The "Only One" Brand – KOBELCO

ANNUAL REPORT 2007

Year Ended March 31, 2007

KOBELCO

KOBE STEEL GROUP

KOBELCO
KOBE STEEL GROUP

Profile

The Kobe Steel Group, a global enterprise built around Kobe Steel, Ltd., is engaged in three major business fields: materials, machinery and power supply. In the materials field, its primary businesses consist of iron and steel, welding, and aluminum and copper products. The machinery field comprises industrial machinery, construction machinery, environmental solutions, and engineering. The third field is the wholesale power supply business.

Our distinctive "Only One" products—original products that defy competitor imitation—are recognized around the world under the KOBELCO brand. Under its Corporate Philosophy, the Kobe Steel Group has set its sights on achieving greater Group unity and further consolidating Group strength. Through the continual creation of new and distinctive products, technologies and outstanding services, we will raise our profitability, create greater enterprise value, and broadly contribute to building a better society.

The Kobe Steel Group's Corporate Philosophy for Group Unity

■ Our 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

Strengthening Group Capabilities

The Kobe Steel Group has established KOBELCO as the Group brand and is expanding its use. With each and every Group company working together to develop the brand value of KOBELCO, together we will build strong Group unity and gain the trust of the communities that we serve.

Contents

Caution Regarding Forward-Looking Statements

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

＊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.

Consolidated Financial Highlights

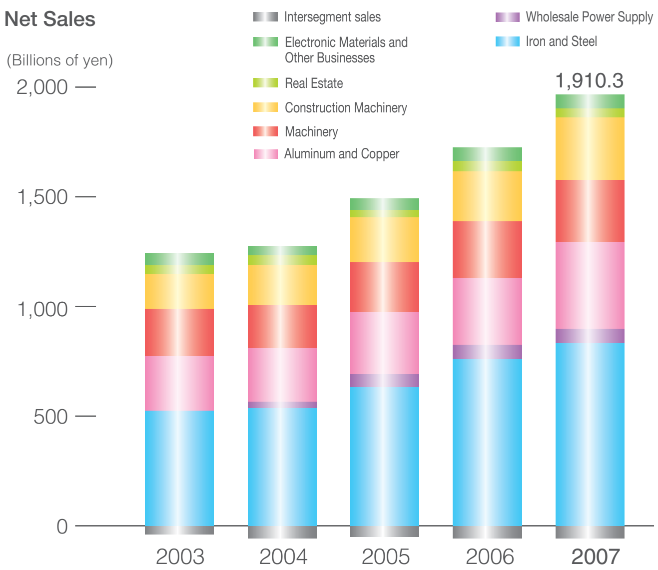
Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2007 and 2006

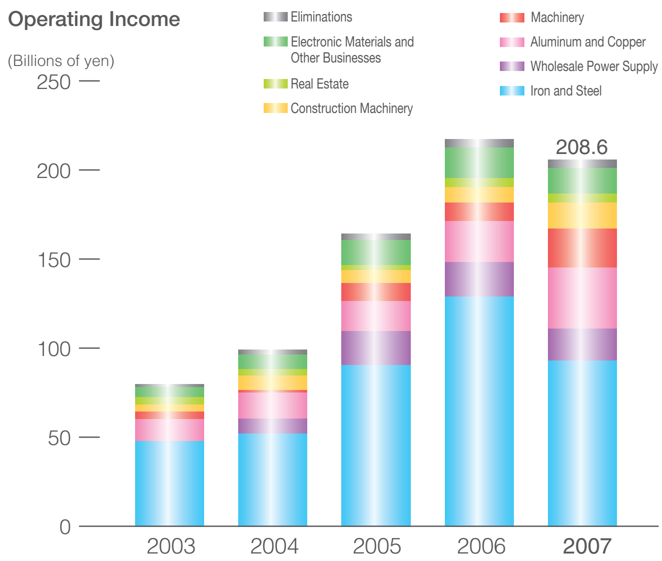
	Millions of yen		Percent change	Thousands of U.S. dollars (Note 1)
	2007	2006	2007/2006	2007
For the year:				
Net sales	**¥1,910,296**	¥1,667,313	14.6%	**$16,182,092**
Iron and Steel	**830,696**	758,368	9.5	**7,036,815**
Wholesale Power Supply	**66,858**	65,209	2.5	**566,353**
Aluminum and Copper	**397,310**	304,945	30.3	**3,365,608**
Machinery	**280,947**	259,278	8.4	**2,379,898**
Construction Machinery	**285,383**	227,027	25.7	**2,417,476**
Real Estate	**41,362**	47,245	(12.5)	**350,377**
Electronic Materials and Other Businesses	**63,579**	61,128	4.0	**538,577**
Total sales	**1,966,135**	1,723,200	14.1	**16,655,104**
Intersegment sales	**(55,839)**	(55,887)	(0.1)	**(473,012)**
Operating income	**208,624**	220,395	(5.3)	**1,767,251**
Iron and Steel	**94,589**	130,906	(27.7)	**801,262**
Wholesale Power Supply	**18,021**	19,530	(7.7)	**152,656**
Aluminum and Copper	**34,671**	23,362	48.4	**293,698**
Machinery	**22,132**	10,382	113.2	**187,480**
Construction Machinery	**14,803**	8,828	67.7	**125,396**
Real Estate	**5,314**	5,127	3.6	**45,015**
Electronic Materials and Other Businesses	**14,304**	17,465	(18.1)	**121,169**
Eliminations	**4,790**	4,795	(0.1)	**40,575**
Income before income taxes	**175,375**	152,693	14.9	**1,485,599**
Net income	**109,669**	84,559	29.7	**929,005**
Capital investment	**133,649**	92,319	44.8	**1,132,141**
Depreciation and amortization	**86,687**	79,507	9.0	**734,324**
Research and development	**24,893**	24,121	3.2	**210,869**
At year end:				
Total assets	**2,241,570**	2,074,242	8.1	**18,988,310**
Net assets (Note 2)	**636,432**	530,000	20.1	**5,391,207**
Interest-bearing debt	**621,227**	589,101	5.5	**5,262,406**
Interest-bearing debt including IPP project financing	**742,276**	720,909	3.0	**6,287,810**

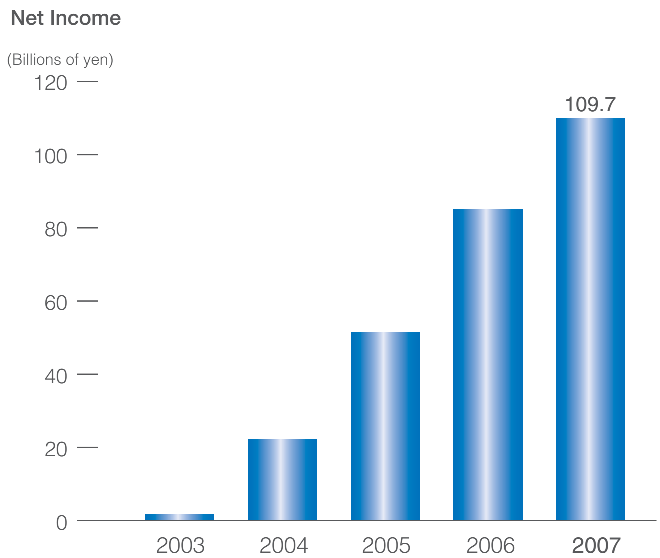
	Yen		Percent change	U.S. dollars (Note 1)
	2007	2006	2007/2006	2007
Per share data:				
Net income	**¥35.37**	¥27.94	26.6%	**$0.30**
Net assets	**194.46**	170.65	14.0	**1.65**
Cash dividends	**7.00**	6.00	16.7	**0.06**

Notes 1. For convenience only, U.S. dollar amounts in this report have been translated from Japanese yen at the rate of ¥118.05 to US$1.00, the rate of exchange prevailing on March 31, 2007.

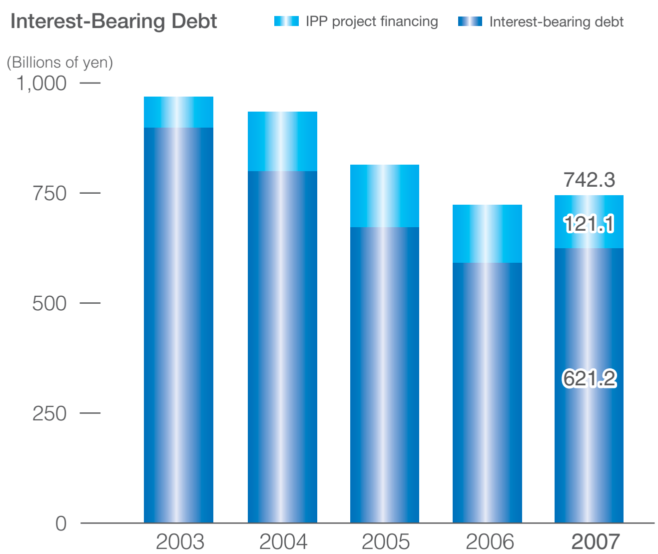
2. Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Statement No. 5 issued by the Accounting Standards Board of Japan on December 9, 2005), and the implementation guidance for the accounting standard for presentation of net assets in the balance sheet (the Financial Accounting Standard Implementation Guidance No. 8 issued by the Accounting Standards Board of Japan on December 9, 2005).

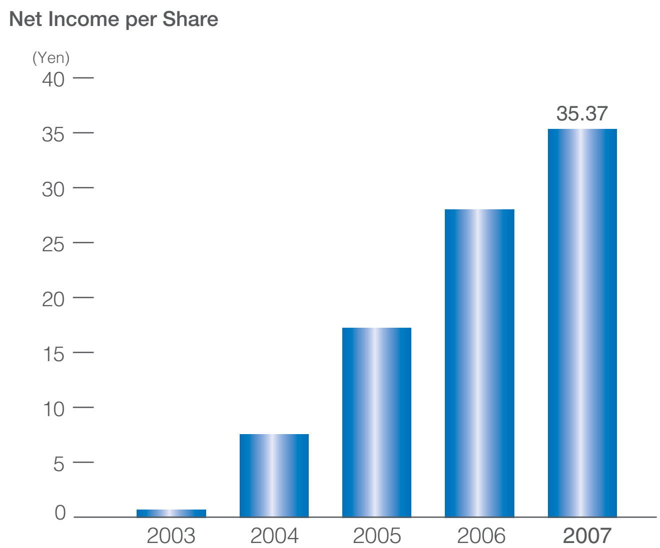

Net Sales
(Billions of yen)
Intersegment sales
Electronic Materials and Other Businesses
Real Estate
Construction Machinery
Machinery
Aluminum and Copper
Wholesale Power Supply
Iron and Steel
1,910.3
2,000
1,500
1,000
500
0
2003
2004
2005
2006
2007


Operating Income
(Billions of yen)
Eliminations
Electronic Materials and Other Businesses
Real Estate
Construction Machinery
Machinery
Aluminum and Copper
Wholesale Power Supply
Iron and Steel
208.6
250
200
150
100
50
0
2003
2004
2005
2006
2007


Net Income
(Billions of yen)
109.7
120
100
80
60
40
20
0
2003
2004
2005
2006
2007


Net Assets
(Billions of yen)
636.4
700
600
500
400
300
200
100
0
2003
2004
2005
2006
2007


Interest-Bearing Debt
IPP project financing
Interest-bearing debt
(Billions of yen)
742.3
121.1
621.2
1,000
750
500
250
0
2003
2004
2005
2006
2007


Net Income per Share
(Yen)
35.37
40
35
30
25
20
15
10
5
0
2003
2004
2005
2006
2007

The First Year of the Fiscal 2006 – 2008 Medium-Term Business Plan—A Decisive First Step

President and CEO Yasuo Inubushi answers questions about the Group's earnings, the progress of the Medium-Term Business Plan and future undertakings.

President, CEO and Representative Director
Yasuo Inubushi

Medium-Term Business Plan Progress

Q Could you tell us what progress was achieved in fiscal 2006, the first year of the Medium-Term Business Plan now underway?

The key words of the Medium-Term Business Plan, which covers the three-year period from fiscal 2006 to 2008, are "stability" and "growth." These key words express our basic goal of attaining a high level of earnings through stability and higher growth.

To that end, Kobe Steel is taking steps to:

1) Increase sales of and develop more "Only One" products—unique and superlative products—the hallmarks of the Kobe Steel Group
2) Fortify our comprehensive manufacturing capabilities with continuous quality improvement—the starting point for every manufacturing company
3) Establish a solid financial position to undertake necessary strategic investments

With a unified effort, the Group is implementing a range of measures through this plan, to achieve our goal of ordinary income of over ¥180.0 billion and net income in excess of ¥100.0 billion in fiscal 2008.

Fiscal 2006, the first year of the Medium-Term Business Plan, got off to a good start overall. The Iron and Steel Segment went all out to respond to strong demand for high-end steel in manufacturing industries, including automotive and shipbuilding. The Aluminum

Progress of Fiscal 2006 – 2008 Medium-Term Business Plan

(Billions of yen)

	Fiscal 2008 Forecast	**Fiscal 2006 Results**	Fiscal 2005 Results
Net Sales	1,900	**1,910.3**	1,667.3
Operating Income	230 or more	**208.6**	220.4
Ordinary Income*	180 or more	**183.3**	176.9
Net Income	100 or more	**109.7**	84.6
Interest-Bearing Debt	550 or less	**621.2**	589.1
Interest-Bearing Debt including IPP Project Finance	650 or less	**742.3**	720.9
Debt/Equity Ratio (Times)**	0.8 or less	**1.2**	1.2
ROA***	5% or more	**4.9%**	4.1%
Sales Ratio of "Only One" Products	40% or more	**40%**	40%

* Although not shown on U.S. GAAP consolidated financial statements or in International Financial Reporting Standards, ordinary income is commonly used in Japan as an indication of profits on the statements of income. Kobe Steel calculates ordinary income by adding other income (expenses) to operating income and excluding non-recurring income (expenses) such as loss on impairment of fixed assets and expenses for environmental measures.
** Debt/Equity Ratio = Interest-bearing debt/stockholders' equity
*** ROA = Net income after taxes/total assets

and Copper Segment took aggressive action to cope with surging demand from the automotive, IT and semiconductor industries—all priority areas for us. In the Machinery and Construction Machinery segments, we steadily responded to high investment demand primarily from overseas markets.

As a result of these efforts, Kobe Steel achieved new performance records with ordinary income of ¥183.3 billion and net income of ¥109.7 billion. Numerically, we achieved the Medium-Term Business Plan's profit targets ahead of schedule. Nevertheless, as some factors were beyond our control, such as an inventory valuation in the Aluminum and Copper Segment that drove up earnings, not all profits were the result of our direct efforts alone. As for assessing our own efforts, we see ourselves as still on the road to achieving our goals.

Meanwhile, with respect to priority measures taken, we have steadily increased sales of Only One products including high strength steel sheet for automobiles, titanium products, crankshafts for ships, compressors, plastic processing machinery and natural gas-based direct reduction plants. In addition, we are making solid progress toward improving manufacturing capability through a range of measures including the upgrade of basic manufacturing equipment and the improvement of manufacturing technology.

Iron and Steel Segment

Q What can you tell us about the future direction of the Iron and Steel Segment?

With the ongoing economic growth in BRIC nations, especially China, the outlook is for continued growth in global demand for steel. In particular, we expect further increase in demand for high-end steel in the automotive, shipbuilding, electronics and other manufacturing industries. While production capacity is picking up, because the number of companies capable of manufacturing high-end steel, our specialty, is limited, we expect the supply and demand balance for high-end steel to remain tight.

Due to the expected growth in steel demand, prices for key raw materials are expected to have nowhere to go but up for the foreseeable future. Consequently, market conditions for rare metals, including zinc and nickel, are unlikely to soften to any significant degree.

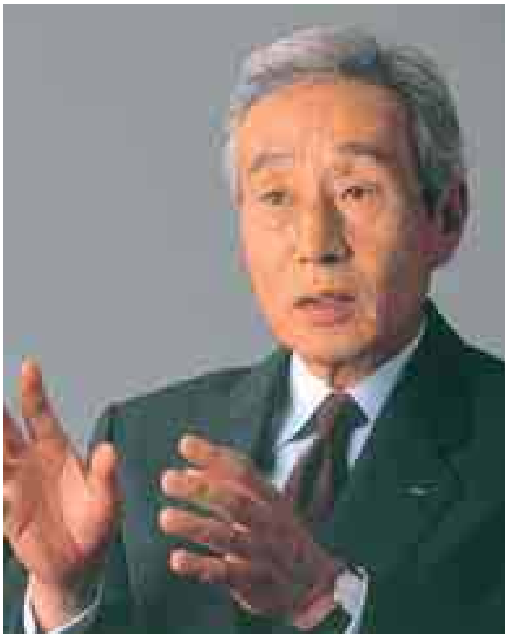
Therefore, we intend to increase sales of Only One products that highlight our strengths. At the same time, we must steadily improve pricing and lower costs to ensure that their profit margins are commensurate with their added value and functionality.

Other Business Segments

Q What is your outlook for the Kobe Steel Group's other business segments?

In the Aluminum and Copper Segment, the automotive, IT and semiconductor markets—areas of particular focus—are showing solid demand growth. We are taking steps to add new production capacity, create more sophisticated, functionally rich products and add greater value. We will use these as tools to gain a decisive advantage.

