main Products and Services]

Wire rod, steel bar, specialty steel bar, steel plates and sheets (hot-rolled, cold-rolled, surface processed), steel castings and forgings, titanium and titanium alloy, steel powder and other powder products, pig iron, slag products, stainless steel tube, building materials, specialty steel products, steel wire, covered welding electrodes, welding wire for automatic and semi-automatic welding, flux, welding robots, welding power sources, welding robot systems, testing, analysis, inspection and research

Net Sales



Major "Only One" Products

Wire Rod & Bar: Valve spring steel, Suspension spring steel, CHQ wire rod for automotive use, Steel bar for automotive use, Wire rod for tire cord, Bearing steel wire & wire rod

Plate: Low temperature service steel plate for LPG ships, Steel plate for large heat-input welding for giant container ships, "Hizumi-less" Residual stress controlled TMCP steel plate, Ni-containing atmospheric corrosion resistant steel plate, High-strength steel plate for architectural construction

Sheet: High-strength steel sheet for automotive (590MPa or more), EG special treatment sheet, Heat-releasing coated steel sheet, Castings & Forgings:Built-up type crankshafts, Solid type crankshafts, Rolls for rolling mills

Titanium: Commercially pure titanium, Titanium alloy

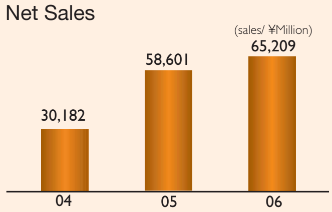
Steel Powder: Steel powder for magnetic applications; Steel powder for soil/ground water treatment; Pre-alloyed steel powder; Segregation-free pre-mixed steel powder

Welding: Flux-cored welding wire (FCW) for carbon steel and stainless steel

Consumables: Welding consumables for heat-resistant low-alloy steel

Wholesale Power Supply Segment

Net Sales



[Main Products and Services]

Wholesale electric power supply

"Only One" Product

Wholesale electric power supply

Aluminum and Copper Segment

[Main Products and Services]

Aluminum can stock, aluminum for large heat exchangers, aluminum for automobiles, aluminum extrusions, disk blanks, aluminum foil, copper tube for air conditioners, copper sheet and strip for semiconductors, copper sheet and strip for terminals, leadframes, aluminum alloys and magnesium alloy castings and forgings, processed aluminum products

Major "Only One" Products

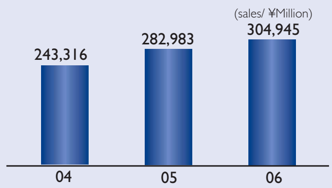
Aluminum Sheet & Plate: Bottle can stock, Panel material for auto bodies, Aluminum sheet for automotive heat exchangers, Disk material for HDDs

Aluminum Extrusions: Auto bumper material, OPC drum material

Aluminum Casting & Forgings: Forged aluminum parts for auto suspensions, Aircraft gearboxes, Vacuum chambers for semiconductor fabrication equipment

Copper Sheet: Auto connectors and terminals, Leadframe materials for semiconductors

Net Sales

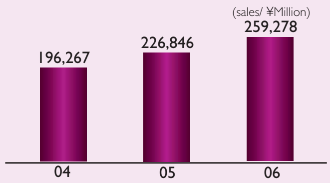


Machinery Segment

[Main Products and Services]

Engineering services (ironmaking, nonferrous metal, pelletizing, petrochemicals), equipment for energy and chemical fields, equipment for nuclear power plants, civil engineering, advanced transit systems, tire and rubber machinery, plastics processing machinery, isostatic pressing systems, metalworking machinery, compressors, refrigeration compressors, heat pumps, crushers and mills, environmental solutions, recycling and soil remediation, cooling towers, heavy electrical equipment, continuous earth-moving systems

Net Sales



Major “Only One” Products

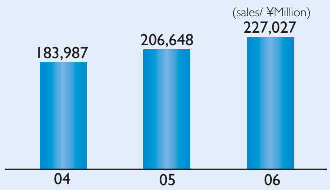
Industrial Machinery: Batch-type rubber mixers, Tire testing machine, Plastic mixing and pelletizing systems, Physical vapor deposition system, Screw gas compressor, Integrally geared turbo gas compressor, Oil-flooded standard screw air compressor, Compact condensing generator

Engineering: Pressure vessel, LNG vaporizer, Brazed aluminum heat exchanger, Open-grid dam, Rubber tire rail system, Coal-based direct reduction processes (FASTMET, FASTMELT), ITmk3, Natural gas-based direct reduction process (MIDREX)

Environment: PCB waste disposal equipment, PVC recycling, Pure water and ultra-pure water producing equipment, Biomass methane ferementation system, Soil remediation, Sludge incineration/Melting/Recycling equipment, Mixers, Hydrogen & Oxygen generation equipment

Construction Machinery Segment

Net Sales



[Main Products and Services]

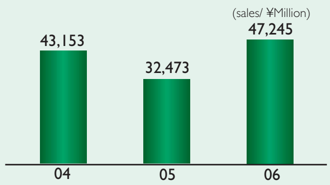
Hydraulic excavators, mini excavators, wheel loaders, crawler cranes, rough terrain cranes, work vessels

Major “Only One” Products

Building demolition equipment, Debris crushing equipment, Automobile dismantling equipment, Handling equipment

Real Estate Segment

Net Sales

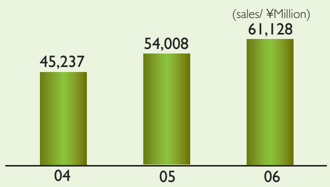


[Main Products and Services]

Real estate development, construction, property sales, brokering, remodeling, leasing, building management, condominium management

Electronic Materials and Other Businesses Segment

Net Sales



[Main Products and Services]

Special alloys and other new materials (sputtering targets, etc.), materials analysis, high-pressured gas container manufacturing, reclaimed silicone wafer, superconductive products, general trading, IC testing services

Major “Only One” Products

Target material used in LCD panels, Semiconductor inspection equipment

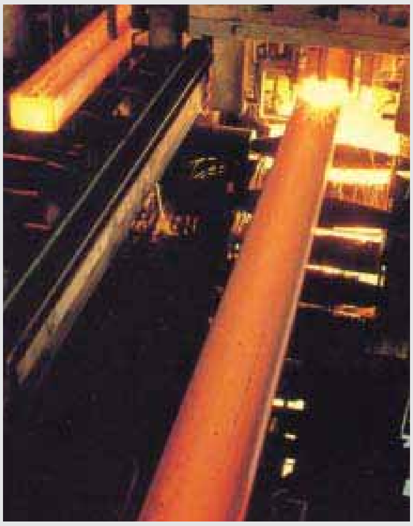
Iron and Steel

During the term under review, demand in Japan for steel remained robust, mainly from the shipbuilding, automotive, and industrial machinery manufacturing industries. However, exports declined due to more severe competition from Chinese producers in low-end steel products, caused by an expansion of China's manufacturing capacity.

Under these circumstances, Kobe Steel emphasized the bottom line in accepting orders. As a result, steel exports declined year-on-year, and overall results were under those of the previous period. Sales prices of steel products rose substantially both in Japan and abroad, against the backdrop of higher raw material costs and the steady demand for high-end steel products, our forte. Sales volume of steel castings and forgings rose, mainly in the marine sector, reflecting the worldwide boom in shipbuilding.

Sales of titanium products increased year-on-year due to growth in demand. Welding consumables enjoyed favorable demand in the shipbuilding, automotive, construction machinery and construction industries, resulting in the third consecutive year of price increases in line with increases in the prices of raw materials.

Owing to these conditions, the overall sales of this business segment increased 20.1% over the previous period to ¥758.4 billion. Operating income increased 42.5% over the previous period to ¥130.9 billion, partly due to the application of the average method to the valuation of inventories.



Research and Development

We are focusing on the development of eco-friendly products that meet customer needs. We have commenced work in the following key areas: in specialty steel, steel for ultra-high-strength valve springs and for lead-free connecting rods that can meet the dual requirements of light weight and zero lead for automotive engine components; and in steel sheet, the next generation of high strength steel sheet. In titanium, we are promoting products that assist in weight reduction and increased strength, such as the world's first titanium alloys for mufflers.

In March 2005, we were awarded the Okochi Memorial Prize, given to companies that have displayed excellence in research and development in manufacturing technology, for our steel for ultra-high-strength valve springs.

In welding consumables, we developed and brought to market the MG-55R, a high-performance welding wire that reduces the incidence of slag by approximately 50 percent; and in welding robot systems, a space-saving, flexible suspended multi-work system for welding steel columns and high-performance joint-welding software.

Investment in Plant and Equipment

We are focusing on projects to increase our competitiveness by innovating and enhancing our distinctive product lines. Efforts are being made toward the goals of stable production by investing in energy-savings, environmental preservation, and the updating of outdated facilities.

Among the major activities in fiscal 2005 was the renovation of cooling equipment, the installation of a leveler for improving the quality of our steel plate, and the remodeling of a continuous hot-dip galvanizing line for high strength steel sheet for automobiles. Construction is progressing well on the new caster at the Kobe Works, which will improve competitiveness in the specialty steel arena, and the renovation of the blast furnaces at the Kakogawa and Kobe works.

As for welding consumables, in order to meet strong demand in Japan and abroad, mainly from the shipbuilding industry, investments were made to increase production of flux-cored wire for carbon steel.

Overseas Expansion

As major Japanese and overseas automakers are expanding their operations in China, we have set up two local processing ventures for specialty steel products there to improve our competitiveness. Kobe Wire Products

Wire Rod for Engine Valve Springs

Development of wire rod for high strength engine valve springs capable of withstanding several thousand cycles of expansion and contraction per minute and a total of 1 billion cycles. Half of the cars in the world run on Kobe Steel's valve springs.

High Strength Steel Sheet

Kobe Steel's high strength steel sheet has enabled car manufactures to reduce the weight of cars and offer protection to drivers under crash conditions. The Company has commercialized in rapid succession an extensive lineup of high strength steel sheet.

Flexible Suspended Multi-Work System

Kobe Steel has developed this innovative proprietary system as a comprehensive welding solution. It features automated welding of joints, a process stage where it has not been possible to use welding robots.

(Foshan) Co., Ltd. in Guangdong Province commenced operations in June 2006. In Jiangsu Province, our second production facility at Jiangyin Sugita Fasten Spring Wire Co., Ltd., is currently under construction. Operations are expected to start up within this fiscal year.

To respond to brisk demand for carbon steel flux cored wire in Europe used in shipbuilding and offshore structures for oil and natural gas drilling, we are constructing a new production facility at our plant in the Netherlands.

Outlook

We will continue to create and sell our products for the shipbuilding and automotive industries, where robust demand is expected, and improve our market presence. In steel castings and forgings and titanium, we will enhance capacity and carry out other measures to meet expected strong demand.

Plant investment projects, such as blast furnace renovations, are being steadily implemented to maximize their benefits and ensure the smooth resumption of operations. From a long-term perspective, we are also enhancing our business base through safety and disaster-prevention measures, the stable supply of raw materials, and the smooth hand-over of specialized skills.

In welding consumables, we intend to maximize production volume to meet growing demand, primarily from the shipbuilding industry. As well, we will expand our presence and scale of operations primarily in Europe, China and North America, to achieve our eventual aim as one of the world's leading welding companies.

Wholesale Power Supply

At the Shinko Kobe Power Station, the two power plants have a maximum generation capacity of 1.4 million kilowatts of power. In line with increases in the cost of coal used as fuel, which we pass on in our electricity price, revenue increased by 11.3% to ¥65.2 billion, and operating income increased by 0.2% to ¥19.5 billion.

Outlook

The utmost attention is being paid to equipment maintenance and the accumulation of operational skills for continued stable operation and consistent profitability.

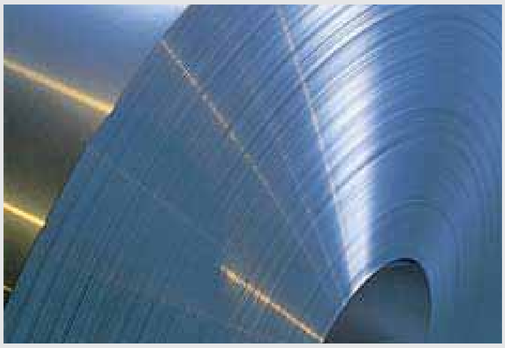
Aluminum and Copper

The sales volume of a major product line — aluminum rolled products — has increased along with the rise in can stock use in Japan. Inroads are also being made in the areas of aluminum sheet for automotive panels and aluminum blanks and substrates for hard disks.

In the export market, we placed a high priority on raising prices and in some cases turned down orders for can stock, printing plates and fin stock for air conditioners. This resulted in decreased shipments compared with the previous period for aluminum rolled products as a whole.

In copper rolled product sales, the sales volume for sheet products exceeded that for the previous period as copper strip for semiconductor leadframes pulled out of an adjustment phase and sales of terminal material used in the car electronics market were brisk. Shipments of copper tube were lower than in fiscal 2004 in reaction to that year's strong demand from the air conditioning industry, caused by the hotter-than-usual summer, as well as a decline in overall sales due to lower exports.

The sales volume performance of aluminum castings and forgings exceeded that of the previous period due to an increase in sales to the semiconductor manufacturing equipment industry. Although overall sales volume went down, ingot and cathode price increases contributed to higher sales. Sales for this segment were ¥304.9 billion, an 7.8% increase over the previous period. Operating income increased ¥6.5 billion year-on-year to ¥23.4 billion, due in part to the application of the average method to inventory valuation.



Research and Development

We are responding to strong demand by focusing investment on "Only One" products mainly for the automotive, IT and semiconductor fields, where demand is expected to increase. We will respond to this strong demand by enhancing quality and productivity through improved production technology.