In the Machinery Segment, we expect high-level demand to continue in the petroleum refining, petrochemical, energy and other fields. Interest in our new iron-making process is increasing in every region of the world. In the Construction Machinery Segment, we expect the global surge in demand to continue for some time. In these segments, through steady response to growing demand, we will gain high order volumes and improve costs.



Capital Investment Strategy

Q What are your thoughts on capital investments to support growth?

We are continuing to make aggressive capital investments to develop and expand our range of Only One products and improving our manufacturing capabilities in accordance with the Medium-Term Business Plan strategies. We are also investing in environmental conservation and improvements.

In the Iron and Steel Segment, in fiscal 2006, our new continuous caster at Kobe Works is now fully up and running, enabling us to raise the ratio of high-end specialty steel production. In fiscal 2007, we will complete the renovation of our No. 2 and No. 3 blast furnaces at the Kakogawa and Kobe works, respectively. We are raising productivity and cutting costs by increasing furnace capacity and optimizing furnace shape to cope with this higher capacity.

In the Aluminum and Copper Segment, we are investing in plant and equipment to meet changing demand. For example we upgraded the motors of a cold rolling mill at our Moka Plant to increase the aluminum sheet rolling speed and upgraded the cold temper rolling mill at the Chofu Works to raise the quality of our high-end copper sheet. In the Machinery Segment, in response to favorable demand, our spending is focused on the addition of production capacity.

Quickly reaping the benefits of these investments will allow us to develop our strengths in a variety of areas, including quality, function and cost, while we steadily respond to demand in fields of promising growth.

In addition, we will balance these actions with the creation of a sound financial position.

Compliance

Q Last year, Kobe Steel experienced problems concerning certain air emissions and the improper monitoring of environmental data at some of its steel facilities. What progress have you made in preventing the recurrence of such incidents?

With respect to the May 2006 revelation of our departure from air and dust emission standards at the Kakogawa and Kobe works, the improper monitoring of data, and the failure to report boiler accidents to relevant authorities, I wish to express my sincerest apologies for the trouble and worry that were caused by these incidents.

To prevent a recurrence and to achieve environmental safety and rigorous compliance with the law, we are conducting environmental safety and compliance training for our employees. At the same time, we have improved our environmental management system, established the Environmental Administration Committee composed of well-known experts from outside the Group, and strengthened environmental oversight with consultants and other external participants. As for equipment and technology, we have taken steps to reduce air and dust emissions by installing various kinds of equipment, including devices that securely load coal into the boilers for desulfurization. In this way, we have been strengthening our preventative measures.

We are also actively investing in local environmental conservation, such as installing dust nets at the Kakogawa Works to reduce the level of dust. At Kobe Steel, environmental conservation and compliance continue to be management priorities and the focus of rigorous and ongoing Group efforts.

Distributing Profits to Shareholders

Q What are your thoughts about distributing profits to shareholders?

Kobe Steel's basic policy is to make continuous and stable dividend payments while taking into account such factors as earnings, dividend payout ratios, investment funds needed for future growth and improvements in our financial position.

The Company has established a benchmark dividend payout ratio of 15 – 25% of net income on a consolidated basis. Based on this policy, and after factoring in Kobe Steel's earnings performance for the period, the dividend payment in fiscal 2006 was ¥7 per share, ¥1 per share higher than in the previous fiscal year. With net income at ¥109.7 billion, the payout ratio was 19.8%.

Over the next several years, we foresee continuing demand for substantial amounts of funds, especially for capital spending. By raising our earning capacity, we can improve our ability to generate cash flows and thereby respond to shareholders' and investors' expectations.

Raising Corporate Value

Q What final message do you have for shareholders and investors?

Under the KOBELCO brand name, the Kobe Steel Group will continue to enhance corporate value by offering a greater range of Only One products and by reinforcing its manufacturing capabilities. Our goal is to increase the level of trust that our various stakeholders, which includes shareholders, investors, customers, employees, and local communities, hold in Kobe Steel.

My sincere hope is that all shareholders and other investors will continue to extend their valued support as we pursue stability and growth into the future.

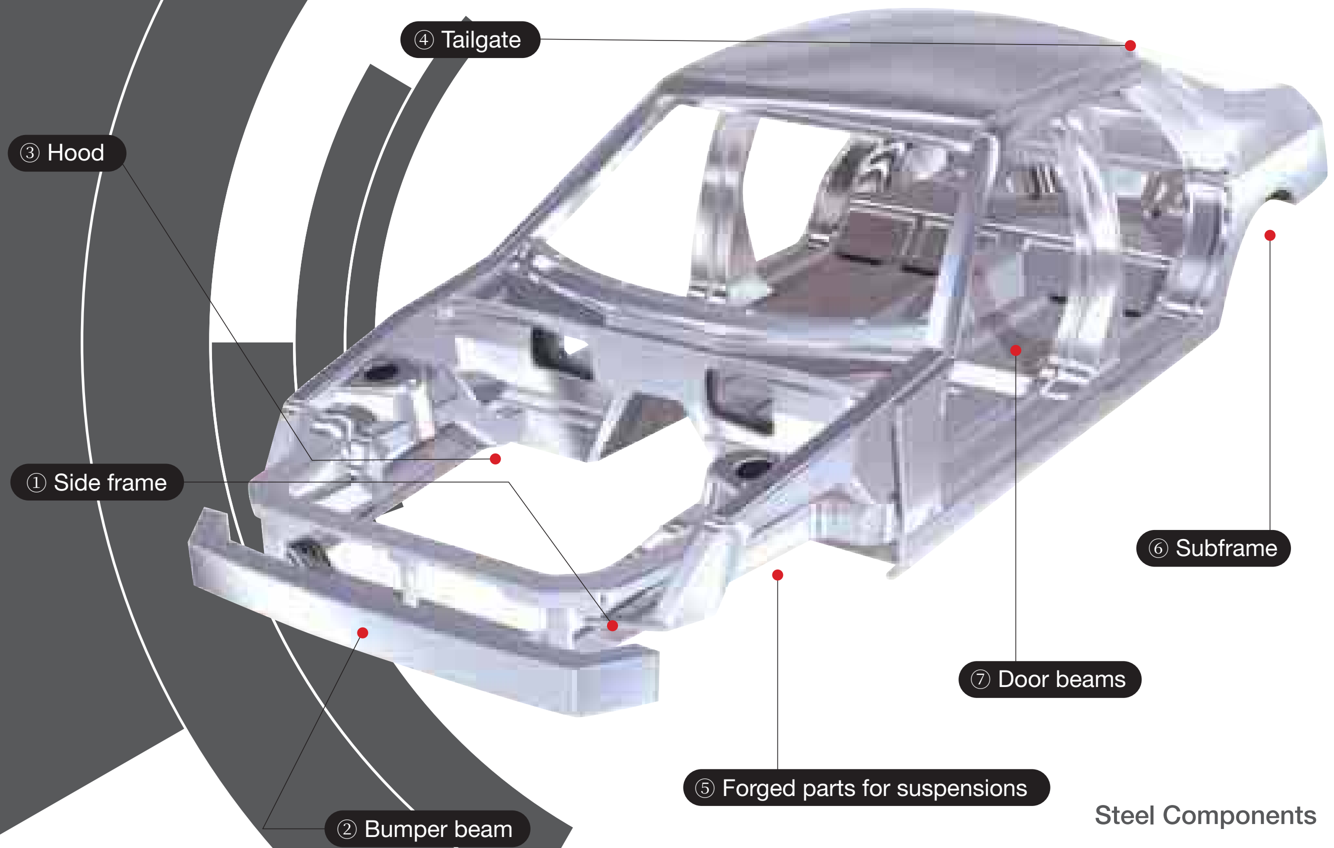
July 2007

Yasuo Inubushi
President, CEO and Representative Director

Feature 1

KOBELCO Know-How

Reshaping



Steel Components

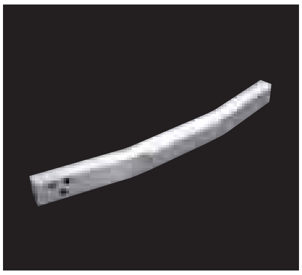
* Wire rod for engine valve springs

Future growth is anticipated in the global automotive industry. Leveraging the know-how developed over the years in such areas as materials, machinery and analysis techniques, the Kobe Steel Group contributes to safer and more ecologically friendly automobile manufacturing with its range of Only One products, which includes high-end steel, aluminum products, and tire manufacturing equipment.

Automobiles

Aluminum Components

① Side frame



② Bumper beam

③ Hood

④ Tailgate

⑤ Forged parts for suspensions

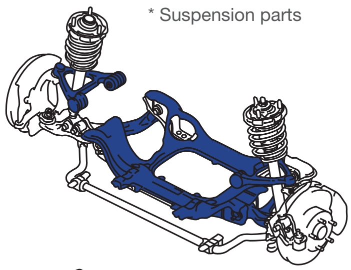
⑥ Subframe

⑦ Door beams

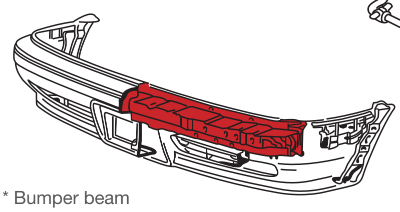
Machinery

Tire machinery

(Batch rubber mixers, tire curing presses, tire uniformity machines)



* Suspension parts



* Bumper beam

* Sheet

* Steel powder for engine and transmission parts

Steel and Automobiles

Automobiles are made of 70% steel, and a wide range of steel products is used in their various parts. Today, with growing demand for both lighter and more fuel-efficient automobiles, as well as for increased safety in the event of collisions, high strength steel sheet is attracting increasing attention.

KOBELCO Strengths

Kobe Steel has pioneered the research and development of high strength steel sheet and has been quick to implement a system of mass-production supply. Ultra high strength steel sheet, an even stronger material, combines high strength with superior workability. The high ratings it has received from auto manufacturers around the world reflect our advanced materials development capabilities acquired from our know-how in specialty steel wire combined with unparalleled customer support technology in the area of high strength steel sheet. In the production of this steel sheet, technological know-how is required at the cooling stage after the application of high temperature heating. Kobe Steel has the world's longest cooling facility and employs cooling technology that no other competitor has, including a wide range of sophisticated cooling patterns that can be precision controlled. One of the advantages of having this proprietary equipment is our ability to provide a stable supply of sophisticated high-quality products.

In 2006, we successfully developed and commercialized ultra high strength steel sheet for automobiles with world-class workability. This material is expected to be gradually incorporated into motor vehicles produced in fiscal 2007 and thereafter.

Production Supply System

The stable procurement of high-grade components in any region of the world is vitally important to automobile manufacturers, who are under continuing global competitive pressure. In response to this need, Kobe Steel is setting up a global supply system for high strength steel sheet for automobiles. At the Kakogawa Works in Japan, where the above-mentioned proprietary equipment is located, we produce this steel sheet for domestic automakers. In the United States, our joint venture with United States Steel Corporation, PRO-TEC Coating Company, supplies local Japanese automakers and the U.S. Big Three automobile manufacturers. In Europe, we have a technology-sharing agreement with voestalpine Stahl GmbH of Austria and are sharing information in a range of areas including technology exchanges and market trends. Researchers from both Kobe Steel and voestalpine were awarded the 2006 SAE/AISI Sydney H. Melbourne Award for Excellence in the Advancement of Automotive Steel Sheet for their joint technical paper "Vehicle Side Structure Concept using Ultra High Strength Steel Sheet and Rollforming Technology."

Continuous annealing line at the Kakogawa Works

Aluminum Products for Automobiles

Aluminum and Automobiles

In recent years, there has been an increasing shift from steel to aluminum as one means of reducing automobile weight. Aluminum is one-third the weight of steel. Because of many cost-related problems in the past, aluminum has mostly been used in high-end automobiles. However, this has changed, and the prospects for aluminum use in mid- to low-end priced automobiles are expanding.

KOBELCO Strengths

Kobe Steel has been involved from the early stages in the adoption of aluminum for use in automobiles, working with automakers in related problem solving and development. Kobe Steel's domestic market share for aluminum forgings for automobile suspensions is currently about 70%, while its share for aluminum panel materials is roughly 50%. This reflects our effectiveness in proposing solutions that convince automakers to make greater use of aluminum. With in-house analysis and design capabilities, our ability to propose optimal aluminum configurations is a major advantage. In addition, our integrated production, from raw material to finished products, gives us a greater advantage in cost competitiveness.

In November 2006, Nissan Motor Co., Ltd. began using our weight-saving aluminum-alloy forgings which is 40% stronger than conventional material, in new domestic car models. In the years ahead, we will leverage our accumulated storehouse of technology and know-how to take the lead in the adoption of aluminum for automobile use.

Production Supply System

In Japan, Kobe Steel manufactures aluminum products for automobiles at three facilities: the Moka Plant in Tochigi Prefecture, the Daian Plant in Mie Prefecture and the Chofu Works in Yamaguchi Prefecture. At the Moka Plant, an aluminum rolling plant boasting the largest production capacity in Asia, we are steadily increasing the production of aluminum panel material for automobiles. As a result, we have already captured a 50% domestic market share in aluminum sheet production. A 1,000-ton press for making prototypes at this facility gives Kobe Steel an unrivaled ability to provide new solutions. At the Chofu Works, our aluminum extrusion facility, we added production capacity and are planning to double capacity by fiscal 2008 for auto bumper material and aluminum stays (a fitting that fastens the bumper to the automobile).

Meanwhile, in the United States, the plant at Kobe Aluminum Automotive Products, LLC (KAAP), a joint venture with Mitsui & Co., Ltd. and Toyoda Tsusho Corporation, came on stream in 2005. KAAP is exclusively devoted to the production of aluminum forgings for automotive suspensions and is steadily increasing its production volume.

6,300-ton forging press at KAAP

Feature 2

KOBELCO Products

Industrial

Aluminum Disks for Hard Disk Drives

Magnetic disks used in computer hard disk drives are made of aluminum alloys. Kobe Steel's production facilities in Japan and Malaysia supply more than 50% of the world's aluminum blanks for these magnetic disks. As a manufacturer with an integrated production system covering everything from materials to substrates, Kobe Steel's aluminum alloy substrates are unrivaled for their smoothness and grinding characteristics.

Photo courtesy of Rolls-Royce plc

Titanium Alloys for Aircraft Engines

As the first company in Japan to begin titanium research, Kobe Steel is Japan's only comprehensive integrated titanium manufacturer involved in every aspect of production, from ingot melting to the final product. Kobe Steel's titanium alloys, manufactured with advanced technological know-how and under rigorous quality standards, are used in aircraft engine and airframe components, and are highly rated both in Japan and abroad. Kobe Steel is adding key titanium manufacturing equipment capacity and responding to a variety of market needs in the expanding aerospace business.

Screw Compressors

Compressors, which pump air and various types of gas by means of pressure, are used in a wide variety of situations, from nonstandard types used in petroleum refining and chemical plants to standard models used as power sources in a wide range of plants. Our screw compressors, which are capable of sustaining the world's highest levels of pressure, are highly rated by customers for their high efficiency, compactness and ability to operate continuously. Kobe Steel holds almost 30% of the global market share for these products. We have also developed standard compressors that offer superior energy savings and low-noise operation and boast one of the highest market shares in Japan.

Screw compressor

Standard compressor

Diversity

Crankshafts for Ships

A crankshaft is a component that translates the reciprocating linear piston motion of diesel engines used in large ships to rotary motion. Built separately within the crankshaft are a rotary shaft component, or "journal," and a "crank throw," a component that corresponds, by analogy, to a bicycle pedal. Assembled from these elements, Kobe Steel's built-up type crankshaft outclasses all competition. By improving manufacturing technology capabilities, raising quality and responding to demand for more sophisticated products, Kobe Steel has retained its position as the world's leading producer for decades.

Chemical Reactors

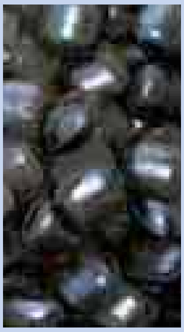
A chemical reactor is a large reactor vessel used for desulfurization, a process that removes the sulfur content from crude oil, and for breaking down crude oil to produce gasoline and light oil. This makes the reactor a critical piece of equipment in petroleum refining plants. Kobe Steel manufactures casting rings and welding consumables—all key reactor components and materials—and is the only manufacturer in the world that integrates everything from fabrication to welding and inspection. Moreover, we hold one of the highest market shares for chemical reactors in the world.

Upgraded Brown Coal Technology

Coal supplies 25% of the world's energy needs. Brown coal and other low-grade coal make up nearly half of all coal reserves. Due to concern over the potential depletion of high-grade coal, the most widely used type, Kobe Steel has developed a technology that upgrades brown coal, allowing it to be effectively utilized as a fuel for electrical power generation.

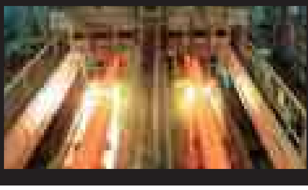
In order to use brown coal, its water content must be removed and its spontaneous combustibility must be contained. Through the application of a water extraction technology developed through research on coal liquefaction, Kobe Steel has developed an innovative technology that removes water content from coal using heated oil, the same principle used in the deep-frying of food. Furthermore, to contain spontaneous combustibility, heavy oil was absorbed into brown coal to fill the tiny air pockets within it, which succeeded in preventing oxygen penetration.