In the automotive field, an integrated approach to technological development is being implemented, covering materials development, surface coatings, joining technology, and structural analysis. Automakers are using our aluminum sheet for roofs and hoods, reinforcement materials for one-piece integrated stay-type bumpers — which are lightweight but have excellent shock-absorbing characteristics — and aluminum forgings for suspension systems. We have achieved success in developing and commercializing numerous products in growth areas such as the IT and semiconductor-related fields. These include a series of alloys for high-performance leadframes and durable, stable aluminum electrode materials for liquid crystal and semiconductor use.

Additionally, Kobelco & Materials Copper Tube, Ltd. has achieved consistent results in the development of copper alloy tube, heat transfer tube for Eco-Cute (carbon dioxide heat pumps for hot-water delivery systems) and advanced, lightweight heat-transfer tube for air conditioners and large refrigerators.

Investment in Plant and Equipment

During the term under review, we decided to implement a number of projects that were necessary for our future growth. Investments, including those by our group companies, were centered on the renovation and upgrading of core facilities.

Strengthening our focus on the automotive and IT fields on which we are placing an emphasis, we will prioritize and carry out investments, linking them to higher profitability.

Overseas Expansion

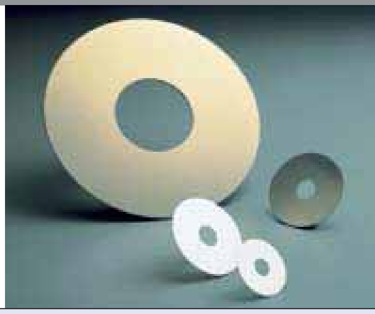
We established Kobe Aluminum Automotive Products, LLC, a manufacturer of aluminum forgings for suspension systems for automobiles in Kentucky, USA in May of 2003. Mass production began in June 2005. Currently, two presses are in operation, and a third press is scheduled to be brought on line during the current fiscal 2006 term. It is our intention to meet the increasing need for lightweight automotive components.

Suzhou Kobe Copper Technology Co., Ltd. was established in Jiangsu Province, China in May 2005. The company is engaged in slitting, sales and technical services for copper sheet for electronic materials, such as terminals, connectors and leadframes. Initial dry runs and production sample evaluations have been completed, and the facility began full-scale operation in July 2006. The processing

Opening Ceremony of Kobe Aluminum Automotive Products

The opening ceremony took place on June 2, 2006. Honorable guests totaling 150 people participated in the ceremony from the State of Kentucky, county and city, as well as from major Japanese and American automakers.

Aluminum Disk Blanks



Demand for magnetic disks for hard disk drives continues to rise with the spread of PCs. Kobe Steel supplies more than 50% of the aluminum blanks used in magnetic disks globally. Through our production bases in Japan and Malaysia, we are raising standards in IT.

Copper Sheet and Strip for Electronic Materials

With circuits becoming more miniaturized and concentrated, we produce copper alloy products for high-strength, highly conductive semiconductor leadframes, terminals and connectors. Our superior reliability is supported by years of experience and first-class technologies.

facility will promptly handle demand from local customers and respond swiftly and flexibly to increases in the market.

Outlook

The demand for aluminum and copper products is anticipated to be solid with increased growth expected in the automotive, IT and semiconductor fields.

Over the medium term, demand is expected to increase in the area of aluminum for automobiles, aluminum vacuum chambers for semiconductor and LCD manufacturing, aluminum blanks and substrates for hard disks, and copper strip for electronic materials.

In the automotive field in particular, environmental regulation and heightened interest among car makers on environmental issues portend well for the increased use of aluminum in vehicle production. We put top priority on the development of the automotive market, and intend to respond to the projected increased need for aluminum in vehicles in Japan and abroad by applying our leading-edge technology — from high-quality materials and design to manufacturing. Amid concerns of higher energy costs, the Company is dedicated to reducing expenditure by undertaking fuel conversion work and energy savings, while lowering inventories. Through these efforts, we will strengthen the Company’s business structure.

Kobe Steel intends to be highly competitive and maintain a leading position in the global marketplace on all counts — cost, quality, and customer service. Leveraging our technological prowess in the aluminum and copper fields, we aim to create new markets as we move forward.

Machinery

In line with our withdrawal from the bridge construction business, orders from domestic public works projects declined. However, against a backdrop of robust private-sector capital investment, orders for plastics processing machinery, rolling mills and compressors were generally favorable mainly in the automotive, railway, petroleum refining and petrochemical industries.

In overseas markets, in conjunction with brisk investments in oil and energy projects throughout the Middle East and Asia, we received a spate of large orders for high-pressure vessels for LNG facilities and petroleum refineries.

Orders for direct reduction plants declined year-on-year, following brisk demand worldwide in the previous term. However, attractive business prospects in the Middle East, Russia and Ukraine are expected to materialize in the future.

As for environmental equipment, despite a steady trend in capital investment in the chemical and food processing equipment industries, there was a steep decline in the environmental equipment field, leading to a decline in sales.

Sales in the Machinery Segment increased 14.3% year-on-year to ¥259.3 billion, due to strong orders for compressors and other products. Operating income increased 0.6% to ¥10.4 billion year-on-year, reflecting a drop in licensing fees for direct reduction plants.

Research and Development

In our machinery business, research and development activities are focused on further enhancement of the advanced features and product quality in the current lineup, as well as the development of new products. To accommodate the needs of LNG power generation using fuel gas under high pressure and to improve the efficiency of the desulfurization process in which hydrogen gas is used to refine petroleum, we developed the world's first screw compressors that can withstand pressures of up to 100 atmospheres.

As for direct reduction plants, we are currently conducting trials on metallic waste recovery technology using a rotary hearth furnace and working to commercialize the ITmk3® Process, a next-generation ironmaking process.

Looking at environmental technologies, Kobe Steel and subsidiary Kobelco Eco-Solutions Co., Ltd. have jointly developed a method to transport the heat generated by factories and refuse incineration plants to distant areas. In a joint government-private enterprise research project in Okinawa Prefecture, we conducted trials on a reduction-heating system to detoxify POPs (Persistent Organic Pollutants).

Investment in Plant and Equipment

Although we were operating at a high pitch during the term under review handling the large number of orders on our books, we also upgraded aging energy-related equipment, such as reactors and heat exchangers, at our plants.

Facilities for the recycling of PVC waste and final waste treatment and disposal facilities were brought on stream.

Non-Standard Compressors

We supply to global markets non-standard compressors with advanced features, such as high-pressure screw compressors with world-beating compression capacity, and natural gas collection/recycling screw compressors that do not exacerbate global warming.

PVC Recycling

Kobelco Vinyloop East Co., Ltd. completed a PVC recycling factory and started operations from June 2006.

Final Disposal of Waste Materials

ERC Takajo Co., Ltd., a subsidiary of Kobelco Eco-Solutions Co., Ltd., constructed a final disposal plant for waste materials in Miyakonojyo, Miyazaki Prefecture and started operations from December 2005.

Overseas Expansion

Established February 2004 in Shanghai as a base of operations in China, subsidiary Kobelco Compressors Manufacturing (Shanghai) Corporation, began full-scale operation in June, 2006. In the United States, on the back of rising energy prices and environmental concerns, we increased our equity in Kobelco EDTI Compressors, Inc., a compressor manufacturing company, from 50% to 92.5% to strengthen our non-standard compressor business. As a result, Kobe Steel now has three bases of operation: Japan, China and the United States.

The tire-manufacturing equipment business in the United States continues to grow with Kobelco Stewart Bolling, Inc. as our strategic base of operations.

In our direct reduction business, we are working in close collaboration with our subsidiary, Midrex Technologies, Inc., to expand orders of gas-based direct reduction plants. In Venezuela, we operate two direct reduced iron plants that produce Hot Briquetted Iron (HBI).

In environmental equipment, exports of chemical and food processing machinery and equipment are being expanded to China and the Southeast Asian region. We are keeping a watchful eye on emerging opportunities in East and Southeast Asia where environmental regulation is being strengthened.

Outlook

We forecast strong demand in the petroleum refining and natural gas-related markets for fiscal 2006 and beyond. Our main objectives are to maximize profit, while maintaining a stable business base.

By business unit, in industrial machinery we intend to focus management and operational resources on plastic mixing and pelletizing systems, tire testing equipment, and the PVD (physical vapor deposition) business.

The focus for compressors is on new product development, with the aim of growing existing businesses and developing new businesses including overseas expansion. Manufacturing capabilities in processing equipment and testing facilities are being enhanced in line with business expansion.

In the engineering field, we are focusing on carrying out construction work on reactors, advanced transit systems and similar large-scale projects, while continuing to pursue orders in the petroleum refining and natural gas markets, which continue to show favorable growth.

In the direct reduction business, we forecast growing, consistent demand for direct reduced iron. Within this context, in addition to our existing gas-based direct reduced iron process, we are developing and commercializing the FASTMET® and FASTMELT® processes, which use coal as the reductant, and the ITmk3® ironmaking process.

In the environmental field, the Kobe Steel Group will continue to focus on achieving stable earnings and reinforcing its capabilities in meeting demand from the private sector. We intend to contribute to the community through such businesses as PCB detoxification, PVC recycling, and the management of final waste treatment facilities.

Construction Machinery

The domestic market for construction machinery was robust. Although public works projects remained stagnant in Japan, private sector investment was strong, and demand was fueled by disaster recovery projects. Contributing to the high demand was the low stock of machines in Japan due to brisk exports of used machinery. Overseas markets expanded steadily in general, and even the Chinese market, which had been weak, showed clear recovery. As a result, Kobe Steel's Construction Machinery segment recorded sales of ¥227.0 billion, a 9.9% increase over the previous term. Operating income rose ¥1.6 billion to ¥8.8 billion.

Hydraulic Excavator Business

We recorded a significant increase in the number of hydraulic excavators sold in Japan. In the building demolition machinery field, we strengthened our line up of products. Unveiled in October 2005, the SK3500D, with a maximum reach of over 65 meters, is listed in the Guinness Book of Records as the building demolition machine with the longest high reach in the world.

To address the intensely competitive market for mini excavators, the excavator business of subsidiary Shinko Engineering Co., Ltd. was transferred to subsidiary Kobelco Construction Machinery Co., Ltd. effective April 2006. The Ogaki facility has become the focal point for integrated manufacturing and marketing of mini excavators.

Overseas, we further strengthened our joint ventures with our alliance partner, CNH Global N.V. To bolster our stock business, consisting of parts and used equipment sales and maintenance services, we established a branch office in Hanoi, Vietnam and a joint venture for used construction machinery sales in Indonesia. Further, to address the needs of the rapidly recovering Chinese market, Hangzhou Kobelco Construction Machinery Co., Ltd., in Zhejiang Province, began operations in October, 2005. This is Kobelco's second Chinese production plant and it serves customers in the coastal region. The first plant, Chengdu Kobelco Construction Machinery Co., Ltd., is located inland in Sichuan Province.

Crane Business

Capitalizing on the growing global demand for cranes, we focused our marketing efforts on high-growth regions and countries rich in natural resources, such as the Middle East and India, and raised profitability in cooperation with the Manitowac Crane Group. We also introduced global models of crawler cranes meeting Tier 3 emission standards. As a result, we achieved a substantial 43% increase in sales of new crane models over the previous year. Overseas sales of crawler cranes accounted for nearly 75% of total sales.

To improve our stock business, efforts were expended to enhance our business structure and increase profitability. We minimized increases in selling prices, despite high materials prices. At the same time, we made steady progress in reducing expenses.

Outlook

Construction machinery demand remains strong. To increase sales volume and respond to market changes, we are taking steps to raise our cost-competitiveness, strengthen our after-sales customer support, and boost our market presence and brand power. In this way, we will further strengthen our customer base.

Hangzhou Kobelco Construction Machinery begins production

In response to expanding demand in the Chinese market, Hangzhou Kobelco Construction Machinery Co., Ltd., in Hangzhou, Zhejiang Province, China, is in full swing.

SK3500D Demolition Machine in Guinness Book

The SK3500D demolition machine has a maximum reach of over 65 meters. The SK3500D is recognized in the Guinness Book of Records as the demolition machine with the longest high reach in the world.

Real Estate

The Real Estate segment has progressed well with a substantial increase in completions and handing overs of residential units in the Tokyo and Kansai areas. This contributed to a 45.5% increase in sales over the previous term for a total of ¥47.2 billion. Operating income increased ¥2.0 billion to ¥5.1 billion.

Maya Seaside Place Fair Coast

We have been developing and marketing the Maya Seaside Place condominiums, a total of 1,114 units, in Kobe. As a culmination, we began sales of the Maya Seaside Place Fair Coast, a 115-unit development. We are proud of creating a comfortable living environment in town.

Real Estate Sales Business

Condominiums were sold at O's Garden East in Akashi City, Hyogo Prefecture; G-Clef Mikage in Kobe City, Hyogo Prefecture; G-Clef Mitaka in Mitaka City, Tokyo; Minami Aoyama Terrace in Minato Ward, Tokyo; and Park House Kichijoji Kitamachi in Musashino City, Tokyo.

We also sold condominiums at Maya Seaside Place Fair Coast in Kobe City, Hyogo Prefecture; G-Clef Tarumi Grand Site in Kobe City, Hyogo Prefecture; and The Place Nakamozu in Sakai City, Osaka.

Commercial Leasing

The Osaka Shinko Building in Osaka, an office building, was purchased along with dormitory facilities and company housing, increasing our premium leasable assets. Apolan Fujigaoka in Yokohama, Kanagawa Prefecture, a senior housing project, is making smooth progress.

Building Management

We have steadily pushed forward with our property management business thanks to the start of operations at the Kakogawa Municipal Gymnasium (a private finance initiative), the Kobe Airport Passenger Terminal, and Blumer HAT Kobe, a shopping complex.

Construction

Construction began on Seflec Rokko Takaha in Kobe City, Hyogo Prefecture, while major renovation started on the Nakayama-Satsukidai Housing Complex in Takarazuka City, Hyogo Prefecture. Construction also began on the Kobe Health Equipment Development Center (provisional name) also in Kobe City and the Hyogo Prefecture Museum of Archeology (provisional name) in Kako-gun, Hyogo Prefecture.

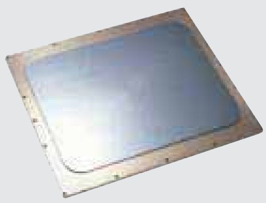
Outlook

Kobe Steel intends to build a strong business foundation in real estate development, construction and property sales. We intend to achieve steady growth in these three areas. In real estate leasing and building management, which provide stable revenue, we intend to expand our premium leasing properties.

Electronic Materials and Other Businesses

Our Electronic Materials and Other Businesses segment is made up of 30 subsidiary companies including materials testing, high-performance materials (such as materials used in liquid crystal displays), LPG containers, and superconductive materials, and 10 affiliate companies. Business results improved greatly, due to improved demand for target materials used in liquid crystal displays and electronics-related testing and analysis. Sales increased 13.2% year-on-year to ¥61.1 billion, with operating income increasing ¥3.4 billion to ¥17.5 billion.

We intend to aggressively meet the demand for target materials used in liquid crystal displays, aiming to build high profitability by improving manufacturing efficiency while containing costs. Additionally, we intend to aggressively pursue the application and develop the market for target materials for the next generation of optical disks.



Kobe Steel Group Business Structure

Kobe Steel, Ltd.

Customers

Iron and Steel

Raw materials supply
- The Kansai Coke and Chemicals Co., Ltd.*
- Sumitomo Titanium Corporation*
- 1 equity-valued affiliate

Manufacturing, sales and services
- Kobelco Logistics, Ltd.
- Shinko Engineering & Maintenance Co., Ltd.
- Shinko Sohgo Service Ltd.
- Kobe Welding Wire Co., Ltd.
- 5 consolidated subsidiaries

Manufacturing and sales
- Nippon Koshuha Steel Co., Ltd.
- Kobe Special Tube Co., Ltd.
- Shinko Kenzai, Ltd.
- Shinko Bolt, Ltd.
- Sakai Steel Sheets Works, Ltd.
- Shinko Wire Company, Ltd.*
- 14 consolidated subsidiaries
- 12 equity-valued affiliates

Manufacturing and sales
- Kobelco Metal Powder of America, Inc.
- 1 consolidated subsidiary
- 4 equity-valued affiliates

Sales
- NI Welding Corporation
- 3 consolidated subsidiaries
- 3 equity-valued affiliates

Sales, investment and services
- Kobe Coating Company
- 6 consolidated subsidiaries
- 1 equity-valued affiliate

Wholesale Power Supply

Production and sales
- Shinko Kobe Power Inc.

Aluminum and Copper

Manufacturing, sales and services
- Kobe Leadmikk, Ltd.
- 6 consolidated subsidiaries
- 1 equity-valued affiliate

Manufacturing and sales
- Sun Aluminium Industries, Ltd.
- Shinko-North Co., Ltd.
- Shinko Metal Products Co., Ltd.
- Kobe Precision Technology Sdn. Bhd.
- Singapore Kobe Pte. Ltd.
- 2 consolidated subsidiaries
- 3 equity-valued affiliates

Manufacturing and sales
- Kobelco & Materials Copper Tube, Ltd.
- 7 consolidated subsidiaries
- 3 equity-valued affiliates

Machinery

Raw materials and services
- Shinko Techno Engineering Co., Ltd.
- 10 consolidated subsidiaries

Manufacturing, sales and services
- Kobelco Compressors Corporation
- 5 consolidated subsidiaries
- 2 equity-valued affiliates

Manufacturing, sales and services
- Kobelco Eco-Solutions Co., Ltd.
- Shinko Engineering Co. Ltd.
- Shinko Electric Co., Ltd.*
- Earth Technica Co., Ltd.
- Complejo Siderurgico de Guayana, C.A.*
- 13 consolidated subsidiaries
- 4 equity-valued affiliates

Construction Machinery

Manufacturing and sales
- Kobelco Construction Machinery Co., Ltd.
- Kobelco Cranes Co., Ltd.
- 29 consolidated subsidiaries
- 7 equity-valued affiliates

Real Estate

Regional urban development and real estate
- Shinko Real Estate Co., Ltd.
- 9 consolidated subsidiaries

Electronic Materials and Other Business

Services
- Kobelco Research Institute, Inc.
- 9 consolidated subsidiaries
- 3 equity-valued affiliates

Raw materials supply and sales
- Shinsho Corporation*

Sales, investment and services
- Shinko JFE Industrial Co., Ltd.
- Genesis Technology Inc.*
- Japan Medical Materials Corporation*
- 14 consolidated subsidiaries
- 2 equity-valued affiliates

1. →: Flow of Products
2. * Denotes equity-valued affiliates, while other companies are consolidated subsidiaries.

Corporate Social Responsibility

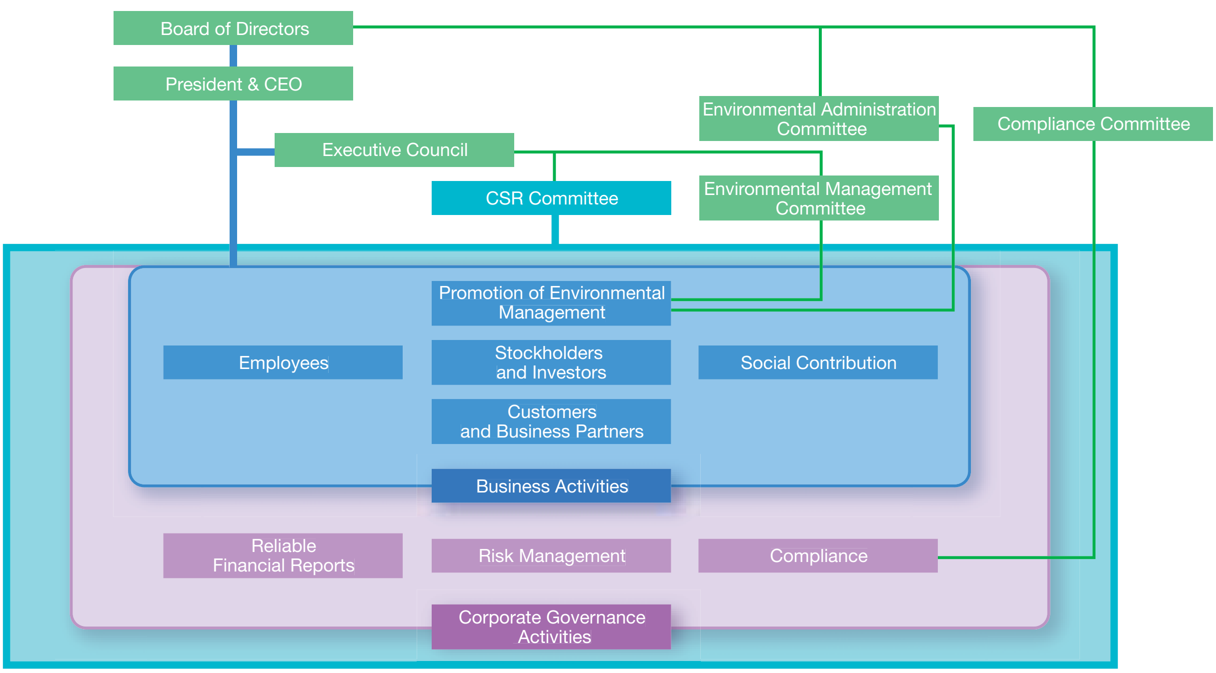
Amid today's rapid-paced globalization, the never-ending stream of corporate mergers, the reshuffling of industrial alliances, and the constantly rising concern for global environmental issues, major changes are also being observed in the attitude of shareholders and the general public toward business enterprises. In these circumstances, the management of the Kobe Steel Group is determined to fulfill its corporate social responsibilities (CSR). We will do this, firstly, by strengthening our legal and ethical compliance system and injecting even greater vigor into our environmental preservation activities, and secondly by creating and maintaining excellent relationships with all our stakeholders, including our customers, employees, shareholders and other investors, the regulatory authorities, our business partners, and the local communities in which we operate.

Toward a More Highly Developed CSR Stance

Kobe Steel has long been working to justify the trust in which we are held by our stakeholders by drawing up a Corporate Code of Ethics and making efforts to ensure that they are followed by all our staff. Recently, we have taken the opportunity afforded by the establishment of our Corporate Philosophy to design a whole range of Groupwide CSR initiatives aimed at facilitating the sustainable development of the Group together with the society of which it is part. In this way, we aim to raise the level of satisfaction with the Group's performance among our stakeholders.

In April 2006 we determined the group's basic CSR policies and set up the CSR Committee to act as a central control body for all CSR activities. CSR has been positioned as a priority companywide theme under Kobe Steel's Medium-Term Business Plan for fiscal 2006 to 2008. The Committee will direct CSR initiatives in a systematic manner and oversee the disclosure of these corporate activities, mainly through reports, to a wide range of stakeholders.

CSR Promotion Structure



Strengthening & Enhancing Corporate Governance

Raising the Effectiveness of Corporate Governance

The Company has, in principle, adopted the corporate officer system. In our opinion, however, in the form in which it has been adopted by the majority of companies, this system does not allow day-to-day operations to be taken sufficiently into account in the course of management decision-making. Accordingly, we have concluded that our directors, who are legally responsible for obligations to customers and the interests of shareholders and others, should be primarily responsible for conducting the business affairs of major importance to the Company.

The current Board of Directors comprises senior management and executives responsible for head office functions, key business divisions, internal companies, and equivalent business units. The Company's corporate officers are selected by the Board of Directors. Their role is to carry out the duties assigned to them by the directors.

Under this management system, Kobe Steel employs an auditing system carried out by five statutory auditors, including three outside auditors. This system has led to a further strengthening of auditing functions and has contributed significantly to more effective corporate governance. In addition, internal audits of all of the company's business activities are conducted by the Audit Department established as an independent organization.

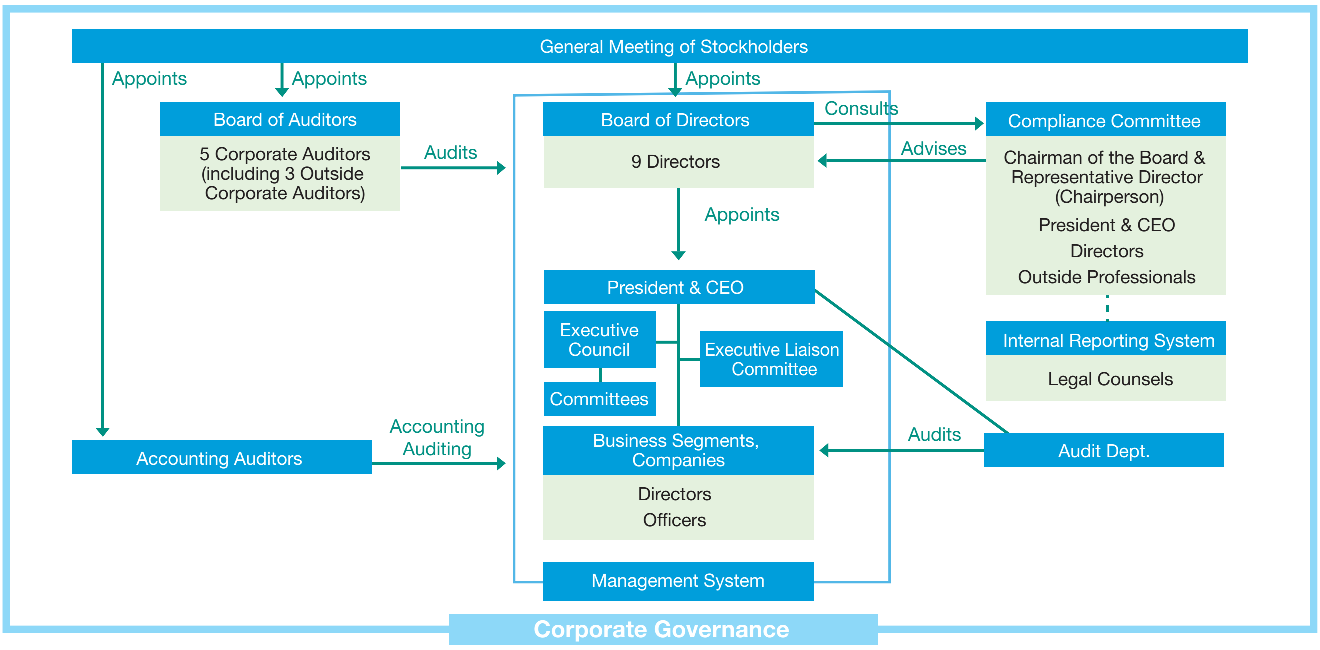
Strengthening the Compliance System

The management recognizes that strengthening the Company's compliance system is its most important task. This is being carried out with the awareness that the Company could not exist if it did not abide by laws, regulations and generally accepted rules of ethical standards.

In June 2003 we reorganized our Corporate Ethics Committee. In its place we established the Compliance Committee to serve as an advisory body to the Board of Directors. To ensure that the Committee adopts fair and neutral positions, four of its members are selected from inside the Company and a majority of five members are from outside the Company. The Committee develops proposals on compliance issues, verifies whether or not progress is being made on compliance, and deliberates on concerns that emerge through the internal reporting (whistle-blowing) system, in order to help management engage in more effective compliance.