After four years of small-scale testing on a pilot plant as an international project in Indonesia, the world's leading coal producer, and with support from Japan's Ministry of Economy, Trade and Industry, we began construction of a large demonstration plant in Indonesia in fiscal 2007, with the goal of starting commercial marketing of the upgraded brown coal process in 2010.

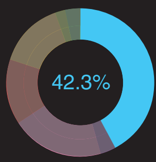


Business Segments

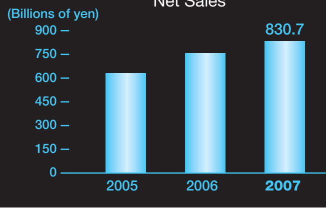
Iron and Steel



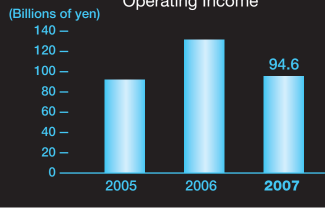
Composition of Net Sales



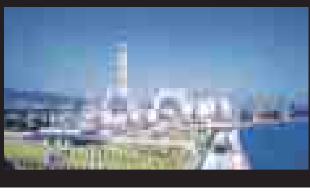
Net Sales



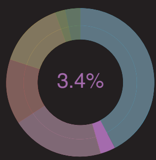
Operating Income



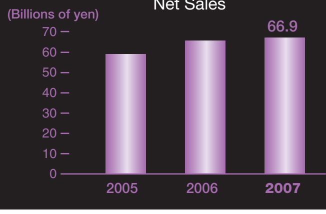
Wholesale Power Supply



Composition of Net Sales



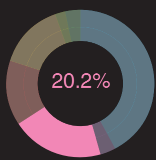
Net Sales



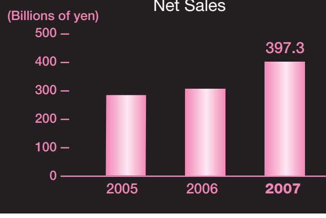
Operating Income

Aluminum and Copper

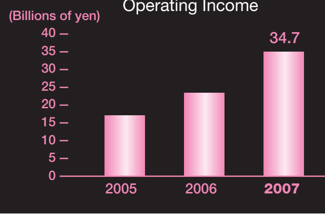
Composition of Net Sales



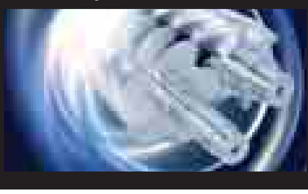
Net Sales



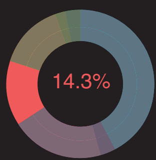
Operating Income



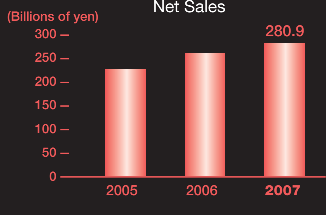
Machinery



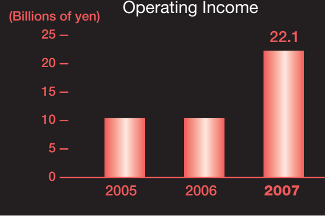
Composition of Net Sales



Net Sales

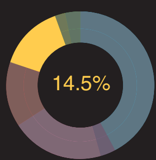


Operating Income

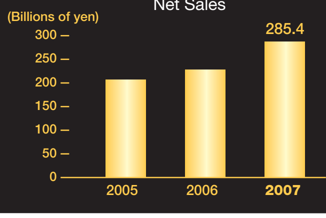


Construction Machinery

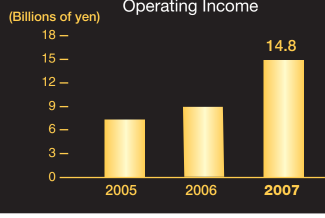
Composition of Net Sales



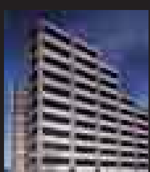
Net Sales



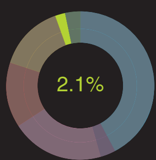
Operating Income



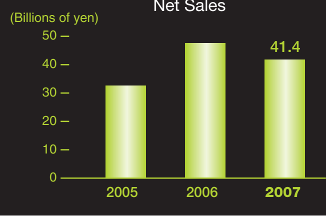
Real Estate



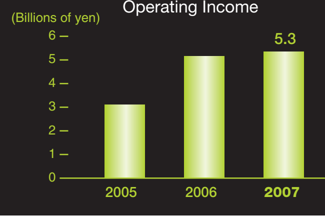
Composition of Net Sales



Net Sales

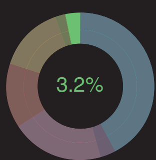


Operating Income

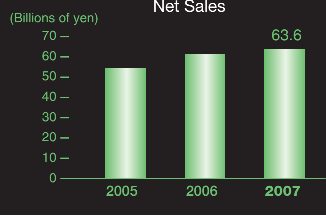


Electronic Materials and Other Businesses

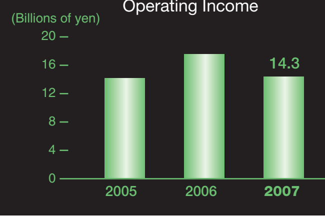
Composition of Net Sales



Net Sales



Operating Income



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

Major "Only One" Products

Wire Rod and 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 and 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 and 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, non-coated welding wire, welding robot systems

Main Products and Services

Wholesale electric power supply

"Only One" Product

Wholesale electric power supply

Main Products and Services

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

Major "Only One" Products

Aluminum Sheet and 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 and 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

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, plastic 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

Major "Only One" Products

Industrial Machinery: Batch-type rubber mixers, tire testing machine, plastic mixing and pelletizing systems, physical vapor deposition system, screw gas compressors, integrally geared turbo gas compressors, oil-flooded standard screw air compressors, compact condensing generators **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 fermentation system, soil remediation, sludge incineration/melting/recycling equipment, mixers, hydrogen & oxygen generation equipment

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

Main Products and Services

Total life business encompassing real estate development, construction, property sales, leasing, remodeling, building management, condominium management, insurance brokering

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, IC testing services, private nursing home management, general trading

Major "Only One" Products

Target material used in LCD panels, semiconductor inspection equipment

Iron and Steel

Business Environment and Performance in Fiscal 2006

Business Environment

Demand for steel in Japan remained strong, especially in the automotive, shipbuilding and other manufacturing industries. Domestic inventories of general steel products, which had accumulated in the previous fiscal year due to a softening in the balance of supply and demand, steadily went down in fiscal 2006. Exports of high-end steel products continued to fare well, while general steel products remained firm with expanding global demand. Demand remained strong for steel castings and forgings in the shipbuilding industry and for titanium products in the aviation industry.

Demand for welding consumables in the shipbuilding, automotive, construction and construction machinery industries in Japan continued to be robust, while overseas demand was especially brisk in shipbuilding and energy-related project fields.

Business Performance

Steel shipments surpassed those of the previous fiscal year thanks to Kobe Steel's steady response to demand, especially for high-end steel products for manufacturing industries. Moreover, steel prices increased slightly year on year owing to a partial upward price revision. Sales of steel castings and forgings, as well as that of titanium products, increased over the previous fiscal year due to burgeoning demand.

All of Kobe Steel's manufacturing facilities for welding consumables operated at high production levels to cope with the robust demand. In addition, the price of welding consumables for stainless steel was revised upward in response to the higher cost of raw materials for stainless steel.

As a result, overall sales in the Iron and Steel Segment climbed 9.5% over the previous fiscal year to ¥830.7 billion. Meanwhile, although last year's inventory valuation boosted fiscal 2005 earnings substantially, the absence of this effect in fiscal 2006, along with changes in the method for calculating depreciation due to revisions in the tax system and expenses incurred in relation to environmental disaster prevention, especially maintenance and construction costs, were all contributing factors to the ¥36.3 billion year-on-year decline in operating income to ¥94.6 billion.

Strategy and Investments

Future Strategy

Kobe Steel will create and expand the sales of highly distinctive "Only One" steel products with an emphasis on the automotive and shipbuilding industries, where strong demand is expected, while increasing its presence in the market. Kobe Steel will respond to the projected intense demand for steel castings and forgings, as well as that for titanium products, by implementing suitable measures, including spending on additional manufacturing capacity.

Anticipating a further increase in demand for welding consumables, primarily from the shipbuilding industry, Kobe Steel will ensure that production capacity is maximized. We will substantially expand the scale of our operations overseas, focusing on Europe, the United States and China, with the goal of becoming one of the "world's leading companies" for welding consumables.

We will also take clear steps to fortify our business foundation by implementing rigorous safety and disaster-prevention measures, realizing a stronger cost competitive position, and effectively transferring work-related skills to younger workers.

Capital Investments

Our primary focus is on projects that will boost Kobe Steel's competitive position by expanding and improving its range of distinctive products and further raising its manufacturing capabilities. We have prioritized spending on energy conservation, the environment and upgrading outdated facilities and equipment with the goal of creating a stable production system.

A major project in fiscal 2006 was the installation of a new continuous caster at the Kobe Works to bolster the competitiveness of specialty steel. The caster began full-scale operation in September 2006. In addition, renovation of a blast furnace at the Kakogawa Works was completed in May 2007, and operations are proceeding smoothly. Renovation of the blast furnace at the Kobe Works is now in the preliminary stage and is progressing favorably, with the final renovation stage scheduled to begin in November 2007.

In welding consumables, to cope with intense demand, especially from domestic and overseas shipbuilders, Kobe Steel invested in additional production capacity for flux-cored wire for carbon steel.

Welding consumables

Medium-Term Business Plan for Fiscal 2006 to 2008—Targets and Progress

Sales of Only One products such as high strength steel sheet for automobiles, crankshafts for ships, titanium products and welding consumables rose steadily. Kobe Steel is making firm progress toward achieving the targets set forth in its Medium-Term Business Plan.

Topics

Development of High Strength Steel Sheet for Automobiles with the World's Highest Level of Workability

Kobe Steel has succeeded in developing high strength, hot-dip galvanized sheet with greater workability than existing high strength steel sheet used in automobiles. The galvanized sheet scores approximately 30% higher than Kobe Steel's other products on a rating index for workability. The application of this high strength, galvanized sheet in difficult-to-form auto body structures will contribute to stronger and lighter auto bodies.

High strength steel sheet for automobiles

Development of Painted Steel Sheet that Absorbs and Dissolves Formaldehyde

Kobe Steel has succeeded in developing "Kobe Pre-Coat Air Breeze" painted steel sheet that absorbs and dissolves formaldehyde, which is one of the causes of sick-house syndrome, in indoor spaces. This is the world's first laminated steel sheet that can reduce sick-house syndrome. We expect demand for this product to grow as a material used in a variety of building interiors.

Development of Steel Powder that Absorbs and Neutralizes Arsenic

Kobe Steel has developed and commercialized a steel powder that efficiently absorbs and neutralizes arsenic. The powder was created to purify wastewater from factories and groundwater, and can, therefore, be effectively used to neutralize arsenic as well as purify water contaminated by heavy metals such as lead and cadmium.

Wholesale Power Supply

Business Environment and Performance in Fiscal 2006

The two power plants at the Shinko Kobe Power Station currently have a combined maximum power generation capacity of 1.4 million kilowatts. Sales in this segment showed a 2.5% year-on-year improvement to ¥66.9 billion due to the higher cost of coal used as fuel, which was passed on in the form of electricity price hikes. Operating income declined by ¥1.5 billion to ¥18.0 billion as a result of incurring higher equipment maintenance costs for maintaining stable operations.

Kobe Steel will take steps to further improve equipment maintenance and accumulate operational technology in an effort to maintain stable operations and ensure steady profits.

Aluminum and Copper

Business Environment and Performance in Fiscal 2006

Despite a drop in sales of can stock for canned beverages due to unseasonable weather, shipments of aluminum rolled products were similar to the previous fiscal year due to brisk domestic and overseas sales of aluminum sheet for automotive panels, aluminum plate for semiconductor manufacturing equipment, and aluminum blanks and substrates for hard disks.

Shipments of copper rolled products surpassed those of the previous fiscal year on the back of continued strong demand for sheet products for use in electronic materials, especially electronic components for automobiles, and higher demand for copper tube mainly in overseas markets.

Although demand from the LCD industry was stagnant due to the market entering an adjustment phase, sales of aluminum castings and forgings to the automotive industry fared well.

As a result, shipments as a whole were similar to the previous year. Sales in the Aluminum and Copper Segment jumped 30.3% year on year to ¥397.3 billion, owing to sharply rising ingot prices that pushed up sales prices.

With the effect of inventory valuation following this steep increase in aluminum and copper ingot prices, operating income rose ¥11.3 billion to ¥34.7 billion.

Strategy and Investments

Future Strategy

Future demand for aluminum and copper products is expected to be strong overall, due in large part to projected growth in demand in the automotive, IT, and semiconductor industries. Over the medium term, an upsurge in demand is also expected for aluminum for use in automobiles, aluminum vacuum chambers for semiconductor and LCD manufacturing equipment, aluminum blanks and substrates for hard disk drives, and copper strip for electronic materials.

We recognize that aluminum use is taking hold in high-volume car models as a result of environmental regulations and strong interest shown by automakers in environmental issues. Efforts to address automotive industry demand have been made a top priority at Kobe Steel, and by leveraging our collective technological strength in everything from high-quality materials to design and manufacturing, we will respond to growing demand for aluminum use in automobiles in Japan and overseas markets.

Moving forward, we will create new markets in aluminum and copper by applying our technological and development capabilities and carve out a firm position as a leading company competitive in terms of cost, quality and customer service.

Aluminum forgings for automobiles

Aluminum vacuum chamber for semiconductor and LCD production

Capital Investments

In fiscal 2006, Kobe Steel decided to implement projects that are critical to its future growth, including investments in Group companies, with an emphasis on upgrading and installing new core equipment. Our policy is to strictly prioritize those fields for investment that will generate higher profits. Presently, Kobe Steel's main areas of focus for future investments are the automotive and IT-related industries.

Medium-Term Business Plan for Fiscal 2006 to 2008—Targets and Progress

Even if the profit accrued from inventory valuation were excluded, operating income in fiscal 2006 surpassed the Medium-Term Business Plan target, thanks to our successful efforts at responding to strong demand and steady implementation of strategic investment projects. Foreseeing strong earnings in fiscal 2007, we expect to make steady progress toward achieving the fiscal 2008 targets set forth in the Medium-Term Business Plan.

Aluminum bottle can stock

Copper sheet for terminals and connectors

Topics

Expanding Automotive Aluminum Forgings in the U.S.

Kobe Aluminum Automotive Products, LLC (or KAAP), which manufactures and sells aluminum forgings for automobile suspension systems in the United States, decided to add a fourth press at its facility in response to increased product demand. KAAP was established in Kentucky, USA, in May of 2003, as a joint venture between Kobe Steel, Mitsui & Co., Ltd., and Toyota Tsusho Corporation, and began mass-production in June 2005. Its third press began operation in December 2006, and the fourth press is scheduled to come on line in April 2008. With demand for lighter automobiles on the rise, Kobe Steel will continue to take steps to meet expected demand growth.

Suzhou Kobe Copper Technology Begins Full-Scale Operation

Suzhou Kobe Copper Technology Co., Ltd. is engaged in slitting, sales and technical services for copper sheet for electronic materials such as terminals, connectors and leadframes. Established in China in May 2005 as a wholly owed subsidiary of Kobe Steel, the company commenced full-scale operations in October 2006. Trial production and product sample evaluations have been completed, and production and shipping began in July 2006. Through prompt product delivery from factory to consumer, Suzhou Kobe Copper Technology intends to swiftly and flexibly respond to increases in demand.

Suzhou Kobe Copper Technology

Machinery

Business Environment and Performance in Fiscal 2006

Amidst active capital spending in the petrochemical industry, the Machinery Segment received many inquiries for plastic processing machinery, resulting in a high number of orders. In contrast, orders for tire manufacturing equipment were down due to lower capital spending by Asian manufacturers, especially in Taiwan and South Korea. Orders for rolling mills were favorable as a result of strong demand from electric steelmakers for the renovation and upgrade of their facilities.

In the compressor business, as active capital spending in the oil refining and petrochemical industries continued, sales of nonstandard compressors were up dramatically. In the engineering business, brisk capital spending, especially in the area of oil refining, pushed chemical reactor orders upward.

In the wake of expanding global demand for iron units, our Iron Unit Division enjoyed strong demand for direct reduced iron (DRI) plants, a specialty of Kobe Steel, and won an order from Oman for a DRI plant that uses the MIDREX® Process.

In the environmental field, Kobe Steel completed successful bids for large waste treatment and sludge disposal projects.

As a result, with strong order volume, sales in the Machinery Segment rose 8.4%, year on year, to ¥280.9 billion. Operating income more than doubled, surging ¥11.8 billion to ¥22.1 billion, thanks to higher sales and improved profitability from increased order volume.

Strategy and Investments

Future Strategy

Kobe Steel has positioned both the energy- and environment-related fields as high priorities. In the industrial machinery business, with unabated surplus demand for polyethylene and polypropylene, we expect vigorous capital spending to continue for some time in the petrochemical industry and orders for plastic processing machinery to grow. Kobe Steel intends to retain its leading market share for plastic processing machinery for polyethylene and work on increasing orders for polypropylene processing machinery.