The Committee also works to spread this activity throughout the Group, and leading group companies have taken such measures as establishing compliance committees to ensure basic corporate ethics are adhered to. In addition, a Kobe Steel Group internal reporting system for whistle-blowing reports has been created under which employees can directly contact lawyers. Moreover, the Committee constantly compiles and updates rules and manuals, and organizes compliance education.

Corporate Governance Structure



Environmental Sustainability

The Company is taking every measure within its power to restore public confidence following cases at our steelmaking plants, in which emission levels exceeded standards and related data was inappropriately handled. To ensure these problems do not recur, we are overhauling our organizational and management structures and upgrading facilities and technologies.

Looking at the longer term, the Kobe Steel Group considers it as its mission to protect the global environment, which is irreplaceable, and pass it on to the next generation in better condition. To this end, the Group has drawn on all its resources to compile a "Basic Policy for Environmental Management" and is ensuring that the principles of environmental management, taking full account of environmental needs, permeate all of its business activities.

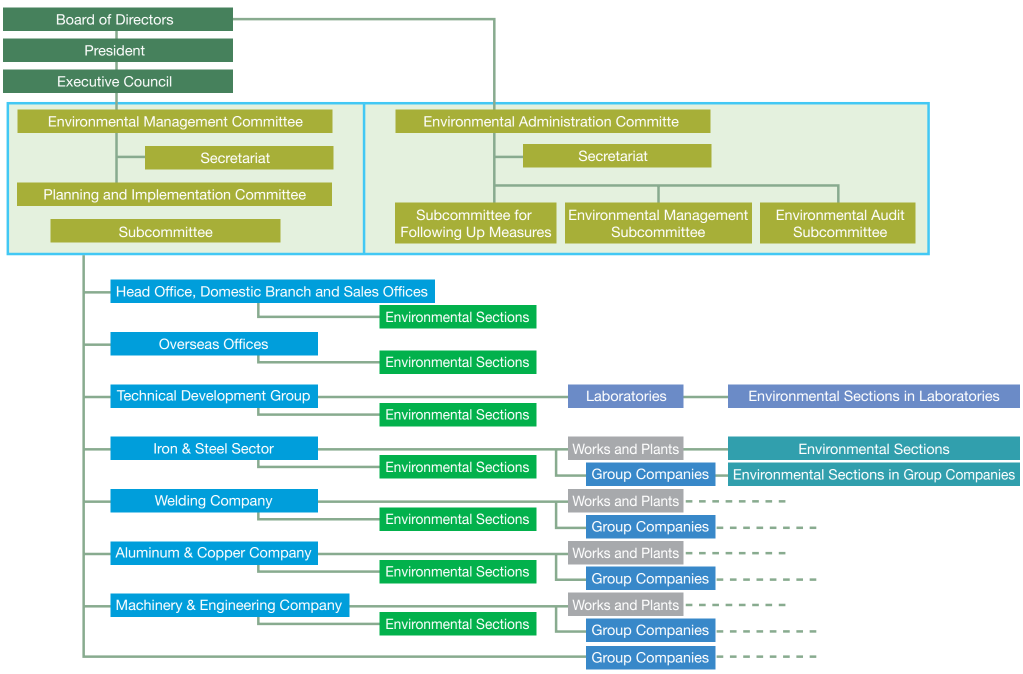
Creation of a System for Promoting Environmental Management

In the past, our Environmental Management Committee coordinated environmental management in the Kobe Steel Group. Following the emissions problem, we have created a new Environmental Committee as a measure to prevent any recurrence. Through such measures we are rebuilding and reinforcing our environmental management system.

Supported by expert opinion from outside the Company, the Environmental Committee discusses progress in environmental management, specific measures in our environmental policies and their implementation, as well as environmental surveys. Its findings are reported to the Board of Directors along with proposals for improvement.

While working in partnership with the Environmental Committee, the Environmental Management Committee organizes study groups to deal with specific topics, and other measures for more efficient environmental management.

Environmental Administration Structure



Environmental Management Policy

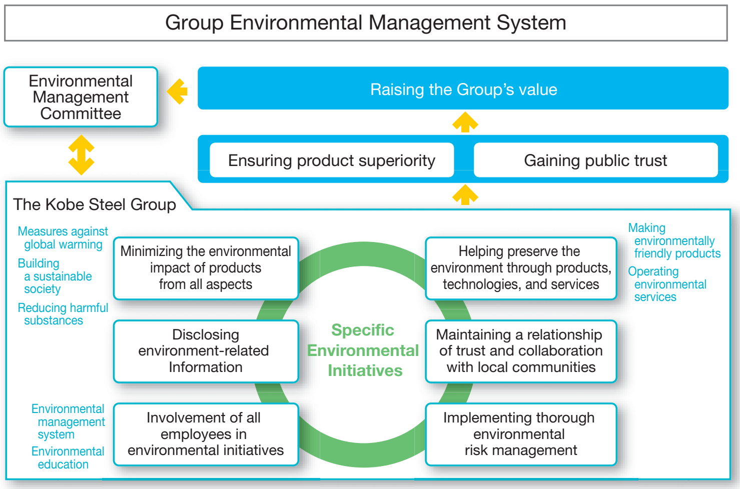
Basic Environmental Management Policies: Pursuing Environmental Management at the Group Level

The Kobe Steel Group takes environmental concerns into account in all its business activities, and aims to harness its comprehensive strengths in environmental management. Specifically, we plan to attain our goals through activities under the following themes:

(1) Reducing environmental impact (environmental preservation)

(2) Creating an environment-related, value-added element in all our products, technology, and services (environmentally innovative products & services)

(3) Building and maintaining a relationship of trust and collaboration with the local communities where we operate (disclosure and open communication on environmental issues)



Environmental Communication

Contribution to Local Communities

Through clean-ups and other volunteer activities by employees, we contribute to the beautification of local communities. Our employees also contribute to the welfare of our community through social volunteer activities.

In environmental awareness-raising activities in fiscal 2005, we dispatched teachers to give lectures on environmental issues at Amagasaki Technical High School and Kobe Takatsuka High School.


Environmental education at Amagasaki Technical High School

Support for Community Activities

In April 2001 the Kobelco Natural Environment Conservation Fund and the Kobelco Environmental Creation Fund were established with the purpose of supporting people engaged in environmental preservation activities.

Support activities in fiscal 2005 included countryside protection, tree planting, environmental study sessions, awareness activities for preventing global warming, support projects for woodland conservation and reforestation, and exhibitions with environmental themes.

The Group will continue to support environmental activities based on a recognition of the importance of undertakings that go beyond regular corporate activities and citizen initiatives.


Tree-planting activities

A Venue for Regional Exchange

The number of visitors to Nadahama Science Square, opened as an educational museum facility at Shinko Kobe Power Station in April 2004, surpassed 100,000 in November 2005, reaching this total ahead of expectation.

This hands-on facility allows visitors to enjoy learning about steelmaking, power generation, energy technology, and environmental preservation through models. It has enjoyed increasing patronage by local families and their children. Visits organized by elementary schools are also increasing.

The Nadahama Science Square was awarded the Information Center for Energy and Environment Education Chairman's Prize in the PR Activities and Facilities for Energy Awards organized by the Japan Productivity Center for Socio-Economic Development.


Nadahama Science Square

Publication of Our Environmental Sustainability Report

Our first environmental sustainability report was published in fiscal 1999. Since then, we have strived to make it easy to understand, taking steps to enhance the content based on feedback from readers.

We intend to further increase the comprehensiveness and accuracy of this publication so we can provide better coverage of our achievements in a wide range of environmental preservation activities in the future.


Environmental Sustainability Report

An English edition can be downloaded from the following site:
http://www.kobelco.co.jp/english/environment/index.html

R&D that Creates "Only One" Products

Supporting the Kobe Steel Group, the Technical Development Group is engaged in basic and advanced research. The Kobe Corporate Research Laboratories in the Technical Development Group work closely with development departments in the business segments, leveraging their wealth of technological expertise, to precisely meet customers' needs. Blending technologies in the fields of materials, machinery, the environment, energy and electronics, the laboratories pursue the development of truly distinctive "Only One" products and ever higher levels of manufacturing expertise.

The Kobe Corporate Research Laboratories serve as the group's R&D base. Effectively combining the specialized technologies of the laboratories, the Technical Development Group undertakes research aimed at enhancing the profitability of the business segments, pioneering new products and technologies for the future.

Materials Research Laboratory

The Materials Research Laboratory (MRL) engages in research based upon four technological fields: materials processing, materials design, mechanical working, and surface control. For the materials business, MRL is working to enhance the performance of materials and surfaces, develop new products with improved features, and optimize manufacturing processes. For machinery-related businesses, MRL focuses on creating differentiated products utilizing its expertise in materials.

Mechanical Engineering Research Laboratory

The Mechanical Engineering Research Laboratory (MERL) carries out research and development in machinery, materials, environment, energy, and steel structures, by using advanced simulation technology and experimental and measurement technology in the fields of strengthen and structural engineering, dynamics and acoustics, fluid and thermal technologies, and combustion and chemical technologies. MERL is working to upgrade product features and improve production processes and design, as well as focus on developing new products and technologies.

Production Systems Research Laboratory

Utilizing production technologies that make full use of cutting-edge electronic expertise in instrumentation and control systems, production planning, machine systems, information and telecommunications systems, the Production System Research Laboratory (PRL) is engaged in bolstering and innovating production technologies for the business segments. Through the application of proprietary technological know-how, we are working to develop new products and technologies for telecommunication networks and information systems.

Electronics Research Laboratory

The core technologies of the Electronics Research Laboratory (ERL) include thin-film materials and film-forming methods, microprocessing and measurement evaluation, and superconducting technology. ERL is working to develop new products and processes for applications in the growth fields of nanotechnology, electronics and information, biotechnology, and the environment. ERL is also promoting the application of its technologies in its production facilities.

Coal & Energy Project Section

We are developing energy conversion technologies, such as the upgrading of brown coal through dewatering and deashing, coal liquefaction, and the hydrocracking of heavy oil. We are working to find ways to effectively use the world's low-grade natural resources, and thereby contribute to securing stable and diversified energy sources for Japan.

[R&D-related subsidiaries]
- Kobelco Research Institute, Inc.
- Shinko Research Co., Ltd.

Principal Technologies Developed by the Business Sectors

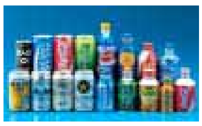
[Iron & Steel]

Iron & steel production technology
- Next-generation ironmaking
- Ultra clean steel refining
- High-precision rolling
- Material control
- Surface treatment, others

Product technology (construction, shipbuilding, automobiles, household appliances, aviation, others)

[Aluminum & Copper]

- Aluminum sheet production technology (wide-width high-speed rolling, automatic controlled rolling)
- Aluminum extruded section production technology (high dimensional accuracy extrusion, thin-wall extrusion)
- Aluminum cast and forged product technology (large-size thin-wall sand casting, hydraulic & mechanical forging)
- Copper sheet and strip production technology (low-distortion low-residual stress sheet, advanced plating)
- Alloy design, material control, surface treatment, sheet forming, extrusion processing, welding & joining, FEM simulation for lightweighting design
- Product technology (electric & electronic devices, appliances, automobiles, aluminum cans, aviation, others)



[Welding]

- Design of welding consumables
- Mechanical/chemical performance evaluation of welding
- Physical analysis of arc phenomenon
- Development/application of welding technology
- Design/development of welding robots
- Development of welding systems
- Development of offline teaching systems
- Design/development of welding power sources

[Machinery & Engineering]

- New ironmaking process
- Compressors (screw, turbo, reciprocating)
- Industrial machinery technology (tire forming, plastic mixing, metalworking, high pressure, deposition, beam)
- Energy equipment technology (high pressure vessels, aluminum heat exchanger, LNG vaporizers, nuclear spent fuel casks)
- Plant engineering (nuclear waste treatment, chemical weapons destruction, advanced transit systems, cable technology)

Strengthening our Strategic Utilization of Intellectual Property Rights

Focusing on the acquisition of intellectual property rights to contribute to business operations

The strategic utilization of intellectual property rights is indispensable to the success of the Kobe Steel Group's plan to expand its lineup of upper-end Only One products. From 1990 onward, the reporting of violations of intellectual property rights to authorities was originally a defensive method. Many leading companies, including those in the steel industry, filed lawsuits. In recent years, accompanying the rapid growth of the Asian economies, there has been a rising incidence of the copying and leaking of technology. The Japanese government set up the Strategic Council on Intellectual Property in 2002. The council calls for a three-pronged strategy encompassing management, R&D and intellectual property.

Against this backdrop, Kobe Steel is bolstering the strategic utilization of its intellectual property. According to the Japan Patent Office's Patent Strategy Indices (evaluating the registration rate and the global application rate) announced in April 2006, Kobe Steel ranked third in the steel/nonferrous metals category among Japanese companies. Under our current medium-term business plan, we intend to unify our three-pronged strategy encompassing business, R&D and intellectual property strategy and bolster the Group's intellectual property rights. To achieve these goals, we are currently reinforcing our system for managing intellectual property rights.

Developing intellectual property rights in Asia and expanding the invention reward system

Since 2000, we have been working on the acquisition of intellectual property rights in Asian markets, whereas we previously focused our attention on the U.S. and European markets. We are boosting our submission of applications in Asian markets, and the number of applications we have filed in China is nearly on par with the U.S.

Meanwhile, to increase our Only One products we have created an Invention Reward System to provide employees with increased incentives to come up with original inventions. Under the previous reward system, each invention was evaluated and assessed on an individual basis. From April 2005 onward, a group of patents classified under a single product or technology category is assessed in terms of the degree to which it contributes to the company's performance. Under the new system, unlimited compensation will be given to inventors of outstanding technologies that enable the creation of distinctive products.

By offering inventors greater incentives, we expect to raise their motivation, and thereby accelerate the generation of highly original products.

Financial Section

Contents

Consolidated Five-Year Summary

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006, 2005, 2004, 2003 and 2002

	Millions of yen					Thousands of U.S. dollars (Note)
	2006	2005	2004	2003	2002	**2006**
Net sales	**¥1,667,313**	¥1,443,772	¥1,219,180	¥1,204,750	¥1,198,014	**$14,193,522**
Operating income	**220,395**	166,577	100,699	81,054	35,499	**1,876,181**
Net income (loss)	**84,559**	51,289	22,066	1,723	(28,519)	**719,835**
Total assets	**2,074,242**	1,901,202	1,916,338	1,902,642	2,045,303	**17,657,632**
Stockholders' equity	**530,000**	379,213	330,127	293,138	280,685	**4,511,790**

	Yen					U.S. dollars (Note)
	2006	2005	2004	2003	2002	**2006**
Amounts per share						
Net income (loss)	**¥27.94**	¥17.28	¥7.44	¥0.59	¥(10.07)	**$0.24**
Diluted net income	**27.25**	16.48	7.38	—	—	**0.23**
Cash dividends applicable to the year	**6.00**	3.00	1.50	—	—	**0.05**

Note: For convenience only, U.S. dollar amounts in this report have been translated from Japanese yen at the rate of ¥117.47 to US$1, the rate of exchange prevailing on March 31, 2006.

Financial Review (Consolidated)

Income Analysis

During the fiscal year under review, corporate earnings in Japan continued to improve and capital investment in the private sector increased. Consumer spending remained strong, and exports rose thanks to economic growth in the United States and East Asia. As a result, the Japanese economy recovered steadily.

In this environment, the Kobe Steel Group moved strongly forward with the implementation of the priority measures under its fiscal 2003–2005 medium-term business plan, including the development and sales expansion of distinctive, market-leading products. We also placed more emphasis on meeting demand from the fast-growing manufacturing industry and worked to improve selling prices. As a result, we achieved a marked improvement in our business results, primarily in the fields of steel products and electronic materials.

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥1,667.3**	¥1,443.8	**15.5%**
Operating income	**220.4**	166.6	**32.3**

Our strong performance was reflected in a ¥223.5 billion increase in net sales from the previous year, to ¥1,667.3 billion on a consolidated basis. Operating income jumped ¥53.8 billion year-on-year to ¥220.4 billion.

Business segment information is as follows.

[Iron and Steel]

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥758.4**	¥631.3	**20.1%**
Operating income	**130.9**	91.9	**42.5**

Net sales in this segment rose ¥127.1 billion year-on-year, from ¥631.3 billion to ¥758.4 billion. Steel demand was robust both domestically and overseas, reflecting steady growth in the global economy. Meanwhile, supply-demand conditions remained steady for midrange and high-end products for manufacturing, including the shipbuilding, automobile and industrial machinery industries. However, the balance between supply and demand deteriorated for general-purpose products against the backdrop of an expansion in production capacity in China. Under this situation, we dealt with general-purpose products based on an order-acceptance policy which attached importance to prices. As a result, production declined and production volume for crude steel fell by 0.15 million ton, from 7.71 million tons the previous year to 7.56 million tons. Meanwhile, there was some improvement in domestic and overseas selling prices, reflecting a sharp rise in raw material prices and steady demand for high-class products, where the Company is strong. Looking at earnings, while the prices of raw materials surged, operating income rose ¥39.0 billion from ¥91.9 billion in the previous year to ¥130.9 billion, thanks to the improvement of selling prices, our continued cost reduction efforts and the effect of inventory valuation based on the average method, which boosted earnings by ¥19.1 billion.

[Wholesale Power Supply]

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥65.2**	¥58.6	**11.3%**
Operating income	**19.5**	19.5	**0.2**

Net sales in this segment rose ¥6.6 billion year-on-year from ¥58.6 billion to ¥65.2 billion, due to a rise in the price of fuel-grade coal which is passed on to unit electricity prices. Operating income remained at nearly the same level, at ¥19.5 billion.

[Aluminum and Copper]

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥304.9**	¥283.0	**7.8%**
Operating income	**23.4**	16.9	**38.2**

Net sales in this segment rose ¥21.9 billion year-on-year, from ¥283.0 billion to ¥304.9 billion. Domestic sales of rolled aluminum products remained brisk, reflecting higher sales of can stock for canned beverages, the mainstay product, stemming from an increase in the use of aluminum bottle cans and the rise in the use of aluminum in automobiles. However, exports of rolled aluminum products declined as price improvement was emphasized and a decision was made not to accept orders for can stock, printing boards, and materials for air-conditioner fins. Total sales volume of rolled aluminum products declined by 22,000 tons from 356,000 tons in the previous year to 334,000 tons. Sales volume for rolled copper products remained at 63,000 tons, nearly the same level as the 62,000 tons in the previous year, as sales of lead frames for semiconductors recovered in the second half after an adjustment period in the first half, and sales of terminal materials used for automobile electronic parts continued to be brisk. Sales volume for steel pipe decreased by 13,000 tons year-on-year, from 90,000 tons to 77,000 tons, in reaction to the very hot summer in the previous year, and exports fell due to the integration of domestic production plants. Overall sales volume declined. However, net sales rose thanks to a sharp increase in the price of aluminum ingot and copper cathode. Operating income climbed ¥6.5 billion from ¥16.9 billion in the previous year to ¥23.4 billion thanks partly to the effect of inventory valuation based on weighted average costing method, which boosted earnings by ¥5.1 billion.

[Machinery]

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥259.3**	¥226.8	**14.3%**
Operating income	**10.4**	10.3	**0.6**

In this segment, orders received from domestic customers declined ¥3.5 billion, from ¥150.1 billion in the previous year to ¥146.6 billion. This was due to a slump in the environmental business stemming from intense competition and the Company's withdrawal from the bridge business, although sales of compressors and rolling mills remained steady against the backdrop of robust private sector capital investment. Orders received from overseas customers decreased ¥33.2 billion, from ¥126.1 billion to ¥92.9 billion, reflecting the absence of the seven orders for direct reduction iron manufacturing plants (total of about ¥60.0 billion) received consecutively in the previous year. Orders for compressors, plastics processing machinery, LNG equipment and high-pressure vessels used for refining oil remained steady against the backdrop of active investment by the petroleum and energy industries in the Middle East and Asia. As a result, total orders received in this segment declined ¥36.7 billion, from ¥276.1 billion in the previous year to ¥239.5 billion, and the order backlog stood at ¥246.7 billion at the end of the fiscal year under review. However, net sales were up ¥32.4 billion, from ¥226.8 billion in the previous year to ¥259.3 billion, thanks to an increase in sales of compressors, for which we have received a lot of orders. Operating income remained at the same level as the previous year, at ¥10.4 billion, because of a decline in income from licensing fees for direct reduction plants.

[Construction Machinery]

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥227.0**	¥206.6	**9.9%**
Operating income	**8.8**	7.2	**22.3**

In the Construction Machinery segment, despite the continuing decline in public works, the domestic market for hydraulic excavators remained firm, underpinned by robust private sector capital investment and replacement demand as the export of used hydraulic excavators to overseas markets including China caused a decline in the domestic stock. The overseas market was steady overall as the recovery became clear in China, where demand had been sluggish following the government's measures to curb investment. In addition, the crane business was brisk thanks to an increase in global demand. As a result, net sales rose ¥20.4 billion, from ¥206.6 billion to ¥227.0 billion. Operating income increased ¥1.6 billion, from ¥7.2 billion to ¥8.8 billion, reflecting the Company's efforts to correct selling prices amid deteriorating factors such as the sharp rise in prices for steel and other materials.

[Real Estate]

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥47.2**	¥32.5	**45.5%**
Operating income	**5.1**	3.1	**66.5**

In this segment, net sales jumped 45.5%, or ¥14.7 billion, from the previous year, to ¥47.2 billion thanks to intensive condominium construction and delivery centering on the Kansai region. Operating income soared 66.5%, or ¥2.0 billion, from the previous year, to ¥5.1 billion.

[Electronic Materials and Other Businesses]

	Billions of yen		Percent change
	2006	2005	**2006/2005**
Net sales	**¥61.1**	¥54.0	**13.2%**
Operating income	**17.5**	14.1	**24.2**

In this segment, the Company consistently met demand for target material for LCDs and testing and analysis related to electronics. As a result, net sales increased ¥7.1 billion, or 13.2%, from the previous year, to ¥61.1 billion. Operating income rose ¥3.4 billion, or 24.2%, to ¥17.5 billion.

Analysis of Cash Flow

Cash and cash equivalents on a consolidated basis increased ¥14.9 billion, or 18.5%, year-on-year, to ¥95.5 billion at the end of the fiscal year under review. Cash used for investing activities totaled ¥94.2 billion, cash used for financing activities such as the repayment of interest-bearing debt totaled ¥93.6 billion and the Company secured ¥198.2 billion yen net cash from operating activities.

(Cash flows from operating activities)
Trade account receivables and inventories increased with the rise in sales, and corporate tax and other payments rose. Consequently, despite an improvement in income before income taxes, net cash generated from operating activities declined ¥27.6 billion, or 12.2%, from the previous year, to ¥198.2 billion.

(Cash flows from investing activities)
There was an increase in capital expenditure related to the iron and steel business. Net cash used for investing activities stood at ¥94.2 billion, up ¥43.7 billion, or 86.4%, from the previous year.

(Cash flows from financing activities)
Expenditure for long-term debt repayment and bond redemption exceeded the cash received from long-term borrowings and bond issuance. As a result, net cash used for financing activities totaled ¥93.6 billion, down ¥70.4 billion, or 42.9%, from the previous year.

Analysis of Financial Position

Total assets at the end of the fiscal year under review increased by ¥173.0 billion from the end of the previous year to ¥2,074.2 billion due to valuation gains for investment securities marked to market thanks to a rise in stock prices, and an increase in the value of inventory due to a change in valuation method. Total interest-bearing debt, excluding project financing relating to the wholesale power supply business, declined ¥80.1 billion, from ¥669.2 billion at the end of the previous year to ¥589.1 billion. Total interest-bearing debt at the end of the fiscal year under review, including project financing, decreased ¥90.7 billion, from ¥811.6 billion at the end of the previous year to ¥720.9 billion. Shareholders' equity rose ¥150.8 billion, from ¥379.2 billion at the end of the previous year to ¥530.0 billion, reflecting the posting of ¥84.6 billion in net income, the conversion of bonds with equity warrants into shares and a rise in the value of stockholdings stemming from a rise in stock prices. As a result, the equity ratio was 25.6% as of March 31, 2006, up 5.7 percentage points from the end of the previous year.

Consolidated Balance Sheets

Kobe Steel, Ltd. and Consolidated Subsidiaries
March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
ASSETS	**2006**	2005	**2006**
Current assets:			
Cash and cash equivalents (Note 14)	**¥ 96,188**	¥ 81,824	**$ 818,830**
Notes and accounts receivable			
Trade	**245,787**	212,011	**2,092,339**
Unconsolidated subsidiaries and affiliates	**82,715**	75,890	**704,137**
Other	**20,562**	28,634	**175,040**
Allowance for doubtful accounts	**(992)**	(793)	**(8,445)**
	348,072	315,742	**2,963,071**
Inventories	**303,003**	252,823	**2,579,408**
Deferred income taxes (Note 13)	**26,249**	24,728	**223,453**
Other	**28,756**	17,692	**244,795**
Total current assets	**802,268**	692,809	**6,829,557**
Investments and other assets:			
Investments in securities (Note 4)	**177,985**	97,235	**1,515,153**
Investments in and advances to unconsolidated subsidiaries and affiliates	**47,840**	39,464	**407,253**
Long-term loans receivable	**5,974**	5,859	**50,856**
Other	**61,907**	60,950	**527,002**
Allowance for doubtful accounts	**(6,129)**	(8,672)	**(52,175)**
	287,577	194,836	**2,448,089**
Plant and equipment (Note 6):			
Land	**203,100**	207,987	**1,728,952**
Buildings and structures	**626,462**	618,354	**5,332,953**
Machinery and equipment	**1,851,017**	1,822,425	**15,757,359**
Construction in progress	**38,827**	32,136	**330,527**
	2,719,406	2,680,902	**23,149,791**
Less accumulated depreciation	**(1,757,533)**	(1,714,267)	**(14,961,547)**
	961,873	966,635	**8,188,244**
Intangible assets	**15,167**	13,912	**129,114**
Deferred income taxes (Note 13)	**7,357**	33,010	**62,628**
	¥2,074,242	¥1,901,202	**$17,657,632**

See accompanying notes.