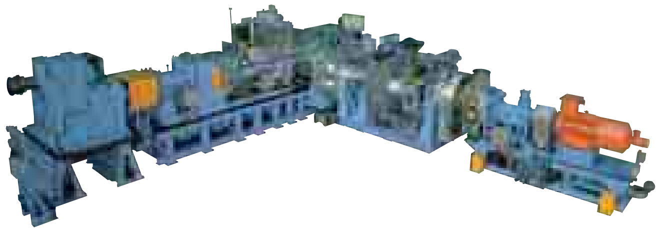
In the compressor business, we are taking steps to further expand orders for nonstandard compressors in the petrochemical and oil refining fields where demand remains strong. We are also growing the business for standard compressors in China, India and other countries.

In the engineering field, with the outlook for continued favorable demand in the petroleum and energy fields, we will make every effort to win as many orders as possible for chemical reactors.

Against the backdrop of continued rising demand forecast for high-grade iron units, we are developing and commercializing coal-based direct reduction and ironmaking processes. ITmk3®* is a next–generation ironmaking process that uses inexpensive non-coking coal, while the FASTMET® and FASTMELT® processes, which also use coal as the reductant, produce DRI. These coal-based processes play an important part in our iron unit business, in addition to our existing gas-based direct reduction process.

* ITmk3® is a process that uses a rotary hearth furnace to turn iron ore fines and ordinary pulverized steaming coal into high-purity iron nuggets (96% – 97% metallic iron content), the same purity as pig iron from a blast furnace. Reduction, melting, and slag removal occur in only 10 minutes in contrast to a reduction time of 8 hours using a blast furnace. No expensive coking coal is used in the production of the iron nuggets.

Iron nuggets



LCM Series plastic mixing and pelletizing system

Capital Investments

With orders on a favorable track, Kobe Steel is under increasing pressure to keep pace with demand. To improve our ability to handle larger order volumes, we hired additional staff and invested primarily in adding production capacity and upgrading outdated equipment in fiscal 2006. In fiscal 2007, we intend to continue investing in capacity increases and equipment upgrades.

Chemical reactors

Medium-Term Business Plan for Fiscal 2006 to 2008—Progress

The Machinery Segment is surpassing the targets of the Medium-Term Business Plan for orders, sales and profits.

Nonstandard compressors

Topics

Ultra High-Efficiency Air-Cooled Screw Heat Pump Chiller Wins Chairman's Prize at Energy Saving Grand Prix

The High-Efficiency Heat Pump*, an ultra high-efficiency air-cooled screw heat pump chiller co-developed with Chubu Electric Power Co., Inc., Tokyo Electric Power Co., Inc., and Kansai Electric Power Co., Inc., won the ECCJ's (Energy Conservation Center, Japan) Chairman's Prize at the 17th annual 2006 Energy Saving Grand Prix sponsored by the Ministry of Economy, Trade and Industry. The High-Efficiency Heat Pump is air-cooled and produces hot or cold water for air conditioning in buildings and factories, offering the industry's highest energy efficiency.

The High-Efficiency Heat Pump

*This air-cooled heat pump generates hot or cold water for air conditioning in buildings, factories and other locations. It is equipped with a heat exchanger that dissipates waste heat energy from air conditioning into the ambient air.

Construction Machinery

Business Environment and Performance in Fiscal 2006

Sales in the Construction Machinery Segment advanced 25.7% year on year to ¥285.4 billion, and operating income surged ¥6.0 billion higher than the previous fiscal year to ¥14.8 billion.

Hydraulic Excavator Business

Overview

The domestic hydraulic excavator market remained buoyant, with demand for hydraulic excavators exceeding that of the previous fiscal year despite a continuing decline in public works projects. This was attributable to increased private sector investment and low excavator stock in Japan due to used excavator exports. Overseas, despite a decrease in housing construction in North America, business was largely favorable thanks to rapid expansion in China, vigorous demand in Europe and fast-growth emerging markets.

In response to this demand, Kobe Steel set up a system to facilitate the expansion of production in Japan and overseas. We opened the Ogaki Factory in April 2006 to integrate domestic production of mini excavators and to further invest in new production capacity. In addition, production capacity was added at our Hiroshima Factory, having made the expansion of hydraulic excavator production a top priority. In preparation for further upsurges in demand, we boosted production capacity at Hangzhou Kobelco Construction Machinery Co., Ltd., our second hydraulic excavator production facility in China.

As a result, in the fast-growing Chinese market, we experienced dramatic growth in unit sales.

Future Strategy

With continued global growth in demand in the hydraulic excavator business, Kobe Steel will take steps to further strengthen its manufacturing capabilities and set up a structure that enables it to respond timely to demand shifts, both qualitatively and quantitatively. In concrete terms, we have prioritized the following objectives: 1) raise the manufacturing capabilities of the Hiroshima and Ogaki factories, our "core" facilities, and build a global production system; 2) promote supply-chain management (SCM) and stabilize supply by improving our procurement capabilities; 3) establish a business operation system for China under the leadership of Kobelco Construction Machinery Co., Ltd.; 4) forge stronger ties with CNH Global N.V. and expand markets including emerging markets; and 5) start to develop new excavator models compatible with future air emission regulations.

Crane Business

Overview

The overseas crane market experienced solid growth primarily in the Middle East, where investment to increase energy production is active, and Southeast Asia, where demand for new cranes continued due to a shortage of used cranes. In the domestic crane market, private-sector demand surged thanks to a recovery in the economy, while overall demand shot up dramatically as domestic crane stocks declined because of used crane exports and manufacturer compliance with environmental laws such as new air emission regulations

Given these favorable demand conditions, unit sales of cranes in Japan and in key overseas markets grew significantly. In fiscal 2006, unit sales of new crane models amounted to roughly 730 units, advancing approximately 38% year on year. In addition, overseas sales of crawler cranes accounted for nearly 80% of the total units sold.

Future Strategy

In the crane business, as strong global demand for cranes is projected to continue, we have prioritized the following objectives: 1) further optimize production and shipping and create a more stable production system; 2) increase procurement sources and steadily cut costs; 3) boost earnings by maintaining a system of collaboration with alliance partners; 4) strengthen efforts in Middle East and India markets and develop new customers in the United States and Europe; 5) fortify the wheel loader business and further enhance the sales and service systems for all-terrain cranes; and 6) establish a system and distribution method that strengthens the life cycle business.

Real Estate

Business Environment and Performance in Fiscal 2006

Business Environment

Although it is clear that deflation in the real estate market is coming to an end, real estate transaction costs are rising and securing suitable development sites is becoming a major issue. As developers remain highly motivated to supply the market, new housing starts continued as in fiscal 2005 at above 1.2 million units. However, with land and construction costs rising, sales prices are on an upswing, and every developer is carefully weighing sales timing and price setting. Meanwhile, demand for office space improved substantially, especially in Japan's three major metropolitan areas, and rents increased accordingly.

Business Performance

Sales in the Real Estate Segment in fiscal 2006 declined 12.5% to ¥41.4 billion on a consolidated basis, reflecting a decrease in condominium sales primarily in metropolitan areas. Nevertheless, we recorded a ¥187 million year-on-year increase in operating income to ¥5.3 billion, thanks to higher profit margins in the property sales business and earnings contributions from new leasable assets.

Strategy and Investments

Future Strategy

Operating mainly in the Kinki region and major metropolitan areas, the Real Estate Segment is a total life business encompassing real estate development, construction, property sales, leasing, remodeling, building and condominium management, and insurance brokering.

Capital Investments

In July of fiscal 2006, we completed constructing and began leasing a new asset, Grancreer Fujigaoka, a condominium complex for the elderly with nursing care that is located on Company-owned property in Yokohama, Kanagawa Prefecture. In addition, we are promoting the Yodoyabashi Kyodo Building Project (tentative name) at the Company-owned Osaka Shinko Building in Chuo Ward, Osaka, as well as the Amagasaki Office Building Project (tentative name), a joint venture located in front of the JR Amagasaki train station in Hyogo Prefecture. Kobe Steel will continue to promote development, primarily of Company-owned property, and has plans to upgrade and expand its high-quality leasable assets.

Medium-Term Business Plan for Fiscal 2006 to 2008—Targets and Progress

The goal of our real estate business is to quickly establish a stable profit base and achieve sustained growth. In the real estate development, construction, and property sales businesses, Kobe Steel is taking steps to conduct stable operations on an appropriate scale and improve the profitability of these businesses. In property leasing, building and condominium management and insurance brokering, we are working to expand the scale of operations, enhance profits and create stable sources of earnings. In fiscal 2006, Kobe Steel made definite progress toward the achievement of these goals.

Electronic Materials and Other Businesses

Business Environment and Performance in Fiscal 2006

Steady efforts to meet the demand for testing and analysis services for electronic materials led to sales in the Electronics Materials and Other Businesses Segment of ¥63.6 billion, 4.0% higher than in the previous fiscal year, but operating income decreased ¥3.2 billion to ¥14.3 billion. The decrease was attributable to prolonged inventory adjustments of target materials for LCDs and intensifying competition for alternative materials. We are taking steps to maximize earnings by improving the manufacturing productivity of current products, reducing costs, and aggressively and rapidly commercializing new products.

Kobe Steel Group Business Structure

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.
Tesac Wire Rope Co., Ltd.
Sakai Steel Sheets Works, Ltd.
Shinko Wire Company, Ltd.*
13 consolidated subsidiaries
10 equity-valued affiliates

Manufacturing and sales
Kobelco Metal Powder of America, Inc.
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

Wholesale Power Supply

Production and sales
Shinko Kobe Power Inc.

Aluminum and Copper

Manufacturing, sales and services
Shinko Leadmikk Co., Ltd.
7 consolidated subsidiaries

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.
8 consolidated subsidiaries
2 equity-valued affiliates

Machinery

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

Manufacturing, sales and services
Kobelco Compressors Corporation
6 consolidated subsidiaries
1 equity-valued affiliate

Manufacturing, sales and services
Kobelco Eco-Solutions Co., Ltd.
Shinko Engineering Co. Ltd.
Shinko Electric Co., Ltd.*
EarthTechnica Co., Ltd.
Complejo Siderurgico de Guayana, C.A.*
14 consolidated subsidiaries
5 equity-valued affiliates

Construction Machinery

Manufacturing and sales
Kobelco Construction Machinery Co., Ltd.
Kobelco Cranes Co., Ltd.
33 consolidated subsidiaries 10 equity-valued affiliates

Real Estate

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

Electronic Materials and Other Businesses

Services
Kobelco Research Institute, Inc.
8 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*
10 consolidated subsidiaries
1 equity-valued affiliate

Kobe Steel, Ltd.

Customers

(Notes) 1. → Flow of products 2. * Equity-valued affiliates (other companies are consolidated subsidiaries)

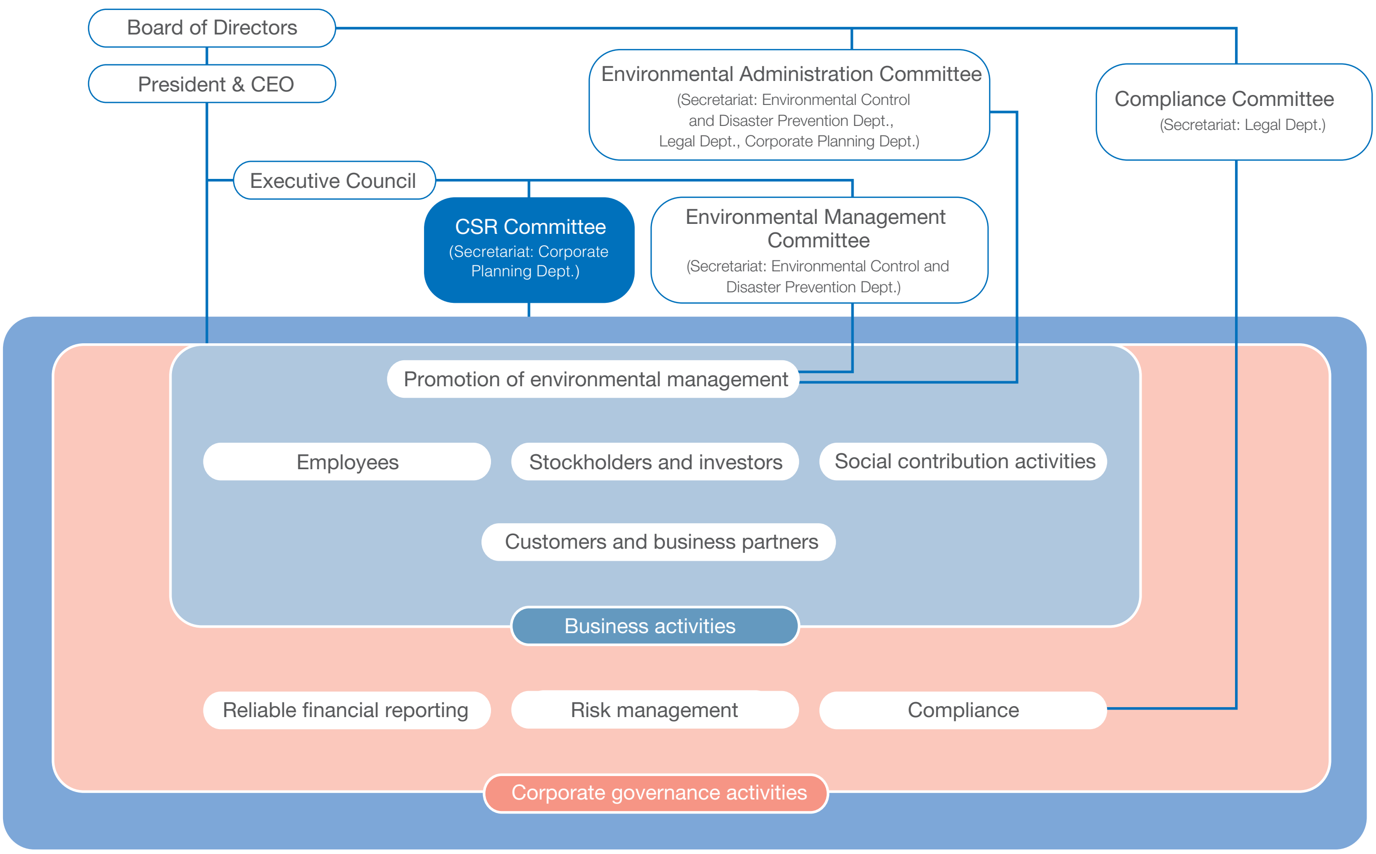
Amid today's rapid globalization, stream of corporate mergers, reshuffling of industrial alliances and rising concern for global environmental issues, the general public has dramatically changed its attitude toward business enterprises. Under these circumstances, the management of the Kobe Steel Group regards the fulfillment of its corporate social responsibility (CSR) as paramount. To this end, we are implementing a variety of initiatives, such as reinforcing our compliance systems and strengthening environmental conservation activities. The underlying principle for these initiatives is, as a good corporate citizen, to better serve our stakeholders, including customers, business partners, shareholders and other investors, as well as regulatory authorities, employees and the local communities in which we operate.

Promoting the Kobe Steel Group's CSR Activities

Based on its Corporate Code of Ethics, the Kobe Steel Group has worked to win the trust of its stakeholders. To further our efforts in this respect, we are promoting Groupwide CSR activities under the Kobe Steel Group Corporate Philosophy. The ultimate goals of these activities are to mutually contribute to the sustainable growth of the Group and society at large, as well as to exceed stakeholder expectations toward higher satisfaction.

In 2006, the Kobe Steel Group finalized its basic CSR policies and established the CSR Committee to coordinate the Group's CSR activities. Promoting CSR as a Groupwide objective in its Medium-Term Business Plan, which extends from fiscal 2006 to 2008, the Group is systematically advancing the implementation of various CSR measures. We also consider the disclosure of CSR-related information as an integral part of our CSR requirements. Accordingly, we are committed to communicating such information to our stakeholders through readily available documentation and other means.

■ CSR Promotion Framework



Strengthening and Enhancing Corporate Governance

Raising the Effectiveness of Corporate Governance

At Kobe Steel, we recognize the inseparability of management decision-making from the execution of day-to-day business operations. Therefore, Company directors, elected by shareholders at the General Shareholders' Meeting and legally responsible to shareholders, customers, and others, must bear primary responsibility for business affairs that are of major importance to the Company.

In order to contribute to ensuring greater management transparency and fairness, in June 2007, we invited two outside directors to join the Board of Directors and created an improved supervisory function for business affairs. The Board is made up of senior management, key executives at corporate headquarters, executives of major business divisions and internal companies, and outside directors. Corporate officers, under the leadership of the directors, are responsible for the conduct of business affairs, and therefore occupy an important position at Kobe Steel. Although not constituting a legal body, officers are elected by the Board of Directors and carry out duties that the president assigns to them.

Based on this framework, we have instituted a system for management decision-making and conducting of business affairs. At the same time, we adopted an auditing system based on four statutory auditors, including two outside auditors, which has resulted in an enhanced auditing function and more effective corporate governance. In addition, we established the Audit Department as an independent auditing body. Audits conducted in the areas of compliance, environment, security and other areas are carried out cooperatively or in partnership with each of the divisions responsible for the respective areas.

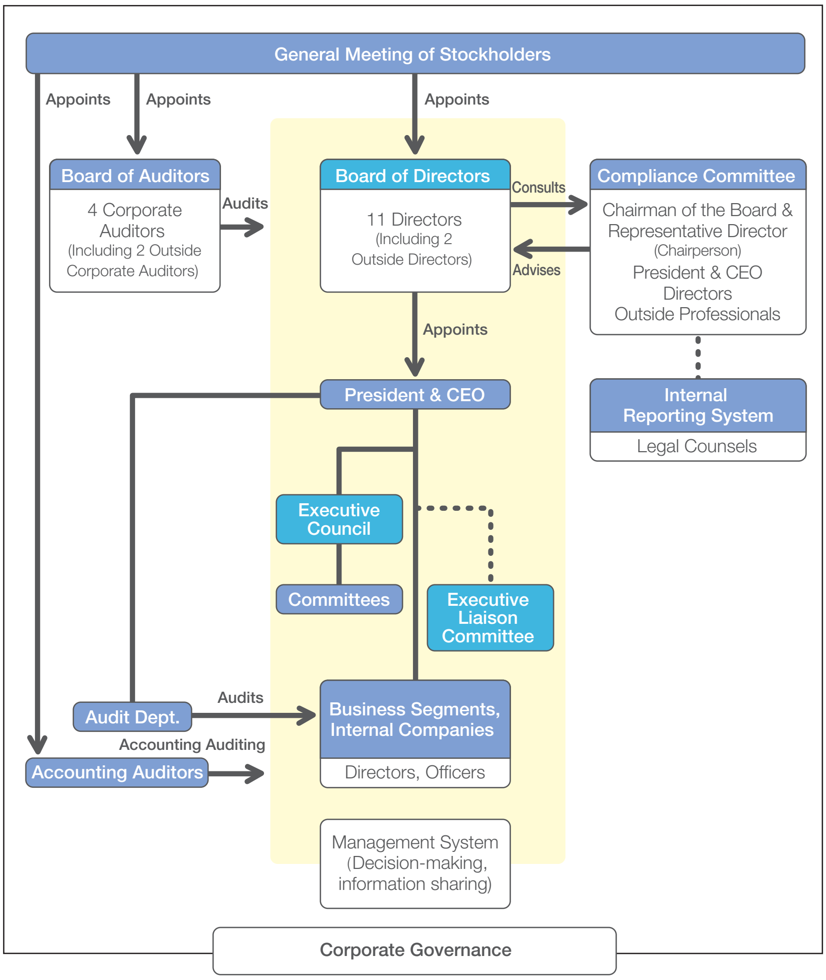
Strengthening the Compliance System

At Kobe Steel, the creation of a stronger compliance system is one of its most important management tasks, and, needless to say, the Company is working hard to bring this about.

The Compliance Committee was established as an advisory body to the Board of Directors. The Committee is composed of members from inside the Company as well as outside members, who hold an impartial and neutral standpoint. The Committee is responsible for compliance-related proposal development, verification of progress in the area of compliance, and the review of cases that emerge from the internal reporting (whistle-blowing) system. Moreover, the director in charge of corporate compliance and the Legal Department's Compliance Planning & Administration Section (a dedicated unit) are primarily responsible for promoting compliance-related training, compiling the Corporate Code of Ethics, establishing rules and regulations, and preparing manuals. They, in cooperation with the planning and administration departments of internal companies and the compliance managers in each department, are working to achieve thorough compliance in business.

Key Group companies have also established their own corporate codes of ethics and compliance committees, and operate internal reporting systems to achieve compliance in their respective organizations.

Corporate Governance Structure



Promoting Environmental Management

The Kobe Steel Group recognizes its obligation to protect the global environment, and therefore, has adopted the mission to pass on a healthy world to future generations. For this reason, the Kobe Steel Group has formulated its Basic Environmental Management Policy and, accordingly, stepped up efforts to promote environmental management in every facet of its business activities. After the occurrence of air emission problems discovered at its steelworks in 2006, the Kobe Steel Group has revamped its environmental management systems and is endeavoring to strengthen its administration to restore public confidence.

Basic Environmental Management Policy: Enhancing Enterprise Value through Groupwide Environmental Management

With the aim of enhancing enterprise value and fulfilling its CSR requirements, the Kobe Steel Group shall conduct its business activities based on the following three principles:

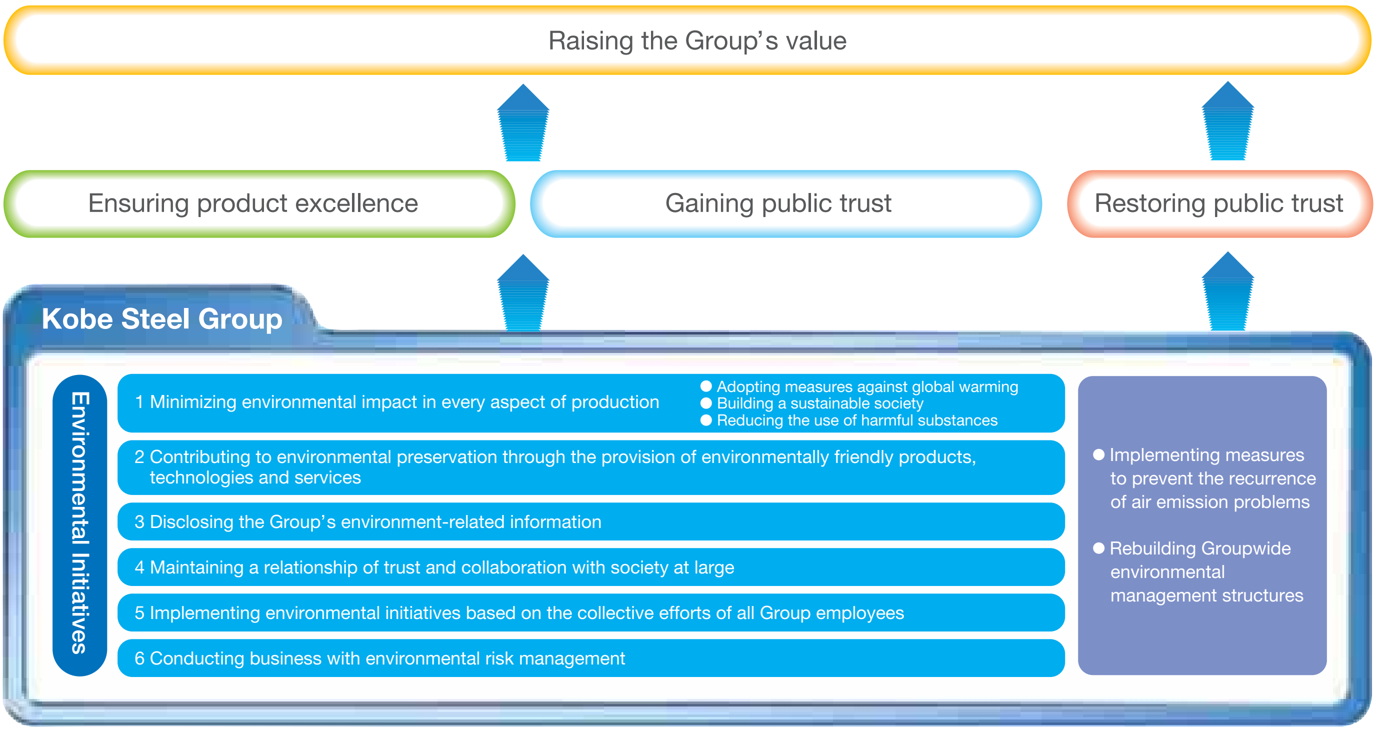
1. Reducing the environmental impact from production
2. Contributing to the environment through environmentally friendly products, technologies and services
3. Maintaining a relationship of trust and collaboration with society at large

Implementation Measures

The Environmental Management Committee is tasked with the creation and implementation of environmental initiatives for the entire Kobe Steel Group, facilitating effective Groupwide environmental management.

We are currently undertaking activities based on the following six principal initiatives: (1) minimizing environmental impact in every aspect of production; (2) contributing to environmental preservation through the provision of environmentally friendly products, technologies and services; (3) disclosing the Group's environment-related information; (4) maintaining a relationship of trust and collaboration with society at large; (5) implementing environmental initiatives based on the collective efforts of all Group employees; and (6) conducting business with environmental risk management.

■ Medium-Term Groupwide Environmental Management Initiatives



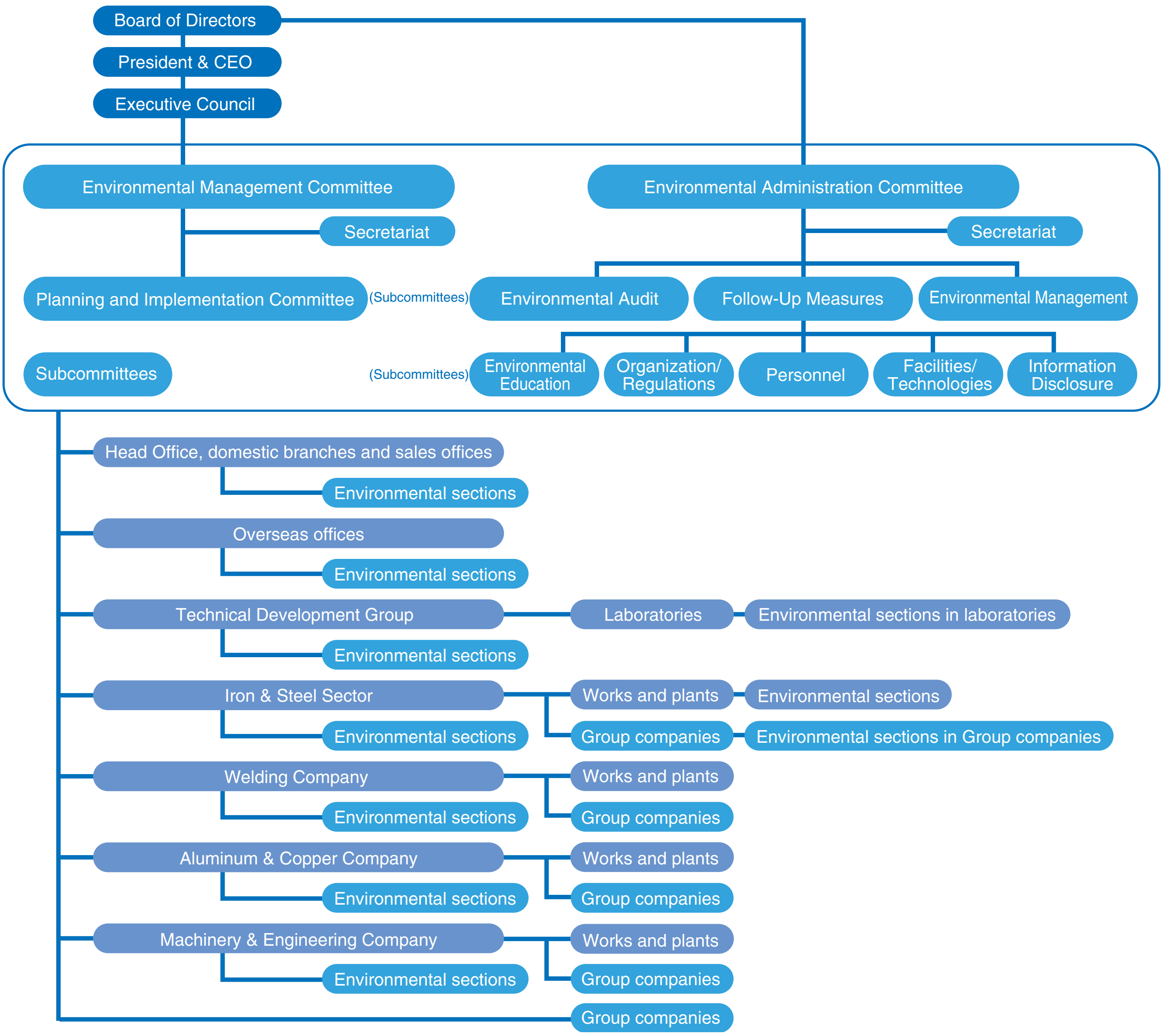
Kobe Steel Group Environmental Management Framework

The Environmental Management Committee has coordinated environmental management for the entire Kobe Steel Group. After the occurrence of air emission problems in 2006, however, we established the Environmental Administration Committee as part of our efforts to prevent the recurrence of similar problems in the future.

With the participation of external specialists and experts, the Environmental Administration Committee carefully deliberates on the progress of environmental management, environmental measures and their implementation, and environmental surveys. The Committee then reports its findings and provides advice to the Board of Directors.

In cooperation with the Environmental Administration Committee, the Environmental Management Committee effectively facilitates environmental activities through the organization of subcommittees that tackle specific issues.

■ Kobe Steel Group Environmental Management Framework



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. Leveraging its expertise in materials technology, MRL also strives to cultivate new businesses.

Mechanical Engineering Research Laboratory

The Mechanical Engineering Research Laboratory (MERL) conducts research and development in machinery, materials, the environment, energy, and steel structures. Through the use of advanced simulation, experimental, measurement, and analysis techniques in the fields of structural, strength, dynamics, acoustics, fluids, thermal, combustion, and chemical technologies, MERL works to enhance product performance, improve production processes and design, and focus on developing new products and technologies in an effort to gain a competitive advantage.

Production Systems Research Laboratory

The Production Systems Research Laboratory (PSRL) is active in bolstering and innovating production technologies for each of the Group's business segments, utilizing cutting-edge technologies for instrumentation and control, production planning, machine systems, information and telecommunications, and signal processing. Maintaining a focus on its core proprietary electronics and system technologies, PSRL is also engaged in the creation of new product menus in machinery-related fields.

Electronics Research Laboratory

The core technologies of the Electronics Research Laboratory (ERL) include thin-film materials design and film deposition, microfabrication, measurement evaluation, and superconductivity. ERL strives to develop new products and processes for application in such growth fields as nanotechnology, electronics and information, biotechnology, and the environment. ERL is also promoting the application of cutting-edge technologies in production facilities.

Coal & Energy Technology Department

The Coal & Energy Technology Department (CETD) is developing energy conversion technologies such as the upgrading of brown coal through dewatering and deashing, coal liquefaction, and the hydrocracking of heavy oil. CETD is working to find ways to effectively use the world's untapped natural resources and 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 Business Segments and Divisions

Iron and Steel

Iron and steel production technologies
Next-generation ironmaking, ultra-clean steel refining, high-precision rolling, material control, surface treatment, others
Product technology (construction, shipbuilding, automobiles, household appliances, aviation, others)

Welding

Design of welding consumables
Mechanical/chemical performance evaluation of welds
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

Aluminum and Copper

Aluminum sheet production technology (wide-width high-speed rolling, automatically controlled rolling)
Aluminum extruded section production technology (high dimensional accuracy extrusion, thin-wall extrusion, electromagnetic forming technology)
Aluminum cast and forged product technology (large-size thin-wall sand casting, hydraulic and 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 pressing, welding and joining, FEM simulation for lightweight designs
Product technology (electric and electronic devices, household appliances, automobiles, aluminum cans, aviation, others)

Machinery and Engineering

New ironmaking processes
Compressors (screw, turbo, reciprocating)
Industrial machinery technology (tire curing presses and testing machines, rubber and plastic mixing, metalworking, high-pressure processes, deposition, beams)
Energy equipment technology (high-pressure vessels, aluminum heat exchangers, LNG vaporizers, nuclear spent-fuel casks)
Plant engineering (nuclear waste treatment, chemical weapons destruction, advanced transit systems, cable technology)

Greater Strategic Use of Intellectual Property Rights

Focusing on the acquisition of intellectual property rights that contribute to business performance

The strategic use of intellectual property rights is essential to the Kobe Steel Group's goal of improving and expanding its range of distinctive "Only One" products. From 1990 onward in the steel and other industries, intellectual property rights were used as a defensive measure. This led to many major companies filing lawsuits. In recent years, accompanying rapid economic growth in Asia, there has been an upsurge in technological imitation and the leakage of technology from numerous companies. In 2002, the Japanese government established the Strategic Council on Intellectual Property, which advocates a three-pronged strategy covering management, development and intellectual property.

In light of the above, Kobe Steel has made greater strategic use of its intellectual property, and now ranks fourth among Japanese companies in the "steel/nonferrous metals" category of the Japan Patent Office's Patent Strategy Index (which evaluates the registration rates and global filing rates of patents) announced in April 2007.

As part of our Medium-Term Business Plan, we are integrating our business, development and intellectual property strategies while improving cooperation in the area of intellectual property throughout the Group. We are also strengthening existing structures and putting systems in place that will facilitate these objectives.

Development of intellectual property rights in Asia and an enhanced invention reward system

In the past, our focus had been on securing intellectual property rights in the United States and Europe. Since 2000, however, we have boosted patent filings in Asia and now file as many patent applications in China as we do in the United States.

Meanwhile, we have enhanced our Invention Reward System to provide stronger incentives for pursuing original inventions that lead to new and improved Only One products. Under our previous reward system, each patent was evaluated and assessed individually. Under the new system, established in April 2005, patents are evaluated in groups under individual product and technology categories, and are rewarded—without limit—based on how much they contribute to business performance. We expect this new incentive system to spark the spirit of invention and thus accelerate the creation of innovative new products.