LIABILITIES, MINORITY INTERESTS AND STOCKHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Current liabilities:			
Short-term borrowings (Note 6)	¥ 119,300	¥ 121,245	$ 1,015,578
Current portion of long-term debt (Note 6)	105,451	111,942	897,685
Notes and accounts payable:			
Trade	347,729	307,580	2,960,152
Construction	22,253	15,492	189,436
Unconsolidated subsidiaries and affiliates	76,173	57,902	648,446
Other	21,728	29,134	184,966
	467,883	410,108	3,983,000
Advances from customers	32,393	29,508	275,756
Customers' and employees' deposits	21,108	25,225	179,688
Income and enterprise taxes payable	48,542	23,803	413,229
Provision for casualty loss	1,430	—	12,173
Provision for environmental measures	2,866	—	24,398
Provision for restructuring costs	6,124	7,365	52,132
Deferred income taxes (Note 13)	2,193	1,130	18,669
Other	78,285	63,432	666,425
Total current liabilities	885,575	793,758	7,538,733
Long-term liabilities:			
Long-term debt (Note 6)	494,225	577,300	4,207,244
Employees' severance and retirement benefits (Note 16)	52,981	49,142	451,017
Provision for environmental measures	2,662	—	22,661
Deferred income taxes (Note 13)	24,455	10,728	208,181
Other	45,751	56,841	389,470
	620,074	694,011	5,278,573
Minority interests	38,593	34,220	328,536
Contingent liabilities (Note 7)			
Stockholders' equity:			
Common stock (Note 8)	233,313	218,163	1,986,150
Authorized — 6,000,000,000 shares			
Issued — 3,115,061,100 shares in 2006 and 2,976,070,294 shares in 2005			
Capital surplus (Note 8)	83,145	67,980	707,798
Retained earnings (Note 8)	157,275	81,634	1,338,852
Land revaluation	(4,358)	409	(37,099)
Net unrealized holding gains on securities	69,000	25,376	587,384
Foreign currency translation adjustments	(7,047)	(13,150)	(59,990)
Treasury stock, at cost:			
9,383,104 shares in 2006 and 8,955,212 shares in 2005	(1,328)	(1,199)	(11,305)
Total stockholders' equity	530,000	379,213	4,511,790
	¥2,074,242	¥1,901,202	$17,657,632

Consolidated Statements of Income

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Net sales	**¥1,667,313**	¥1,443,772	**$14,193,522**
Cost of sales	**(1,297,291)**	(1,140,422)	**(11,043,594)**
Gross profit	**370,022**	303,350	**3,149,928**
Selling, general and administrative expenses (Note 10)	**(149,627)**	(136,773)	**(1,273,747)**
Operating income	**220,395**	166,577	**1,876,181**
Other income (expenses):			
Interest and dividend income	**3,831**	2,572	**32,613**
Interest expense	**(21,147)**	(23,773)	**(180,020)**
Seconded employees' salaries net of reimbursement	**(19,162)**	(19,289)	**(163,122)**
Foreign exchange gain	**3,989**	16	**33,958**
Equity in income of unconsolidated subsidiaries and affiliates	**10,505**	10,011	**89,427**
Gain on sale of securities	**1,026**	2,676	**8,734**
Loss on separation of real estate business (Note 11)	**(14,100)**	—	**(120,031)**
Expenses for environmental measures	**(5,600)**	—	**(47,672)**
Loss on sale or disposal of plant and equipment	**(4,575)**	(2,382)	**(38,946)**
Casualty loss	**(4,540)**	—	**(38,648)**
Loss on impairment of fixed assets (Note 12)	—	(9,076)	—
Effect of applying new accounting standard for retirement benefits	—	(12,736)	—
Loss on write down of inventories	—	(10,944)	—
Amortization of prior service costs of pension plans	—	6,975	—
Other, net	**(17,929)**	(15,940)	**(152,627)**
	(67,702)	(71,890)	**(576,334)**
Income before income taxes	**152,693**	94,687	**1,299,847**
Income taxes (Note 13):			
Current	**60,007**	25,741	**510,828**
Deferred	**5,435**	16,225	**46,267**
	65,442	41,966	**557,095**
Minority interests in income of subsidiaries	**2,692**	1,432	**22,917**
Net income	**¥ 84,559**	¥ 51,289	**$ 719,835**

	Yen		U.S. dollars (Note 1)
Per share	**2006**	2005	**2006**
Net income	**¥27.94**	¥17.28	**$0.24**
Diluted net income	**27.25**	16.48	**0.23**
Cash dividends applicable to the year	**6.00**	3.00	**0.05**

See accompanying notes.

Consolidated Statements of Stockholders’ Equity

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

		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 on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2004	2,976,070,294	¥218,163	¥67,975	¥ 31,633	¥ 1,905	¥20,994	¥ (9,554)	¥ (989)
Cash dividends	—	—	—	(4,462)	—	—	—	—
Bonuses to directors	—	—	—	(14)	—	—	—	—
Net income	—	—	—	51,289	—	—	—	—
Effect of change in interests in subsidiaries	—	—	—	2,273	—	—	—	—
Increase due to changes in scope of consolidation	—	—	—	178	—	—	—	—
Increase due to merger of consolidated subsidiaries	—	—	—	79	—	—	—	—
Decrease due to changes in scope of consolidation	—	—	—	(356)	—	—	—	—
Gain on sale of treasury stock	—	—	5	—	—	—	—	—
Increase in treasury stock	—	—	—	—	—	—	—	(210)
Adjustment to land revaluation	—	—	—	1,014	(1,496)	—	—	—
Increase in unrealized holding gains on securities	—	—	—	—	—	4,382	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	(3,596)	—
Balance at March 31, 2005	2,976,070,294	218,163	67,980	81,634	409	25,376	(13,150)	(1,199)
Conversion of convertible bond	**138,990,806**	**15,150**	**15,150**	—	—	—	—	—
Cash dividends	—	—	—	**(8,922)**	—	—	—	—
Bonuses to directors	—	—	—	**(23)**	—	—	—	—
Net income	—	—	—	**84,559**	—	—	—	—
Increase due to changes in scope of consolidation	—	—	—	**41**	—	—	—	—
Decrease due to changes in scope of consolidation	—	—	—	**(14)**	—	—	—	—
Gain on sale of treasury stock	—	—	**15**	—	—	—	—	—
Increase in treasury stock	—	—	—	—	—	—	—	**(129)**
Adjustment to land revaluation	—	—	—	—	**(4,767)**	—	—	—
Increase in unrealized holding gains on securities	—	—	—	—	—	**43,624**	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	**6,103**	—
Balance at March 31, 2006	**3,115,061,100**	**¥233,313**	**¥83,145**	**¥157,275**	**¥(4,358)**	**¥69,000**	**¥ (7,047)**	**¥(1,328)**

	Thousands of U.S. dollars (Note 1)						
	Common stock (Note 8)	Capital surplus (Note 8)	Retained earnings (Note 8)	Land revaluation	Net unrealized holding gains on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2005	$1,857,181	$578,701	$ 694,935	$ 3,482	$216,021	$(111,944)	$(10,207)
Conversion of convertible bond	**128,969**	**128,969**	—	—	—	—	—
Cash dividends	—	—	**(75,952)**	—	—	—	—
Bonuses to directors	—	—	**(196)**	—	—	—	—
Net income	—	—	**719,835**	—	—	—	—
Increase due to changes in scope of consolidation	—	—	**349**	—	—	—	—
Decrease due to changes in scope of consolidation	—	—	**(119)**	—	—	—	—
Gain on sale of treasury stock	—	**128**	—	—	—	—	—
Increase in treasury stock	—	—	—	—	—	—	**(1,098)**
Adjustment to land revaluation	—	—	—	**(40,581)**	—	—	—
Increase in unrealized holding gains on securities	—	—	—	—	**371,363**	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	**51,954**	—
Balance at March 31, 2006	**$1,986,150**	**$707,798**	**$1,338,852**	**$(37,099)**	**$587,384**	**$ (59,990)**	**$(11,305)**

See accompanying notes.

Consolidated Statements of Cash Flows

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Cash flows from operating activities:			
Income before income taxes	**¥152,693**	¥ 94,687	**$1,299,847**
Depreciation	**79,507**	80,290	**676,828**
Interest and dividend income	**(3,831)**	(2,572)	**(32,613)**
Interest expense	**21,146**	23,773	**180,012**
Gain on sale of securities	**(1,026)**	(2,676)	**(8,734)**
Equity in income of unconsolidated subsidiaries and affiliates	**(10,505)**	(10,011)	**(89,427)**
Loss on separation of real estate business	**14,100**	—	**120,031**
Casualty loss	**1,430**	—	**12,173**
Environmental measures	**5,528**	—	**47,059**
Loss on write down of inventories	**—**	10,944	**—**
Loss on impairment of fixed assets	**—**	9,076	**—**
Effect of applying new accounting standard for retirement benefits	**—**	12,736	**—**
Amortization of prior service costs of pension plans	**—**	(6,975)	**—**
Loss on sale or disposal of plant and equipment	**4,575**	2,382	**38,946**
Decrease (increase) in trade receivables from customers	**(22,683)**	7,696	**(193,096)**
Increase in inventories	**(46,797)**	(29,508)	**(398,374)**
Increase in trade payables to customers	**44,449**	44,233	**378,386**
Other	**9,824**	21,082	**83,629**
Subtotal	**248,410**	255,157	**2,114,667**
Cash received for interest and dividends	**5,286**	3,461	**44,999**
Cash paid for interest	**(22,007)**	(24,248)	**(187,341)**
Cash paid for income taxes	**(33,508)**	(8,619)	**(285,247)**
Net cash provided by operating activities	**198,181**	225,751	**1,687,078**
Cash flows from investing activities:			
Purchase of plant, equipment and other assets	**(89,667)**	(56,175)	**(763,318)**
Proceeds from sale of plant, equipment and other assets	**4,645**	7,739	**39,542**
Purchase of investments in securities	**(12,001)**	(8,491)	**(102,162)**
Proceeds from sale of investments in securities	**3,636**	3,684	**30,953**
Decrease (increase) in short-term loans receivable	**(493)**	1,247	**(4,197)**
Payments for long-term loans receivable	**(607)**	(165)	**(5,167)**
Proceeds from collection of long-term loans receivable	**237**	2,195	**2,018**
Other	**35**	(577)	**298**
Net cash used in investing activities	**(94,215)**	(50,543)	**(802,033)**
Cash flows from financing activities:			
Increase (decrease) in short-term borrowings	**12,559**	(45,898)	**106,912**
Increase (decrease) from commercial paper	**(15,000)**	15,000	**(127,692)**
Proceeds from long-term debt	**39,546**	25,316	**336,648**
Repayment of long-term debt	**(83,808)**	(110,007)	**(713,442)**
Proceeds from issuance of bonds	**10,000**	10,580	**85,128**
Repayment of bonds	**(30,486)**	(21,735)	**(259,522)**
Payment of dividends	**(8,858)**	(4,415)	**(75,406)**
Other	**(17,546)**	(32,786)	**(149,367)**
Net cash used in financing activities	**(93,593)**	(163,945)	**(796,741)**
Effect of exchange rate changes on cash and cash equivalents	**2,784**	(98)	**23,699**
Increase in cash and cash equivalents	**13,157**	11,165	**112,003**
Cash and cash equivalents at beginning of year	**80,592**	68,503	**686,065**
Cash and cash equivalents of newly consolidated subsidiaries	**1,736**	924	**14,778**
Cash and cash equivalents at end of year (Note 14)	**¥ 95,485**	¥ 80,592	**$ 812,846**

See accompanying notes.

Notes to Consolidated Financial Statements

Years ended March 31, 2006 and 2005

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 stockholders' 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 is included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2006, which was ¥117.47 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.

Commencing in fiscal 2005, ending March 31, 2006, in order to present the financial position more appropriately, the method of evaluating inventories in the Iron and Steel, Wholesale Power Supply, and Aluminum and Copper segments was changed from the "last-in, first-out method" to the "average method."

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 made in order to reflect the change of the market prices of the raw materials on the value of inventories on the Balance Sheet to more appropriately present the financial position.

As a result, compared with the "last-in, first-out method," cost of sales decreased ¥24,288 million ($206,759 thousand) and both operating income and income before income taxes increased by the same amount.

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, 2006, the accounts of 162 (159 in 2005) subsidiaries have been included in the consolidated financial statements. Intercompany transactions and accounts have been eliminated.

Fifty-seven (62 in 2005) 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, 2006, Fifty-five (55 in 2005) 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 five 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) 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 income 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.

(3) 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.

(4) Provision for Casualty Loss

The provision for casualty loss for repairs to plant and equipment damaged in a fire accident at the power station in Kakogawa Works in May 2005 is stated as an estimated loss at the end of the fiscal year.

(5) Provision for Environmental Measures

The provision for environmental measures to prevent the spread of ground pollution at the site of the former Amagasaki Works and for obligatory PCB treatment is stated as an estimated cost at the end of the fiscal year.

(6) 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.

(7) Inventories

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

Iron and Steel, Wholesale Power Supply and Aluminum and Copper Segment:

Average method

Finished goods and work in process in Machinery, Construction Machinery and Real Estate Segment:

Specific identification method

(8) 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 (mainly five years).

(9) 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.

(10) Employees' Severance and Retirement Benefits

The Company and its domestic consolidated subsidiaries provide two types of post-employment benefit plans, unfunded lump-sum payment plans and funded non-contributory pension plans. A domestic consolidated subsidiary provides the contribution pension plan.

The Company and its domestic consolidated 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.

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.

(11) 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.

(12) 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 its domestic consolidated subsidiaries.

(13) 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 income items resulting from transactions with the Company at the rates used by the Company.

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

(14) 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.

(15) 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 its domestic consolidated subsidiaries.

(16) Derivatives

The Company and its domestic consolidated 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.

(17) Consolidated Tax Return

Effective March 31, 2004, the Company filed a consolidated tax return with certain domestic subsidiaries.

(18) 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 3 months at the time of purchase are considered to be cash and cash equivalents.

(19) Accounting Standard for Impairment of Fixed Assets

Effective April 1, 2004, the Company and its domestic consolidated subsidiaries adopted 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 accounting standard for impairment of fixed assets (the Finance Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003).

The effect of the adoption of the new accounting standard was to decrease income before income taxes by ¥9,076 million in fiscal 2004, ending March 31, 2005. The accumulated impairment loss was deducted directly from each asset's acquisition cost.

3. Leases

Original lease obligations as lessee under non-capitalized finance leases at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Buildings and structures	**¥ 783**	¥ 631	**$ 6,666**
Machinery and equipment	**51,270**	51,616	**436,452**
	¥52,053	¥52,247	**$443,118**

Future minimum lease payments as lessee under non-capitalized finance leases at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Due within one year	**¥ 8,325**	¥ 8,221	**$ 70,869**
Due after one year	**16,799**	16,863	**143,007**
	¥25,124	¥25,084	**$213,876**
Lease expense for the years ended March 31	**¥ 9,329**	¥ 9,777	**$ 79,416**

Future minimum lease payments as lessee under operating leases at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Due within one year	**¥ 2,655**	¥ 2,921	**$22,602**
Due after one year	**7,385**	9,169	**62,867**
	¥10,040	¥12,090	**$85,469**

Leased assets as lessor under finance leases, accounted for as operating leases, at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Machinery and equipment	**¥ —**	¥159	**$ —**
Less accumulated depreciation	**—**	(149)	**—**
	¥ —	¥ 10	**$ —**

Future minimum lease payments to be received as lessor under finance leases, accounted for as operating leases, at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Future minimum lease payments receivable:			
Due within one year	**¥ —**	¥ 6	**$ —**
Due after one year	**—**	4	**—**
	¥ —	¥10	**$ —**
Lease income for the years ended March 31	**¥ 1**	¥15	**$ 9**

Future minimum lease payments receivable as lessor under operating leases, at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Due within one year	**¥ 356**	¥ 359	**$ 3,031**
Due after one year	**3,984**	4,344	**33,915**
	¥4,340	¥4,703	**$36,946**

4. Securities

The following tables summarize acquisition costs, book values and fair values of securities with available fair values as of March 31, 2006 and 2005:

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2006			2005			2006
	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	**¥50**	**¥51**	**¥1**	¥50	¥52	¥2	**$9**
	¥50	**¥51**	**¥1**	¥50	¥52	¥2	**$9**

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2006			2005			2006
	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	**¥38,618**	**¥149,609**	**¥110,991**	¥28,516	¥70,467	¥41,951	**$944,845**
Other	**10**	**16**	**6**	10	10	—	**51**
	38,628	**149,625**	**110,997**	28,526	70,477	41,951	**944,896**
Other securities:							
Equity securities	**353**	**260**	**(93)**	1,920	1,618	(302)	**(792)**
Other	**—**	**—**	**—**	3	2	(1)	**—**
	353	**260**	**(93)**	1,923	1,620	(303)	**(792)**
	¥38,981	**¥149,885**	**¥110,904**	¥30,449	¥72,097	¥41,648	**$944,104**

The following table summarizes book values of securities with no available fair values as of March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Held-to-maturity debt securities			
Non-listed foreign bond	**¥100**	¥ —	**$851**

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Available-for-sale securities:			
Non-listed equity securities	**¥21,792**	¥20,750	**$185,511**
Preferred subscription certificate	**5,000**	5,000	**42,564**

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)
	2006	2005	2006
Within one year	**¥ 50**	¥ —	**$426**
Over one year but within five years	**100**	50	**851**

Sales of available-for-sale securities for the years ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Sales	**¥1,602**	¥1,409	**$13,638**
Gains on sales	**428**	497	**3,643**
Losses on sales	**15**	4	**128**

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, 2006 and 2005 were as follows:

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2006			2005			**2006**
	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	**¥11,305**	**¥11,430**	**¥(125)**	¥11,000	¥11,205	¥(205)	**$(1,064)**
Others	**—**	**—**	**—**	160	159	1	**—**
To buy foreign currencies:							
U.S. dollars	**7,809**	**7,807**	**(2)**	7,981	7,980	(1)	**(17)**
Others	**—**	**—**	**—**	32	31	(1)	**—**
			¥(127)			¥(206)	**$(1,081)**

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, 2006 and 2005.

Interest rate swap agreements outstanding at March 31, 2006 and 2005 were as follows:

	Millions of yen				Thousands of U.S. dollars (Note 1)
	2006		2005		**2006**
	Contracted amount	Recognized gain (loss)	Contracted amount	Recognized gain (loss)	Recognized gain (loss)
Interest rate swap agreements					
To receive floating and pay fixed rates	**¥ 738**	**¥ (2)**	¥ 1,800	¥ (14)	**$ (17)**
To receive fixed and pay floating followed by fixed rates	**55,300**	**(1,450)**	55,300	(1,750)	**(12,344)**
		¥(1,452)		¥(1,764)	**$(12,361)**

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, 2006 and 2005.

6. Short-Term Borrowings and Long-Term Debt

Short-term borrowings at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Bank loans (average rate 1.42% in 2006 and 1.2% in 2005)	**¥119,300**	¥106,245	**$1,015,578**
Commercial paper (average rate 0.0% in 2005)	**—**	15,000	**—**
	¥119,300	¥121,245	**$1,015,578**

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
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	**$ 85,128**
0.3% to 3.5% yen bonds, due 2006 through 2015	**252,579**	272,800	**2,150,158**
Zero coupon convertible bond, due 2006	**—**	30,000	**—**
Euro medium-term notes, due 2006	**1,203**	1,220	**10,241**
Loans, principally from banks and insurance companies	**335,894**	375,222	**2,859,402**
	599,676	689,242	**5,104,929**
Less current portion	**105,451**	111,942	**897,685**
	¥494,225	¥577,300	**$4,207,244**

The aggregate annual maturities of long-term debt at March 31, 2006 were as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars (Note 1)
2007	¥105,451	$ 897,685
2008	139,382	1,186,533
2009	97,151	827,028
2010 and thereafter	257,692	2,193,683
	¥599,676	$5,104,929

At March 31, 2006 and 2005, 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)
	2006	2005	**2006**
Assets pledged as collateral			
Plant and equipment-net of accumulated depreciation	**¥249,777**	¥270,440	**$2,126,305**
Other assets	**44,692**	39,128	**380,455**
	¥294,469	¥309,568	**$2,506,760**
Secured short-term borrowings and long-term debt			
Bonds (includes due within 1 year)	**¥ 1,800**	¥ 2,720	**$ 15,323**
Short-term borrowings	**19,473**	23,618	**165,770**
Long-term borrowings (includes due within 1 year)	**133,063**	140,174	**1,132,740**
Other debt	**—**	2	**—**
	¥154,336	¥166,514	**$1,313,833**

At March 31, 2006 and 2005, 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)
	2006	2005	**2006**
Short-term borrowings	**¥ 7,853**	¥ 7,594	**$ 66,851**
Long-term borrowings	**31,069**	38,721	**264,485**
Guarantee of loans	**587**	716	**4,997**
	¥39,509	¥47,031	**$336,333**

7. Contingent Liabilities

At March 31, 2006 and 2005 the Company and its consolidated domestic subsidiaries were contingently liable as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Trade notes discounted	**¥1,932**	¥1,085	**$16,447**
Trade notes endorsed	**625**	516	**5,321**
Guarantees of loans			
Related parties	**3,260**	1,351	**27,752**
Others	**1,087**	1,626	**9,253**
	¥6,904	¥4,578	**$58,773**

Guarantees of loans include contingent guarantees and letters of awareness of ¥700 million ($5,959 thousand) in 2006 and ¥802 million in 2005.

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, 2006 were ¥24,121 million ($205,338 thousand) and ¥19,700 million for the year ended March 31, 2005.

10. Selling, General and Administrative Expenses

Selling, general and administrative expenses for the years ended March 31, 2006 and 2005 were summarized as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Freight	¥ 40,079	¥ 34,847	$ 341,185
Employees' compensation	36,681	31,421	312,258
Research and development	9,565	6,659	81,425
Depreciation	3,022	2,718	25,726
Other	60,280	61,128	513,153
	¥149,627	¥136,773	$1,273,747

11. Loss on Separation of Real Estate Business

The Company transferred its real estate business to its subsidiary, Shinko Real Estate Co., Ltd., on October 1, 2005.

Loss on Separation of Real Estate Business was incurred due to the loss on revaluation of real estate arising from the transfer.

12. Loss on Impairment of Fixed Assets

Loss on impairment of fixed assets for the year ended March 31, 2005 consisted of the following:

	Millions of yen
Leasehold property	
Land (Ichikawa, Chiba Prefecture, etc. : 4 properties in total)	¥1,573
Idle assets	
Buildings and structures, land, etc. (Kaizuka, Osaka Prefecture, etc. : 15 properties in total)	2,259
Assets for business	
Buildings and structures, land, etc. (Amagasaki, Hyogo Prefecture, etc. : 4 properties in total)	5,244
	¥9,076

The Company and its consolidated domestic subsidiaries grouped their fixed assets based on the unit of business establishments in principle, and recognized impairment losses for the leasehold property and idle assets whose fair value have diminished significantly compared to book values due to the recent decline in land prices, and a part of assets for business due to the deterioration of profitability or recent decline in land prices.

Book values of those fixed assets were reduced to recoverable amounts and impairment loss of ¥9,076 million was recognized in the year ended March 31, 2005. The amount consisted of buildings and structures of ¥1,325 million, machinery and equipment of ¥695 million, land of ¥6,990 million, and other assets of ¥65 million.

The recoverable amounts of leasehold property and idle assets were net realizable values calculated based on publicly-assessed land values.

The recoverable amount of assets for business was the present values of expected cash flows from on-going utilization and subsequent disposition of assets based on the discount rate of 6%.

13. Income Taxes

Significant components of the Group's deferred income tax assets and liabilities as of March 31, 2006 and 2005 were as follows:

	Millions of yen	Thousands of U.S. dollars (Note 1)
	2006	2006
Deferred income tax assets		
Employees' severance and retirement benefits	¥ 21,792	$ 185,511
Unrealized profit	21,279	181,144
Loss on write down of securities	6,425	54,695
Land revaluation	6,253	53,231
Loss on impairment of fixed assets	5,659	48,174
Enterprise taxes	3,210	27,326
Loss carryforwards	2,426	20,652
Provision for environmental measures	2,246	19,120
Other	34,646	294,934
Total deferred income tax assets	103,936	884,787
Valuation allowance	(22,020)	(187,453)
Deferred income tax assets	81,916	697,334
Deferred income tax liabilities		
Net unrealized holding gains on securities	45,107	383,987
Special tax purpose reserve	9,114	77,586
Land revaluation	6,027	51,307
Other	14,710	125,223
Total deferred income tax liabilities	74,958	638,103
Net deferred income tax assets	¥ 6,958	$ 59,231

	Millions of yen
	2005
Deferred income tax assets	
Employees' severance and retirement benefits	¥ 21,416
Unrealized profit	21,059
Loss on write down of securities	10,991
Loss carryforwards	8,433
Loss on impairment of fixed assets	5,806
Loss on write down of inventories	4,448
Other	35,687
Total deferred income tax assets	107,840
Valuation allowance	(12,591)
Deferred income tax assets	95,249
Deferred income tax liabilities	
Net unrealized holding gains on securities	16,908
Gain on merger	11,700
Special tax purpose reserve	8,146
Other	12,615
Total deferred income tax liabilities	49,369
Net deferred income tax assets	¥ 45,880

Significant items in the reconciliations of the aggregate statutory income tax rate to the effective income tax rate for the years ended March 31, 2006 and 2005 were as follows:

	2006
Aggregate statutory income tax rate in Japan	**40.6%**
Non-deductible entertainment expenses	**1.4**
Other	**0.8**
Effective income tax rate	**42.8%**

	2005
Aggregate statutory income tax rate in Japan	40.6%
Non-deductible entertainment expenses	2.6
Other	1.1
Effective income tax rate	44.3%

14. Consolidated Statements of Cash Flows

The reconciliations of cash and cash equivalents in the cash flow statements and balance sheets as of March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Cash and cash equivalents (balance sheets)	**¥96,188**	¥81,824	**$818,830**
Time deposits (due over 3 months)	**(703)**	(1,232)	**(5,984)**
Cash and cash equivalents (cash flow statements)	**¥95,485**	¥80,592	**$812,846**

Non-cash financing activities as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Convertible bond converted into common stock	**¥15,150**	¥ —	**$128,969**
Convertible bond converted into capital surplus	**15,150**	—	**128,969**
Bond premium	**(300)**	—	**(2,554)**
Decrease in convertible bond due to exercise of warrants	**¥30,000**	¥ —	**$255,384**

15. Related Party Transactions

Net sales include sales to Shinsho Corporation, which is an affiliate of the Company, of ¥197,701 million ($1,682,991 thousand) and ¥170,148 million for the years ended March 31, 2006 and 2005, respectively.

16. 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, 2006 and 2005 consists of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Projected benefit obligation	**¥(216,497)**	¥(211,158)	**$(1,842,998)**
Fair value of pension assets	**216,424**	167,376	**1,842,377**
Unrecognized net transition obligation	**833**	1,374	**7,091**
Unrecognized actuarial differences	**(31,244)**	11,673	**(265,974)**
Prepaid pension cost	**(22,497)**	(18,407)	**(191,513)**
Liability for severance and retirements benefits	**¥ (52,981)**	¥ (49,142)	**$ (451,017)**

Included in the consolidated statements of income for the years ended March 31, 2006 and 2005 are severance and retirement benefit expenses comprised of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	**2006**
Service costs – benefits earned during the year	**¥ 6,463**	¥ 6,782	**$ 55,018**
Interest cost on projected benefit obligation	**4,800**	4,993	**40,861**
Expected return on plan assets	**(2,262)**	(3,031)	**(19,256)**
Amortization of net transition obligation	**1,037**	12,837	**8,828**
Amortization of actuarial differences	**1,733**	2,095	**14,753**
Amortization of prior service costs	**—**	(7,067)	**—**
Severance and retirement benefit expenses	**¥11,771**	¥16,609	**$100,204**

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 2.0% in 2006 and 2.5% in 2005.
The rates of expected return on plan assets used by the Group are mainly 2.1% in 2006 and 2.9% in 2005.