Contents

Consolidated Five-Year Summary

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2007, 2006, 2005, 2004 and 2003

	Millions of yen					Thousands of U.S. dollars (Note 1)
	2007	2006	2005	2004	2003	**2007**
Net sales	**¥1,910,296**	¥1,667,313	¥1,443,772	¥1,219,180	¥1,204,750	**$16,182,092**
Operating income	**208,624**	220,395	166,577	100,699	81,054	**1,767,251**
Net income	**109,669**	84,559	51,289	22,066	1,723	**929,005**
Total assets	**2,241,570**	2,074,242	1,901,202	1,916,338	1,902,642	**18,988,310**
Net assets (Note 2)	**636,432**	530,000	379,213	330,127	293,138	**5,391,207**

	Yen					U.S. dollars (Note 1)
	2007	2006	2005	2004	2003	**2007**
Amounts per share						
Net income	**¥ 35.37**	¥ 27.94	¥ 17.28	¥ 7.44	¥ 0.59	**$ 0.30**
Diluted net income	**—**	27.25	16.48	7.38	—	**—**
Cash dividends applicable to the year	**7.00**	6.00	3.00	1.50	—	**0.06**

Notes 1. For convenience only, U.S. dollar amounts in this report have been translated from Japanese yen at the rate of ¥118.05 to US$1.00, the rate of exchange prevailing on March 31, 2007.

2. Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Statement No. 5 issued by the Accounting Standards Board of Japan on December 9, 2005), and the implementation guidance for the accounting standard for presentation of net assets in the balance sheet (the Financial Accounting Standard Implementation Guidance No. 8 issued by the Accounting Standards Board of Japan on December 9, 2005).

Financial Review

In fiscal 2006, ended March 31, 2007, the Japanese economy demonstrated a gradual upswing. This was attributed to increased private-sector capital investment fueled by a prolonged period of high corporate earnings as well as to firm consumer spending on the back of modest improvements in disposable incomes. Overseas, the global economy also proceeded along a growth trajectory, particularly in China and the rest of Asia.

Under these circumstances, consolidated net sales rose ¥243.0 billion compared with the previous fiscal year to ¥1,910.3 billion. While earnings climbed in line with the increase in revenue, operating income fell ¥11.8 billion year on year to ¥208.6 billion. This reflected a decrease in inventory valuation gains under the average method, which pushed up profits in fiscal 2005, and the impact of the change in depreciation method for machinery and equipment adopted during the fiscal year under review, which drove up depreciation expenses.

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥1910.3**	¥1667.3	14.6%
Operating income	**208.6**	220.4	(5.3)

Business segment information is provided as follows.

Iron and Steel

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥830.7**	¥758.4	9.5%
Operating income	**94.6**	130.9	(27.7)

Domestic demand for steel products was strong throughout the fiscal year under review, mainly in the automotive, shipbuilding and other manufacturing industries. Complementing positive conditions, domestic inventories, which had continued to swell in fiscal 2005 due to a softening in the balance of supply and demand for low-end steel products, declined steadily. Exports of high-end steel products also remained firm while the market for low-end steel products was brisk on the back of growing global demand. Against this backdrop, Kobe Steel successfully increased shipment volumes owing to robust demand for high-end steel products mainly from the manufacturing industry. Buoyed by increased sales prices of certain products, Kobe Steel also enjoyed a slight improvement in its overall average sales price compared with the previous fiscal year. Turning to other products, brisk demand for steel castings and forgings from the shipbuilding industry and for titanium mill products from the aircraft industry contributed to a year-on-year improvement in segment sales. Activities in welding consumables were robust throughout fiscal 2006, driven by strong demand from the domestic shipbuilding and automotive industries as well as from overseas shipbuilding and energy-related projects.

Accounting for the aforementioned factors, segment sales climbed ¥72.3 billion, or 9.5%, compared with the previous fiscal year to ¥830.7 billion. Operating income, on the other hand, declined ¥36.3 billion, or 27.7%, to ¥94.6 billion. This was mainly attributed to the decrease in inventory valuation gains, which pushed up profits in fiscal 2005, the implementation of changes in depreciation methods, and environmental-related and disaster prevention expenses mainly for maintenance and repair work.

Wholesale Power Supply

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥66.9**	¥65.2	2.5%
Operating income	**18.0**	19.5	(7.7)

The Shinko Kobe Power Station currently boasts a maximum output capacity of 1.4 million kilowatts of electricity. Sales in this segment edged up ¥1.6 billion, or 2.5%, compared with the previous fiscal year to ¥66.9 billion, as increases in fuel-grade coal costs were passed on to unit electricity prices. Operating income fell ¥1.5 billion, or 7.7%, year on year to ¥18.0 billion due to increased facility maintenance costs for ensuring stable operations.

Aluminum and Copper

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥397.3**	¥304.9	30.3%
Operating income	**34.7**	23.4	48.4

Shipments of rolled aluminum products were flat compared with the previous fiscal year. While unseasonable weather contributed to a decline in sales of cans for beverages, domestic and export sales remained strong for aluminum sheet for automotive and semiconductor manufacturing equipment industries as well as for blanks and substrates. Shipments of rolled copper products increased year on year, reflecting robust results in copper sheet for automotive electrical components and strong overseas sales of copper tube. Despite signs of inventory adjustments in the LCD market, brisk demand in the automotive industry drove up both shipments and sales of aluminum castings and forgings.

Under these circumstances, overall shipments were on par with the previous fiscal year. Buoyed by the sharp rise in metal prices that pushed up sales prices, segment sales surged ¥92.4 billion, or 30.3%, year on year to ¥397.3 billion. Operating income jumped ¥11.3 billion, or 48.4%, to ¥34.7 billion due to the hike in aluminum ingot and copper cathode prices, which pushed up profits due to the effects of inventory valuation.

Machinery

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥280.9**	¥259.3	8.4%
Operating income	**22.1**	10.4	113.2

In the Machinery Segment, domestic orders increased ¥34.6 billion, or 23.6%, compared with the previous fiscal year to ¥181.2 billion. On the back of robust private-sector capital investment, orders were strong for compressors, rolling mills and other products. In the environmental field, Kobe Steel received orders for large waste treatment and sludge disposal projects. Overseas, orders climbed ¥34.6 billion, or 37.3%, year on year to ¥127.5 billion. This was attributed to active capital investment in oil refining, petrochemical and energy fields in the Middle East, Asia and North America, which led to strong demand for compressors, plastic processing machinery and chemical reactors. Kobe Steel also received an order for a gas-based direct reduced iron plant.

As a result, total orders increased ¥69.2 billion, or 28.9%, compared with the previous fiscal year to ¥308.7 billion, while the backlog of orders as of the fiscal year-end rose ¥59.4 billion, or 24.1%, year on year to ¥306.2 billion.

Buoyed by this growth in orders, segment sales increased ¥21.7 billion, or 8.4%, to ¥280.9 billion. Operating income more than doubled, jumping ¥11.8 billion, or 113.2%, to ¥22.1 billion.

Construction Machinery

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥285.4**	¥227.0	25.7%
Operating income	**14.8**	8.8	67.7

In the fiscal year under review, Kobe Steel enjoyed robust demand for hydraulic excavators. Despite the continued slump in public works projects, positive conditions were supported by strong private-sector investment as well as increased demand for equipment renewal and upgrade on the back of exports of used equipment to China, which served to reduce domestic inventories. Operating conditions in overseas markets were also favorable. Despite signs of a slowdown in the United States, the sharp recovery and expansion of the Chinese market had a positive impact. The crane business remained robust particularly in the Middle East and Southeast Asia. Accounting for these factors, segment sales rose ¥58.4 billion, or 25.7%, compared with the previous fiscal year to ¥285.4 billion. Operating income increased ¥6.0 billion, or 67.7%, year on year to ¥14.8 billion.

Real Estate

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥41.4**	¥47.2	(12.5)%
Operating income	**5.3**	5.1	3.6

Impacted by the decline in condominium settlements, sales in the Real Estate Segment fell ¥5.9 billion, or 12.5%, compared with the previous fiscal year to ¥41.4 billion. On the other hand, operating income rose slightly to ¥5.3 billion, reflecting our successful efforts to reduce costs.

Electronic Materials and Other Businesses

	Billions of yen		Percent change
	2007	2006	2007/2006
Net sales	**¥63.6**	¥61.1	4.0%
Operating income	**14.3**	17.5	(18.1)

Conditions in the Electronic Materials and Other Businesses Segment were mixed. Buffeted by inventory adjustments in LCDs and increased competition for alternative materials, shipments of target materials for LCDs declined year on year. This was more than offset, however, by steady demand for testing and analysis services for electronic materials. As a result, segment sales edged up ¥2.5 billion, or 4.0%, compared with the previous fiscal year to ¥63.6 billion. Operating income declined ¥3.2 billion, or 18.1%, year on year to ¥14.3 billion, due to the drop in demand for target materials for LCDs.

Analysis of Cash Flows

For the fiscal year under review, net cash provided by operating activities was ¥172.8 billion while net cash used in investing activities amounted to ¥128.6 billion. Following payments for the purchase of treasury stock as well as dividends, net cash used in financing activities totaled ¥48.8 billion. As a result, and accounting for the effect of exchange rate changes, the net decrease in cash and cash equivalents of ¥3.7 billion and changes in consolidated subsidiaries, cash and cash equivalents at the end of the fiscal year increased ¥2.7 billion to ¥98.2 billion.

Cash Flows from Operating Activities

Net cash provided by operating activities was ¥172.8 billion, a decrease of ¥25.4 billion compared with the previous fiscal year. Major cash inflow was the increase in income before income taxes, while major cash outflow was the increase in cash paid for income taxes

Cash Flows from Investing Activities

Net cash used in investing activities was ¥128.6 billion, a year-on-year increase of ¥34.3 billion. This was mainly attributed to the purchase of fixed assets.

Cash Flows from Financing Activities

Net cash used in financing activities narrowed ¥44.8 billion compared with the previous fiscal year to ¥48.8 billion. Major cash outflows were the payment for purchase of treasury stock and payment of dividends. Major cash inflows included proceeds from the issuance of bonds and proceeds from long-term debt.

Analysis of Financial Position

Total assets as of the end of the fiscal year under review stood at ¥2,241.6 billion, an increase of ¥167.3 billion from ¥2,074.2 billion as of March 31, 2006. This was mainly attributed to the increase in inventories reflecting the rise in raw material prices, strategic investments to enhance business competitiveness and the implementation of essential blast furnace improvements to promote stable production. Total interest-bearing debt, excluding project financing related to the wholesale power supply business, increased ¥32.1 billion from ¥589.1 billion as of the end of the previous fiscal year to ¥621.2 billion. Including project financing, total interest-bearing debt as of March 31, 2007 rose ¥21.4 billion year on year from ¥720.9 billion to ¥742.3 billion.

Net assets climbed ¥106.4 billion year on year from ¥530.0 billion to ¥636.4 billion. While Kobe Steel undertook payments totaling ¥30.3 billion for the purchase of treasury stock and ¥27.8 billion for the payment of dividends, the increase is mainly attributed to net income for the period of ¥109.7 billion and the adoption of new accounting standards that require the inclusion of minority interests. As a result, the equity ratio (total net assets less minority interests to total assets) was 26.4% as of March 31, 2007, up 0.8 of a percentage point from the end of the previous fiscal year.

Consolidated Balance Sheets

Kobe Steel, Ltd. and Consolidated Subsidiaries
March 31, 2007 and 2006

ASSETS	Millions of yen 2007	Millions of yen 2006	Thousands of U.S. dollars (Note 1) 2007
Current assets:			
Cash and cash equivalents (Note 15)	**¥ 99,668**	¥ 96,188	**$ 844,286**
Notes and accounts receivable			
Trade	**268,693**	245,787	**2,276,095**
Unconsolidated subsidiaries and affiliates	**70,067**	82,715	**593,537**
Other	**22,261**	20,562	**188,572**
Allowance for doubtful accounts	**(831)**	(992)	**(7,040)**
	360,190	348,072	**3,051,164**
Inventories	**367,333**	303,003	**3,111,673**
Deferred income taxes (Note 13)	**20,695**	26,249	**175,308**
Other	**35,593**	28,756	**301,508**
Total current assets	**883,479**	802,268	**7,483,939**
Investments and other assets:			
Investments in securities (Note 4)	**193,670**	177,985	**1,640,576**
Investments in and advances to unconsolidated subsidiaries and affiliates	**53,862**	47,840	**456,264**
Long-term loans receivable	**6,072**	5,974	**51,436**
Other	**66,952**	61,907	**567,150**
Allowance for doubtful accounts	**(5,112)**	(6,129)	**(43,304)**
Total investments and other assets	**315,444**	287,577	**2,672,122**
Plant and equipment (Note 6)**:**			
Land	**203,427**	203,100	**1,723,227**
Buildings and structures	**646,941**	626,462	**5,480,229**
Machinery and equipment	**1,886,872**	1,851,017	**15,983,668**
Construction in progress	**72,147**	38,827	**611,156**
	2,809,387	2,719,406	**23,798,280**
Less accumulated depreciation	**(1,804,617)**	(1,757,533)	**(15,286,887)**
Total plant and equipment	**1,004,770**	961,873	**8,511,393**
Intangible assets	**16,791**	15,167	**142,237**
Deferred income taxes (Note 13)	**21,086**	7,357	**178,619**
	¥ 2,241,570	¥ 2,074,242	**$ 18,988,310**

See accompanying notes.

LIABILITIES, MINORITY INTERESTS AND STOCKHOLDERS' EQUITY/NET ASSETS	Millions of yen 2007	Millions of yen 2006	Thousands of U.S. dollars (Note 1) 2007
Current liabilities:			
Short-term borrowings (Note 6)	¥ **88,102**	¥ 119,300	$ **746,311**
Current portion of long-term debt (Note 6)	**105,449**	105,451	**893,257**
Notes and accounts payable:			
Trade	**419,225**	347,729	**3,551,249**
Construction	**37,592**	22,253	**318,441**
Unconsolidated subsidiaries and affiliates	**80,045**	76,173	**678,061**
Other	**8,934**	21,728	**75,680**
	545,796	467,883	**4,623,431**
Advances from customers	**53,884**	32,393	**456,451**
Customers' and employees' deposits	**12,617**	21,108	**106,878**
Income and enterprise taxes payable	**21,673**	48,542	**183,592**
Provision for casualty loss	**—**	1,430	**—**
Provision for environmental measures	**276**	2,866	**2,338**
Provision for restructuring costs	**4,109**	6,124	**34,807**
Deferred income taxes (Note 13)	**3,402**	2,193	**28,818**
Other	**85,138**	78,285	**721,203**
Total current liabilities	**920,446**	885,575	**7,797,086**
Long-term liabilities:			
Long-term debt (Note 6)	**548,525**	494,225	**4,646,548**
Employees' severance and retirement benefits (Note 17)	**46,919**	52,981	**397,450**
Provision for environmental measures	**4,247**	2,662	**35,976**
Deferred income taxes (Note 13)	**42,266**	24,455	**358,035**
Other	**42,735**	45,751	**362,008**
Total long-term liabilities	**684,692**	620,074	**5,800,017**
Minority interests	**—**	38,593	**—**
Contingent liabilities (Note 7)			
Stockholders' equity (Note 2)**:**			
Common stock (Note 8)	**—**	233,313	**—**
Authorized — 6,000,000,000 shares			
Issued — 3,115,061,100 shares in 2006			
Capital surplus (Note 8)	**—**	83,145	**—**
Retained earnings (Note 8)	**—**	157,275	**—**
Land revaluation differences, net of taxes	**—**	(4,358)	**—**
Unrealized gains on securities, net of taxes	**—**	69,000	**—**
Foreign currency translation adjustments	**—**	(7,047)	**—**
Treasury stock, at cost: 9,383,104 shares in 2006	**—**	(1,328)	**—**
Total stockholders' equity	**—**	530,000	**—**
	¥ **—**	¥2,074,242	$ **—**
Net assets (Note 2)**:**			
Stockholders' equity:			
Common stock (Note 8)	**233,313**	—	**1,976,391**
Authorized — 6,000,000,000 shares			
Issued — 3,115,061,100 shares in 2007			
Capital surplus (Note 8)	**83,282**	—	**705,481**
Retained earnings (Note 8)	**239,182**	—	**2,026,108**
Treasury stock, at cost: 70,435,335 shares in 2007	**(31,519)**	—	**(266,997)**
	524,258	—	**4,440,983**
Valuation and translation adjustments:			
Unrealized gains on securities, net of taxes	**75,565**	—	**640,110**
Unrealized gains on hedging derivatives, net of taxes	**2,179**	—	**18,458**
Land revaluation differences, net of taxes	**(4,899)**	—	**(41,499)**
Foreign currency translation adjustments	**(5,021)**	—	**(42,533)**
	67,824	—	**574,536**
Minority interests	**44,350**	—	**375,688**
Total net assets	**636,432**	—	**5,391,207**
	¥2,241,570	¥ —	**$18,988,310**

Consolidated Statements of Income

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2007 and 2006

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Net sales	**¥ 1,910,296**	¥ 1,667,313	**$ 16,182,092**
Cost of sales	**(1,543,158)**	(1,297,291)	**(13,072,071)**
Gross profit	**367,138**	370,022	**3,110,021**
Selling, general and administrative expenses (Note 10)	**(158,514)**	(149,627)	**(1,342,770)**
Operating income	**208,624**	220,395	**1,767,251**
Other income (expenses):			
Interest and dividend income	**5,129**	3,831	**43,448**
Interest expense	**(20,597)**	(21,147)	**(174,477)**
Seconded employees' salaries net of reimbursement	**(18,157)**	(19,162)	**(153,808)**
Foreign exchange gain	**727**	3,989	**6,158**
Equity in income of unconsolidated subsidiaries and affiliates	**14,057**	10,505	**119,077**
Gain on sale of securities	**2,842**	1,026	**24,075**
Loss on impairment of fixed assets (Note 12)	**(4,774)**	—	**(40,440)**
Loss on sale or disposal of plant and equipment	**(4,290)**	(4,575)	**(36,341)**
Expenses for environmental measures	**(3,129)**	(5,600)	**(26,506)**
Loss on separation of real estate business (Note 11)	**—**	(14,100)	**—**
Casualty loss	**—**	(4,540)	**—**
Other, net	**(5,057)**	(17,929)	**(42,838)**
	(33,249)	(67,702)	**(281,652)**
Income before income taxes	**175,375**	152,693	**1,485,599**
Income taxes (Note 13)**:**			
Current	**58,413**	60,007	**494,816**
Deferred	**2,976**	5,435	**25,209**
	61,389	65,442	**520,025**
Minority interests in income of subsidiaries	**4,317**	2,692	**36,569**
Net income	**¥ 109,669**	¥ 84,559	**$ 929,005**

	Yen		U.S. dollars (Note 1)
	2007	2006	**2007**
Per share			
Net income	**¥ 35.37**	¥ 27.94	**$ 0.30**
Diluted net income	**—**	27.25	**—**
Cash dividends applicable to the year	**7.00**	6.00	**0.06**

See accompanying notes.