17. Segment Information

(1) Industry Segment

The Group's operations are divided into seven principal business segments:
Iron and Steel, Wholesale Electricity Supply, Aluminum and Copper, Machinery, Construction Machinery, Real Estate, and Electronic Materials & Other Businesses.
Business segment information was as follows:

Years ended March 31, 2006 and 2005		Millions of yen		Thousands of U.S. dollars (Note 1)
		2006	2005	**2006**
Sales to outside customers:	Iron and Steel	**¥ 734,749**	¥ 613,803	**$ 6,254,780**
	Wholesale Power Supply	**65,209**	58,601	**555,112**
	Aluminum and Copper	**303,890**	282,091	**2,586,958**
	Machinery	**246,912**	215,207	**2,101,916**
	Construction Machinery	**226,645**	206,065	**1,929,386**
	Real Estate	**43,543**	28,562	**370,673**
	Electronic Materials & Other Businesses	**46,365**	39,443	**394,697**
	Consolidated net sales	**1,667,313**	1,443,772	**14,193,522**
Inter-segment sales:	Iron and Steel	**23,619**	17,524	**201,064**
	Wholesale Power Supply	**—**	—	**—**
	Aluminum and Copper	**1,055**	892	**8,981**
	Machinery	**12,366**	11,639	**105,269**
	Construction Machinery	**382**	583	**3,252**
	Real Estate	**3,702**	3,911	**31,515**
	Electronic Materials & Other Businesses	**14,763**	14,565	**125,674**
		55,887	49,114	**475,755**
Total sales:	Iron and Steel	**758,368**	631,327	**6,455,844**
	Wholesale Power Supply	**65,209**	58,601	**555,112**
	Aluminum and Copper	**304,945**	282,983	**2,595,939**
	Machinery	**259,278**	226,846	**2,207,185**
	Construction Machinery	**227,027**	206,648	**1,932,638**
	Real Estate	**47,245**	32,473	**402,188**
	Electronic Materials & Other Businesses	**61,128**	54,008	**520,371**
		1,723,200	1,492,886	**14,669,277**
Operating costs and expenses:	Iron and Steel	**627,462**	539,459	**5,341,466**
	Wholesale Power Supply	**45,679**	39,105	**388,857**
	Aluminum and Copper	**281,583**	266,073	**2,397,063**
	Machinery	**248,896**	216,529	**2,118,805**
	Construction Machinery	**218,199**	199,429	**1,857,487**
	Real Estate	**42,118**	29,394	**358,543**
	Electronic Materials & Other Businesses	**43,663**	39,942	**371,695**
	Eliminations	**(60,682)**	(52,736)	**(516,575)**
	Consolidated operating costs and expenses	**1,446,918**	1,277,195	**12,317,341**
Operating income:	Iron and Steel	**130,906**	91,868	**1,114,378**
	Wholesale Power Supply	**19,530**	19,496	**166,255**
	Aluminum and Copper	**23,362**	16,910	**198,876**
	Machinery	**10,382**	10,316	**88,380**
	Construction Machinery	**8,828**	7,220	**75,151**
	Real Estate	**5,127**	3,078	**43,645**
	Electronic Materials & Other Businesses	**17,465**	14,066	**148,676**
	Eliminations	**4,795**	3,623	**40,820**
	Consolidated operating income	**¥ 220,395**	¥ 166,577	**$ 1,876,181**

Years ended March 31, 2006 and 2005		Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 1) 2006
Assets:	Iron and Steel	¥ 846,890	¥ 796,491	$ 7,209,415
	Wholesale Power Supply	198,548	210,419	1,690,202
	Aluminum and Copper	267,625	234,779	2,278,242
	Machinery	235,355	223,796	2,003,533
	Construction Machinery	215,611	203,787	1,835,456
	Real Estate	141,304	108,908	1,202,894
	Electronic Materials & Other Businesses	117,346	57,547	998,944
	Corporate and Eliminations	51,563	65,475	438,946
	Total	2,074,242	1,901,202	17,657,632
Depreciation:	Iron and Steel	40,764	41,526	347,016
	Wholesale Power Supply	12,487	12,441	106,300
	Aluminum and Copper	13,578	13,596	115,587
	Machinery	5,321	5,625	45,297
	Construction Machinery	3,286	3,135	27,973
	Real Estate	1,514	1,698	12,888
	Electronic Materials & Other Businesses	2,648	2,359	22,542
	Corporate and Eliminations	(91)	(90)	(775)
	Total	79,507	80,290	676,828
Impairment of fixed assets:	Iron and Steel	—	1,744	—
	Wholesale Power Supply	—	—	—
	Aluminum and Copper	—	—	—
	Machinery	—	837	—
	Construction Machinery	—	239	—
	Real Estate	—	4,202	—
	Electronic Materials & Other Businesses	—	—	—
	Corporate and Eliminations	—	2,054	—
	Total	—	9,076	—
Capital expenditures:	Iron and Steel	49,636	37,106	422,542
	Wholesale Power Supply	149	1,039	1,268
	Aluminum and Copper	14,672	13,475	124,900
	Machinery	9,107	3,867	77,526
	Construction Machinery	5,301	5,079	45,126
	Real Estate	8,176	1,211	69,601
	Electronic Materials & Other Businesses	3,041	1,806	25,888
	Corporate and Eliminations	2,237	2,433	19,043
	Total	¥ 92,319	¥ 66,016	$ 785,894

Corporate assets of ¥279,696 million ($2,380,999 thousand) and ¥278,226 million at March 31, 2006 and 2005, respectively, are comprised principally of bank and time deposits and assets of administration departments of the Company.

As mentioned on "1. Basis of Presenting Consolidated Financial Statements," the method of evaluating inventories in the Iron and Steel, Wholesale Power Supply, and Aluminum and Copper segments has been changed from the "last-in, first-out method" to the "average method."

As a result, compared with "last-in, first-out method," operating costs and expenses decreased by ¥19,125 million ($162,807 thousand) in the Iron and Steel segment, ¥89 million ($758 thousand) in the Wholesale Power Supply segment and ¥5,074 million ($43,194 thousand) in the Aluminum and Copper segment.

Also, operating income in the above segments increased by the same amounts respectively.

(2) Overseas Sales

Overseas sales for the years ended March 31, 2006 and 2005 were as follows:

		Percentages of 2006 consolidated net sales	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 1) 2006
Overseas Sales:	Asia	15.3%	¥255,645	¥229,764	$2,176,258
	Other areas	9.9	165,228	136,160	1,406,555
	Total	25.2%	¥420,873	¥365,924	$3,582,813

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, Korea, Thailand, Malaysia
Other areas	United States

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, 2006 and 2005, and the related consolidated statements of income, stockholders' 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, 2006 and 2005, 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.

Without qualifying our opinion, we draw attention to the following.

(1) As discussed in Note 2 (19) to the consolidated financial statements, Kobe Steel, Ltd. and consolidated domestic subsidiaries adopted early the new accounting standards for impairment of fixed assets in the year ended March 31, 2005.

(2) As discussed in Note 1 to the consolidated financial statements, commencing in the year, ended 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".

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 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.

KPMG AZSA & Co.

Osaka, Japan
June 28, 2006

Directors, Corporate Auditors, and Corporate Officers

(As of June 28, 2006)

Chairman of the Board and Representative Director

Koshi Mizukoshi

President, Chief Executive Officer and Representative Director

Yasuo Inubushi

■ Head Office and Technical Development Group

Executive Vice President and Representative Director

Hiroshi Sato

Senior Managing Directors

Takashi Matsutani
Keiji Koyama

Senior Officers

Tatsuki Yoshida
Yutaka Kawata
Hiroaki Fujiwara

Officers

Hiroji Izumi
Seiji Okita
Yuichi Seki

■ Iron and Steel Sector

Executive Vice President and Representative Director

Toshio Kimura

Executive Officer

Tomoyuki Kaya

Senior Officers

Tsuyoshi Tanaka
Masaaki Nakazono
Koichi Onishi
Keiichi Murase

Officers

Terumichi Abe
Takanori Kominami
Ikuhiro Yamaguchi
Yasunobu Kumon
Hironobu Yoshida
Masayasu Kimura

■ Welding Company

Senior Managing Director

Isao Aida *

■ Aluminum and Copper Company

Senior Managing Director

Hiroyuki Nakayama *

Senior Officers

Hideo Ohgi
Tetsu Takahashi
Ryosuke Shimomura

Officer

Seiichi Nagai

■ Machinery and Engineering Company

Executive Vice President and Representative Director

Shigeto Kotani *

Senior Officers

Kazuo Shigekawa
Jun Tanaka

Officer

Shuzo Mohri

Statutory Auditors

Toru Asaoka
Toshinori Okoshi
Shigetake Ogata
Taku Morota
Takasuke Kaneko

Note: *Denotes the president of the company

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Hokuriku (Toyama)
Shikoku (Takamatsu)
Chugoku (Hiroshima)
Kyushu (Fukuoka)
Okinawa (Naha)

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Kobe Steel, Ltd.
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PEOPLE'S REPUBLIC OF CHINA
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Shanghai 200020 PEOPLE'S REPUBLIC OF CHINA
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Research Laboratory
Kobe Corporate Research Laboratories
5-5, Takatsukadai 1-chome, Nishi-ku, Kobe, Hyogo 651-2271
Phone: (078) 992-5600 Fax: (078) 992-5532

Investor Information

(as of March 31, 2006)

Founded: September 1905
Incorporated: June 1911
Employees: 8,673 (Consolidated 29,068)
Fiscal Year: April 1-March 31

General Meeting: The ordinary general meeting of the Company's stockholders is usually held in Kobe, Japan in June of each year.

Authorized and Issued Share Capital:

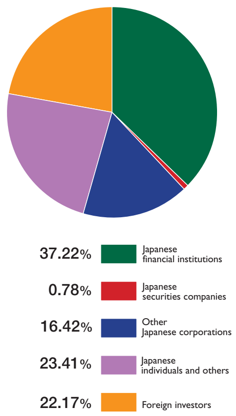
The authorized share capital of the Company, as defined in the Articles of Incorporation, is 6,000,000,000 shares of common stock. At March 31, 2006, a total of 3,115,061,100 were in issue.

Principal Stockholders:

At March 31, 2006, the ten largest stockholders of the Company were as follows:

	Thousands of share	Percent
Japan Trustee Services Bank, Ltd.	174,137	5.59%
Nippon Life Insurance Company	139,234	4.47%
The Master Trust Bank of Japan, Ltd.	138,340	4.44%
Mizuho Corporate Bank, Ltd.	70,369	2.26%
Nippon Steel Corporation	63,975	2.05%
Sumitomo Metal Industries, Ltd.	63,975	2.05%
Mitsubishi UFJ Trust and Banking Corporation	52,336	1.68%
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	47,347	1.52%
Sojitz Corporation	42,016	1.35%
State Street Bank and Trust Company 505103	37,985	1.22%

Distribution of Shares:



Directors' and Corporate Auditors' Stockholdings

The following is a list of the directors and corporate auditors with their stockholdings in the Company at June 28, 2006.

	Number of shares owned
Koshi Mizukoshi	249,000
Yasuo Inubushi	114,000
Hiroshi Sato	137,000
Toshio Kimura	108,000
Shigeto Kotani	96,000
Hiroyuki Nakayama	56,000
Takashi Matsutani	89,000
Isao Aida	70,000
Keiji Koyama	56,000
Toru Asaoka	102,000
Toshinori Okoshi	44,000
Shigetake Ogata	28,000
Taku Morota	38,000
Takasuke Kaneko	19,000

Listing 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.

Depositary for American Depositary Receipts:

The Bank of New York Company Inc.
101 Barclay Street, New York, NY 10286, U.S.A.
Tel: +1(212)815-3700 (U.S. toll free: 888-269-2377)
URL:http://www.adrbny.com

Public Notices:

http://www.kobelco.co.jp

* All public notices of the Company shall be given by electronic means. In the event that the Company is unable to give electronic public notice, the public notices shall be published in the Nihon Keizai Shimbun.

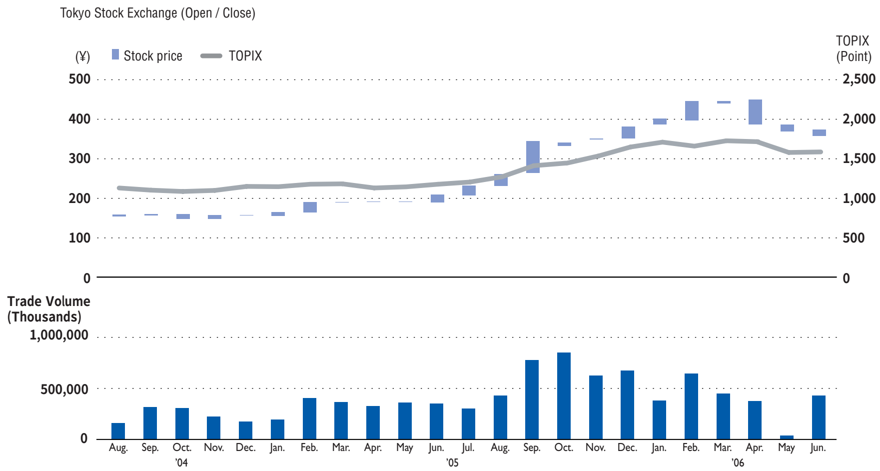
Transfer Agent & Office:

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

Independent Auditors:

KPMG AZSA & Co.
6-5, Kawara-machi 3-chome, Chuo-ku, OSAKA 541-0048 JAPAN

Common Stock Price Range:



Information:

Japan
IR Group
Corporate Planning Department
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KOBE STEEL GROUP

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