Consolidated Statements of Changes in Net Assets (Notes 2 and 14)

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2007 and 2006

	Thousands	Millions of yen							
	Number of shares of common stock	Common stock (Note 8)	Capital surplus (Note 8)	Retained earnings (Note 8)	Land revaluation differences, net of taxes	Unrealized gains on securities, net of taxes	Foreign currency translation adjustments	Treasury stock	Total
Balance at March 31, 2005	2,976,070	¥218,163	¥67,980	¥ 81,634	¥ 409	¥ 25,376	¥ (13,150)	¥(1,199)	¥379,213
Conversion of convertible bonds	138,991	15,150	15,150						30,300
Cash dividends				(8,922)					(8,922)
Bonuses to directors				(23)					(23)
Net income				84,559					84,559
Increase due to changes in scope of consolidation				41					41
Decrease due to changes in scope of consolidation				(14)					(14)
Gain on sale of treasury stock			15						15
Increase in treasury stock								(129)	(129)
Adjustment to land revaluation					(4,767)				(4,767)
Increase in unrealized holding gains on securities						43,624			43,624
Adjustments from translation of foreign currency financial statements							6,103		6,103
Balance at March 31, 2006	3,115,061	¥233,313	¥83,145	¥157,275	¥(4,358)	¥ 69,000	¥ (7,047)	¥(1,328)	¥530,000

	Thousands	Millions of yen									
	Number of shares of common stock	Common stock (Note 8)	Capital surplus (Note 8)	Retained earnings (Note 8)	Treasury stock	Unrealized gains on securities, net of taxes	Unrealized gains on hedging derivatives, net of taxes	Land revaluation differences, net of taxes	Foreign currency translation adjustments	Minority interests	Total
Shareholders' equity at March 31, 2006 as previously reported	3,115,061	¥233,313	¥83,145	¥157,275	¥ (1,328)	¥69,000	¥ —	¥(4,358)	¥(7,047)	¥ —	¥530,000
Reclassification due to adoption of new accounting standards for presentation of net assets in the balance sheet at April 1, 2006										38,593	38,593
Net assets at April 1, 2006	3,115,061	¥233,313	¥83,145	¥157,275	¥ (1,328)	¥69,000	¥ —	¥(4,358)	¥(7,047)	¥38,593	¥568,593
Cash dividends				**(28,010)**							**(28,010)**
Bonuses to directors				**(27)**							**(27)**
Net income				**109,669**							**109,669**
Stock swap			**111**		**69**						**180**
Purchase of treasury stock					**(30,280)**						**(30,280)**
Sale of treasury stock			**26**		**20**						**46**
Decrease due to changes in scope of consolidation				**(266)**							**(266)**
Adjustment to land revaluation				**541**							**541**
Net changes other than stockholders' equity						**6,565**	**2,179**	**(541)**	**2,026**	**5,757**	**15,986**
Net changes during the year			**137**	**81,907**	**(30,191)**	**6,565**	**2,179**	**(541)**	**2,026**	**5,757**	**67,839**
Balance at March 31, 2007	**3,115,061**	**¥233,313**	**¥83,282**	**¥239,182**	**¥(31,519)**	**¥75,565**	**¥2,179**	**¥(4,899)**	**¥(5,021)**	**¥44,350**	**¥636,432**

	Thousands	Thousands of U.S. dollars (Note 1)									
	Number of shares of common stock	Common stock (Note 8)	Capital surplus (Note 8)	Retained earnings (Note 8)	Treasury stock	Unrealized gains on securities, net of taxes	Unrealized gains on hedging derivatives, net of taxes	Land revaluation differences, net of taxes	Foreign currency translation adjustments	Minority interests	Total
Shareholders' equity at March 31, 2006 as previously reported	3,115,061	$1,976,391	$704,320	$1,332,274	$ (11,249)	$584,498	$ —	$ (36,917)	$ (59,695)	$ —	$4,489,623
Reclassification due to adoption of new accounting standards for presentation of net assets in the balance sheet at April 1, 2006										326,921	326,921
Net assets at April 1, 2006	3,115,061	$1,976,391	$704,320	$1,332,274	$ (11,249)	$584,498	$ —	$ (36,917)	$ (59,695)	$326,921	$4,816,544
Cash dividends				**(237,272)**							**(237,272)**
Bonuses to directors				**(229)**							**(229)**
Net income				**929,005**							**929,005**
Stock swap			**941**		**584**						**1,525**
Purchase of treasury stock					**(256,501)**						**(256,501)**
Sale of treasury stock			**220**		**169**						**389**
Decrease due to changes in scope of consolidation				**(2,253)**							**(2,253)**
Adjustment to land revaluation				**4,583**							**4,583**
Net changes other than stockholders' equity						**55,612**	**18,458**	**(4,583)**	**17,162**	**48,767**	**135,416**
Net changes during the year			**1,161**	**693,834**	**(255,748)**	**55,612**	**18,458**	**(4,583)**	**17,162**	**48,767**	**574,663**
Balance at March 31, 2007	**3,115,061**	**$1,976,391**	**$705,481**	**$2,026,108**	**$(266,997)**	**$640,110**	**$18,458**	**$ (41,499)**	**$ (42,533)**	**$375,688**	**$5,391,207**

See accompanying notes.

Consolidated Statements of Cash Flows

Kobe Steel, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2007 and 2006

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Cash flows from operating activities:			
Income before income taxes	¥ 175,375	¥ 152,693	$ 1,485,599
Depreciation	86,687	79,507	734,324
Interest and dividend income	(5,129)	(3,831)	(43,448)
Interest expense	20,597	21,146	174,477
Gain on sale of securities	(2,842)	(1,026)	(24,075)
Equity in income of unconsolidated subsidiaries and affiliates	(14,057)	(10,505)	(119,077)
Casualty loss	(1,430)	1,430	(12,113)
Environmental measures	(1,004)	5,528	(8,505)
Loss on impairment of fixed assets	4,774	—	40,440
Loss on separation of real estate business	—	14,100	—
Loss on sale or disposal of plant and equipment	4,290	4,575	36,341
Decrease (increase) in trade receivables from customers	23,207	(22,683)	196,586
Increase in inventories	(54,260)	(46,797)	(459,635)
Increase in trade payables to customers	39,684	44,449	336,163
Other	(6,766)	9,824	(57,314)
Subtotal	269,126	248,410	2,279,763
Cash received for interest and dividends	9,052	5,286	76,679
Cash paid for interest	(20,370)	(22,007)	(172,554)
Cash paid for income taxes	(85,022)	(33,508)	(720,220)
Net cash provided by operating activities	172,786	198,181	1,463,668
Cash flows from investing activities:			
Purchase of plant, equipment and other assets	(123,676)	(89,667)	(1,047,657)
Proceeds from sale of plant, equipment and other assets	1,495	4,645	12,664
Purchase of investments in securities	(10,020)	(12,001)	(84,879)
Proceeds from sale of investments in securities	6,183	3,636	52,376
Decrease (increase) in short-term loans receivable	684	(493)	5,794
Payments for long-term loans receivable	(339)	(607)	(2,872)
Proceeds from collection of long-term loans receivable	249	237	2,109
Other	(3,133)	35	(26,540)
Net cash used in investing activities	(128,557)	(94,215)	(1,089,005)
Cash flows from financing activities:			
Increase (decrease) in short-term borrowings	(33,010)	12,559	(279,627)
Increase (decrease) from commercial paper	—	(15,000)	—
Proceeds from long-term debt	120,430	39,546	1,020,161
Repayment of long-term debt	(60,189)	(83,808)	(509,860)
Proceeds from issuance of bonds	61,100	10,000	517,577
Repayment of bonds	(68,430)	(30,486)	(579,669)
Payment of dividends	(27,763)	(8,858)	(235,180)
Payment for purchase of treasury stock	(30,261)	—	(256,341)
Other	(10,700)	(17,546)	(90,640)
Net cash used in financing activities	(48,823)	(93,593)	(413,579)
Effect of exchange rate changes on cash and cash equivalents	892	2,784	7,556
Increase (decrease) in cash and cash equivalents	(3,702)	13,157	(31,360)
Cash and cash equivalents at beginning of year	95,485	80,592	808,852
Cash and cash equivalents of newly consolidated subsidiaries	6,380	1,736	54,045
Cash and cash equivalents at end of year (Note 15)	¥ 98,163	¥ 95,485	$ 831,537

See accompanying notes.

Notes to Consolidated Financial Statements

Years ended March 31, 2007 and 2006

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of Kobe Steel., Ltd. ("the Company") and its consolidated subsidiaries 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 ("Japanese GAAP"), which are different in certain respects as to application and disclosure requirements from International Financial Reporting Standards.

The accounts of the Company's 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 certain expanded disclosure and the inclusion of the consolidated statement of shareholders' equity for 2006, 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. Certain 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.

Commencing in the fiscal year ended March 31, 2006, the Company and its consolidated subsidiaries ("the Group") have changed the principal method of valuation for inventories in the Iron and Steel, Wholesale Power Supply, and Aluminum and Copper segments from the last-in, first-out (LIFO) method to the average method. As a result of this change, inventories of raw materials, such as iron ore, coal, aluminum and copper, of which market prices are subject to rapid change, are more accurately accounted for in the balance sheet. Under the average method, cost of sales for the fiscal year ended March 31, 2007 was ¥24,288 million less than it would have been under the LIFO method.

The consolidated balance sheet as of March 31, 2007, which has been prepared in accordance with the new accounting standard as discussed in Note 2 (19), is presented with the consolidated balance sheet as of March 31, 2006 prepared in accordance with the previous presentation rules.

Also, as discussed in Note 2 (20), the consolidated statement of changes in net assets for the year ended March 31, 2007 has been prepared in accordance with the new accounting standard. The accompanying consolidated statement of shareholders' equity for the year ended March 31, 2006 was voluntarily prepared for the purpose of inclusion in the consolidated financial statements although such statements were not required to be filed with the local Finance Bureau.

Commencing in the fiscal year ended March 31, 2007, the Group has changed the principal method of calculating depreciation for machinery and equipment from the straight-line method to the declining balance method. As demand for production from the Company is expected to remain strong, this change was made to present the Group's performance and financial position more accurately by optimizing the long-run allocation of capital expenditure and to strengthen the financial base through the early payback of invested capital. Under the declining balance method, depreciation was ¥6,357 million ($53,850 thousand) more than it would have been under the straight-line method, and operating income and income before income taxes were ¥5,021 million ($42,533 thousand) and ¥5,019 million ($42,516 thousand) less, respectively.

The translation of the Japanese yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2007, which was ¥118.05 to U.S. $1.00. 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.

2. Summary of Accounting Policies

(1) Consolidation

The consolidated financial statements include the accounts of the Company and its significant subsidiaries, the management of which is controlled by the Company. For the year ended March 31, 2007, the accounts of 163 (162 in 2006) subsidiaries have been included in the consolidated financial statements. Intercompany transactions and accounts have been eliminated.

Sixty-three (57 in 2006) 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, 2007, 52 (55 in 2006) affiliates were accounted for by the equity method.

The difference between the cost of investments and the equity in net assets at the dates of acquisition, if considered significant, is amortized over the estimated years when the amortization period can be determined, or over five years when it cannot. Where the difference is small, it's 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. 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 valuation and translation adjustments in net assets. Realized gains and losses on the sale of such securities are computed using moving-average cost based on the carrying value at March 31, 2000 or at the 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, or available-for-sale securities declines significantly, the securities are stated at fair market value and the difference between the 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, the 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, the 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 for obligatory PCB treatment and to prevent the spread of ground pollution at the site of the Moka Plant and Takasago Works 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 an amount based on the estimated loss from restructuring discontinued operations at the end of the fiscal year.

(7) Inventories
Inventories are valued at cost. Cost is determined principally by the average method in the Iron and Steel, Wholesale Power Supply and Aluminum and Copper Segments and by the specific identification method for finished goods and work in progress in the Machinery, Construction Machinery and Real Estate Segments.

(8) Depreciation
Depreciation of plant and equipment and intangible assets is principally provided by the straight-line method for buildings and structures and intangible assets and the declining-balance method for machinery and equipment.

Useful lives are based mainly on schedules in Japanese tax laws. Intangible assets include software for internal use which is amortized over the estimated useful life of 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 a 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 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 years 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 valuation and translation adjustments in net assets.

(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 year-end rates, except net assets accounts, which are translated at historical rates, and statement of income items resulting from transactions with the Company, which are translated at rates used by the Company.

The Company and its domestic consolidated subsidiaries report foreign currency translation adjustments in net assets 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
The Company and its domestic consolidated subsidiaries account for finance leases that do not transfer ownership and do not have bargain purchase provisions in the same manner as operating leases.

(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 the 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 the derivative financial instruments until the related losses or gains on the corresponding hedged items are recognized. Deferred gains or deferred losses on these derivative instruments are reported, net of applicable income taxes, as a separate component of valuation and translation adjustments in net assets.

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 three months at the time of purchase are considered to be cash and cash equivalents.

(19) Accounting Standard for Presentation of Net Assets in the Balance Sheet
Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Statement No. 5 issued by the Accounting Standards Board of Japan on December 9, 2005), and the implementation guidance for the accounting standard for presentation of net assets in the balance sheet

(the Financial Accounting Standard Implementation Guidance No. 8 issued by the Accounting Standards Board of Japan on December 9, 2005), (collectively, "the New Accounting Standards").

The consolidated balance sheet as of March 31, 2007 prepared in accordance with the New Accounting Standards comprises three sections, which are the assets, liabilities and net assets sections. The consolidated balance sheet as of March 31, 2006 prepared pursuant to the previous presentation rules comprises the assets, liabilities, minority interests and shareholders' equity sections.

Under the New Accounting Standards, the following items are presented differently at March 31, 2007 compared to March 31, 2006. The net assets section includes deferred gains on hedges, net of taxes. Under the previous presentation rules, deferred gains on hedges were included in the assets or liabilities section without considering the related income tax effects. Minority interests are included in the net assets section at March 31, 2007. Under the previous presentation rules, companies were required to present minority interests in the liabilities section and between the non-current liabilities and the shareholders' equity sections, respectively.

The adoption of the New Accounting Standards had no impacts on the consolidated statement of income for the year ended March 31, 2007. Also, if the New Accounting Standards had not been adopted at March 31, 2007, the shareholders' equity amounting to ¥589,903 million ($4,997,061 thousand) would have been presented.

(20) Accounting Standard for Statement of Changes in Net Assets
Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Statement of Changes in Net Assets" (Statement No. 6 issued by the Accounting Standards Board of Japan on December 27, 2005), and the implementation guidance for the accounting standard for statement of changes in net assets (the Financial Accounting Standard Implementation Guidance No. 9 issued by the Accounting Standards Board of Japan on December 27, 2005), (collectively, "the Additional New Accounting Standards").

The Company prepared the accompanying consolidated statement of changes in net assets for the year ended March 31, 2007 in accordance with the Additional New Accounting Standards. The accompanying consolidated statement of shareholders' equity for the year ended March 31, 2006, which was voluntarily prepared for inclusion in the consolidated financial statements, has not been adapted to the new presentation rules of 2007.

(21) Accounting Standard for Business Combination and Divestitures
Effective April 1 2006, the Company and its domestic consolidated subsidiaries adopted "Accounting Standard for Business Combinations" (issued by the Business Accounting Council on October 31, 2003), "Accounting Standard for Business Divestitures" (Statement No. 7 issued by the Accounting Standards Board of Japan on December 27, 2005), and the "Implementation Guidance for the Accounting Standard for Business Combinations and Divestitures" (the Financial Accounting Standard Implementation Guidance No.10 issued by the Accounting Standards Board of Japan on December 27, 2005)

3. Leases

Original lease obligations as lessee under non-capitalized finance leases at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Buildings and structures	¥ 827	¥ 783	$ 7,005
Machinery and equipment	54,504	51,270	461,703
	¥55,331	¥52,053	$468,708

Future minimum lease payments as lessee under non-capitalized finance leases at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Due within one year	¥ 8,851	¥ 8,325	$ 74,977
Due after one year	17,985	16,799	152,350
	¥26,836	¥25,124	$227,327
Lease expense for the years ended March 31	¥ 9,578	¥ 9,329	$ 81,135

Future minimum lease payments as lessee under operating leases at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Due within one year	¥2,551	¥ 2,655	$21,609
Due after one year	6,076	7,385	51,470
	¥8,627	¥10,040	$73,079

Future minimum lease payments to be received as lessor under finance leases that were accounted for as operating leases at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Future minimum lease payments receivable:			
Due within one year	¥—	¥—	$—
Due after one year	—	—	—
	¥—	¥—	$—
Lease income for the years ended March 31	¥—	¥ 1	$—

Future minimum lease payments receivable as lessor under operating leases at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Due within one year	¥ 402	¥ 356	$ 3,405
Due after one year	3,981	3,984	33,723
	¥4,383	¥4,340	$37,128

4. Securities

The following tables summarize acquisition costs, book values and fair values of securities with available fair values as of March 31, 2007 and 2006:

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2007			2006			2007
	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	¥51	¥1	$—

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2007			2006			2007
	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	¥39,294	¥160,971	¥121,677	¥38,618	¥149,609	¥110,991	$1,030,725
Other	10	17	7	10	16	6	59
	39,304	160,988	121,684	38,628	149,625	110,997	1,030,784
Other securities:							
Equity securities	4,787	4,677	(110)	353	260	(93)	(932)
	4,787	4,677	(110)	353	260	(93)	(932)
	¥44,091	¥165,665	¥121,574	¥38,981	¥149,885	¥110,904	$1,029,852

The following table summarizes book values of securities with no available fair values as of March 31, 2007 and 2006:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Held-to-maturity debt securities			
Non-listed foreign bond	¥100	¥100	$847

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	2007
Available-for-sale securities:			
Non-listed equity securities	¥22,853	¥21,792	$193,587
Preferred subscription certificate	5,000	5,000	42,355

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)
	2007	2006	**2007**
Within one year	**¥ —**	¥ 50	**$ —**
Over one year but within five years	**100**	100	**847**

Sales of available-for-sale securities for the years ended March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Sales	**¥3,396**	¥1,602	**$28,767**
Gains on sales	**1,192**	428	**10,097**
Losses on sales	**5**	15	**42**

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 Group 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, 2007 and 2006 were as follows:

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2007			2006			**2007**
	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	**¥17,973**	**¥18,109**	**¥(136)**	¥11,305	¥11,430	¥(125)	**$(1,152)**
Others	**10,444**	**10,299**	**145**	—	—	—	**1,228**
To buy foreign currencies:							
U.S. dollars	**11,002**	**11,000**	**(2)**	7,809	7,807	(2)	**(17)**
Others	**433**	**437**	**4**	—	—	—	**34**
			¥ 11			¥(127)	**$ 93**

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 with the contracted foreign exchange rates at March 31, 2007 and 2006.

Interest rate swap agreements outstanding at March 31, 2007 and 2006 were as follows:

	Millions of yen				Thousands of U.S. dollars (Note 1)
	2007		2006		**2007**
	Contracted amount	Recognized gain (loss)	Contracted amount	Recognized gain (loss)	Recognized gain (loss)
Interest rate swap agreements					
To receive floating and pay fixed rates	**¥ 200**	**¥ (0)**	¥ 738	¥ (2)	**$ (0)**
To receive fixed and pay floating followed by fixed rates	**55,300**	**(1,191)**	55,300	(1,450)	**(10,089)**
		¥(1,191)		¥(1,452)	**$(10,089)**

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, 2007 and 2006.

6. Short-Term Borrowings and Long-Term Debt

Short-term borrowings at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Bank loans (average rate 2.30% in 2007 and 1.42% in 2006)	**¥88,102**	¥119,300	**$746,311**

Long-term debt at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
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	**$ 84,710**
0.3% to 3.5% yen bonds, due 2008 through 2017	**246,471**	252,579	**2,087,852**
Euro medium-term notes, due 2006	**—**	1,203	**—**
Loans, principally from banks and insurance companies	**397,503**	335,894	**3,367,243**
	653,974	599,676	**5,539,805**
Less current portion	**105,449**	105,451	**893,257**
	¥548,525	¥494,225	**$4,646,548**

The aggregate annual maturities of long-term debt at March 31, 2007 were as follows:

Years ending March 31,	Millions of yen	Thousands of U.S. dollars (Note 1)
2008	¥105,449	$ 893,257
2009	139,278	1,179,822
2010	84,675	717,281
2011 and thereafter	324,572	2,749,445
	¥653,974	$5,539,805

At March 31, 2007 and 2006, 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)
	2007	2006	**2007**
Assets pledged as collateral			
Plant and equipment, net of accumulated depreciation	**¥222,034**	¥249,777	**$1,880,847**
Other assets	**28,796**	44,692	**243,931**
	¥250,830	¥294,469	**$2,124,778**
Secured short-term borrowings and long-term debt			
Bonds (includes those due within 1 year)	**¥ 1,448**	¥ 1,800	**$ 12,266**
Short-term borrowings	**13,349**	19,473	**113,079**
Long-term borrowings	**121,210**	133,063	**1,026,768**
Other debt	**709**	—	**6,006**
	¥136,716	¥154,336	**$1,158,119**

At March 31, 2007 and 2006, included in the assets pledged as collateral were assets that were promised to be pledged as collateral for short-term borrowings, long-term borrowings and the guarantee of loans as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Short-term borrowings	**¥ 7,667**	¥ 7,853	**$ 64,947**
Long-term borrowings	**23,410**	31,069	**198,306**
Guarantee of loans	**393**	587	**3,329**
	¥31,470	¥39,509	**$266,582**

7. Contingent Liabilities

At March 31, 2007 and 2006 the Group was contingently liable as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Trade notes discounted	**¥ 200**	¥ 1,932	**$ 1,694**
Trade notes endorsed	**1,623**	625	**13,748**
Guarantees of loans			
Related parties	**8,751**	3,260	**74,130**
Others	**2,308**	1,087	**19,551**
	¥12,882	¥ 6,904	**$109,123**

Guarantees of loans include contingent guarantees and letters of awareness of ¥700 million ($5,930 thousand) at March 31, 2007 and ¥700 million at March 31, 2006.

8. Net assets

As described in Note 2 (19), net assets comprises three subsections, which are the owners' equity, accumulated gains (losses) from valuation and translation adjustments, and minority interests.

The Japanese Corporate Law ("the Law") became effective on May 1, 2006, replacing the Japanese Commercial Code ("the Code"). The Law is generally applicable to events and transactions occurring after April 30, 2006 and for fiscal years ending after that date.

Under Japanese laws and regulations, the entire amount paid for new shares is required to be designated as common stock. However, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one-half of the price of the new shares as additional paid-in capital, which is included in capital surplus.

Under the Law, in cases where a dividend distribution of surplus is made, the smaller of an amount equal to 10% of the dividend or the excess, if any, of 25% of common stock over the total of additional paid-in-capital and legal earnings reserve must be set aside as additional paid-in-capital or legal earnings reserve. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets.

Under the Code, companies were required to set aside an amount equal to at least 10% of the aggregate amount of cash dividends and other cash appropriations as legal earnings reserve until the total of legal earnings reserve and additional paid-in capital equaled 25% of common stock.

Under the Code, legal earnings reserve and additional paid-in capital could be used to eliminate or reduce a deficit by a resolution of the shareholders' meeting or could be capitalized by a resolution of the Board of Directors. Under the Law, both of these appropriations generally require a resolution of the shareholders' meeting.

Additional paid-in capital and legal earnings reserve may not be distributed as dividends. Under the Code, however, on condition that the total amount of legal earnings reserve and additional paid-in capital remained equal to or exceeded 25% of common stock, they were available for distribution by resolution of the shareholders' meeting. Under the Law, all additional paid-in-capital and all legal earnings reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for dividends.

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 Japanese laws and regulations.

At the Board of Directors meeting held on May 18, 2007, the Board of Directors approved cash dividends amounting to ¥12,205 million ($103,388 thousand). These appropriations have not been accrued in the consolidated financial statements as of March 31, 2007. Such appropriations are recognized in the period in which they are approved by the Board of Directors.

9. Research and Development Expenses

Research and development expenses, included in cost of sales and selling, general, and administrative expenses were ¥24,893 million ($210,868 thousand) for the year ended March 31, 2007 and ¥24,121 million for the year ended March 31, 2006.

10. Selling, General and Administrative Expenses

Selling, general and administrative expenses for the years ended March 31, 2007 and 2006 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Freight	**¥ 43,598**	¥ 40,079	**$ 369,318**
Employees' compensation	**38,221**	36,681	**323,770**
Research and development	**10,242**	9,565	**86,760**
Depreciation	**3,106**	3,022	**26,311**
Other	**63,347**	60,280	**536,611**
	¥158,514	¥149,627	**$1,342,770**

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 the 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, 2007 consisted of the following:

	Millions of yen	Thousands of U.S. dollars (Note 1)
Idle assets		
Land, etc., (Kobe, Hyogo Prefecture, etc.: 3 properties in total)	¥ 4,080	$ 34,562
Assets for business		
Land (Chiba, Chiba Prefecture)	553	4,684
Leasehold property		
Land (Kakogawa, Hyogo Prefecture)	141	1,194
	¥ 4,774	$ 40,440

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 idle assets whose fair values have diminished significantly compared to book values primarily due to the decline in land prices. The Group also recognized losses for assets for business and leasehold property whose fair values have also diminished due to the decline in land prices.

Book values of those fixed assets were reduced to recoverable amounts and impairment loss of ¥4,774 million ($40,440 thousand) was recognized in the year ended March 31, 2007. The amount consisted of land of ¥4,758 million ($40,304 thousand), machinery and equipment of ¥16 million ($136 thousand).

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

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

13. Income Taxes

Significant components of the Group's deferred income tax assets and liabilities as of March 31, 2007 and 2006 were as follows:

	Millions of yen	Thousands of U.S. dollars (Note 1)
	2007	**2007**
Deferred income tax assets		
Unrealized profit	**¥ 20,868**	**$ 176,773**
Employees' severance and retirement benefits	**17,887**	**151,521**
Accrued bonuses to employees	**9,979**	**84,532**
Loss on write-down of securities	**7,894**	**66,870**
Loss on impairment of fixed assets	**7,226**	**61,211**
Land revaluation	**5,067**	**42,922**
Enterprise taxes	**2,476**	**20,974**
Provision for environmental measures	**1,838**	**15,570**
Loss carryfowards	**1,487**	**12,596**
Other	**27,875**	**236,129**
Total deferred income tax assets	**102,597**	**869,098**
Valuation allowance	**(24,706)**	**(209,284)**
Deferred income tax assets	**77,891**	**659,814**
Deferred income tax liabilities		
Net unrealized holding gains on securities	**49,837**	**422,168**
Special tax purpose reserve	**8,811**	**74,638**
Land revaluation	**5,371**	**45,498**
Other	**17,759**	**150,436**
Total deferred income tax liabilities	**81,778**	**692,740**
Net deferred income tax assets	**¥ (3,887)**	**$ (32,926)**

	Millions of yen
	2006
Deferred income tax assets	
Employees' severance and retirement benefits	¥ 21,792
Unrealized profit	21,279
Loss on write-down of securities	6,425
Land revaluation	6,253
Loss on impairment of fixed assets	5,659
Enterprise taxes	3,210
Loss carryforwards	2,426
Provision for environmental measures	2,246
Other	34,646
Total deferred income tax assets	103,936
Valuation allowance	(22,020)
Deferred income tax assets	81,916
Deferred income tax liabilities	
Net unrealized holding gains on securities	45,107
Special tax purpose reserve	9,114
Land revaluation	6,027
Other	14,710
Total deferred income tax liabilities	74,958
Net deferred income tax assets	¥ 6,958

Significant items in the reconciliation of the aggregate statutory income tax rate to the effective income tax rate for the years ended March 31, 2007 and 2006 were as follows:

	2007
Aggregate statutory income tax rate in Japan	**40.6%**
Non-deductible entertainment expenses	**1.3**
Temporary difference for investments in subsidiaries	**(2.6)**
Equity in income of unconsolidated subsidiaries and affiliates	**(1.3)**
Other	**(3.0)**
Effective income tax rate	**35.0%**

	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%

14. Consolidated Statements of Changes in Net Assets

Changes in number of shares issued and outstanding during the year ended at March 31, 2007 were as follows:

	Number of shares
Common stock outstanding	
Balance at March 31, 2006	3,115,061,100
(No increase)	0
(No decrease)	0
Balance at March 31, 2007	3,115,061,100

	Number of shares
Treasury stock outstanding	
Balance at March 31, 2006	9,383,104
Increase due to purchase of odd-lot stock	722,866
Increase due to purchase of treasury stock based on resolution of the Board of Directors	60,867,000
Decrease due to sale of odd-lot stock	(96,478)
Decrease due to stock swap	(464,676)
Other reasons (net changes)	23,519
Balance at March 31, 2007	70,435,335

15. Consolidated Statements of Cash Flows

The reconciliation of cash and cash equivalents in the cash flow statements and balance sheets as of March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Cash and cash equivalents (balance sheets)	**¥99,668**	¥96,188	**$844,286**
Time deposits (due over 3 months)	**(1,505)**	(703)	**(12,749)**
Cash and cash equivalents (cash flow statements)	**¥98,163**	¥95,485	**$831,537**

Non-cash financing activities as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Convertible bonds converted into common stock	**¥—**	¥15,150	**$—**
Convertible bonds converted into capital surplus	**—**	15,150	**—**
Bond premium	**—**	(300)	**—**
Decrease in convertible bonds due to exercise of warrants	**¥—**	¥30,000	**$—**

16. Related Party Transactions

Net sales include sales to Shinsho Corporation, which is an affiliate of the Company, of ¥219,711 million ($1,861,169 thousand) and ¥197,701 million for the years ended March 31, 2007 and 2006, respectively.

17. 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, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Projected benefit obligation	**¥(207,368)**	¥(216,497)	**$(1,756,612)**
Fair value of pension assets	**219,556**	216,424	**1,859,856**
Unrecognized net transition obligation	**754**	833	**6,387**
Unrecognized actuarial differences	**(32,129)**	(31,244)	**(272,164)**
Prepaid pension cost	**(27,732)**	(22,497)	**(234,917)**
Liability for severance and retirements benefits	**¥ (46,919)**	¥ (52,981)	**$ (397,450)**

Included in the consolidated statements of income for the years ended March 31, 2007 and 2006 are severance and retirement benefit expenses that comprised the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2007	2006	**2007**
Service costs – benefits earned during the year	**¥ 6,938**	¥ 6,463	**$ 58,772**
Interest cost on projected benefit obligation	**4,073**	4,800	**34,502**
Expected return on plan assets	**(2,615)**	(2,262)	**(22,152)**
Amortization of net transition obligation	**124**	1,037	**1,050**
Amortization of actuarial differences	**(1,065)**	1,733	**(9,022)**
Severance and retirement benefit expenses	**¥ 7,455**	¥11,771	**$ 63,150**

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 generally 2.0% for the years ended March 31, 2007 and 2006.
The rate of expected return on plan assets is generally 2.1% for the years ended March 31, 2007 and 2006.

18. Segment Information

(1) Industry Segment

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

		Millions of yen		Thousands of U.S. dollars (Note 1)
		2007	2006	**2007**
Sales to outside customers:	Iron and Steel	**¥ 805,636**	¥ 734,749	**$ 6,824,532**
	Wholesale Power Supply	**66,858**	65,209	**566,353**
	Aluminum and Copper	**396,181**	303,890	**3,356,044**
	Machinery	**274,911**	246,912	**2,328,767**
	Construction Machinery	**285,333**	226,645	**2,417,052**
	Real Estate	**33,867**	43,543	**286,887**
	Electronic Materials and Other Businesses	**47,510**	46,365	**402,457**
	Consolidated net sales	**1,910,296**	1,667,313	**16,182,092**
Intersegment sales:	Iron and Steel	**25,061**	23,619	**212,291**
	Wholesale Power Supply	**—**	—	**—**
	Aluminum and Copper	**1,129**	1,055	**9,564**
	Machinery	**6,036**	12,366	**51,131**
	Construction Machinery	**50**	382	**424**
	Real Estate	**7,495**	3,702	**63,490**
	Electronic Materials and Other Businesses	**16,068**	14,763	**136,112**
		55,839	55,887	**473,012**
Total sales:	Iron and Steel	**830,696**	758,368	**7,036,815**
	Wholesale Power Supply	**66,858**	65,209	**566,353**
	Aluminum and Copper	**397,310**	304,945	**3,365,608**
	Machinery	**280,947**	259,278	**2,379,898**
	Construction Machinery	**285,383**	227,027	**2,417,476**
	Real Estate	**41,362**	47,245	**350,377**
	Electronic Materials and Other Businesses	**63,579**	61,128	**538,577**
		1,966,135	1,723,200	**16,655,104**
Operating costs and expenses:	Iron and Steel	**736,107**	627,462	**6,235,553**
	Wholesale Power Supply	**48,837**	45,679	**413,698**
	Aluminum and Copper	**362,639**	281,583	**3,071,910**
	Machinery	**258,815**	248,896	**2,192,418**
	Construction Machinery	**270,580**	218,199	**2,292,080**
	Real Estate	**36,048**	42,118	**305,362**
	Electronic Materials and Other Businesses	**49,274**	43,663	**417,399**
	Eliminations	**(60,628)**	(60,682)	**(513,579)**
	Consolidated operating costs and expenses	**1,701,672**	1,446,918	**14,414,841**
Operating income:	Iron and Steel	**94,589**	130,906	**801,262**
	Wholesale Power Supply	**18,021**	19,530	**152,656**
	Aluminum and Copper	**34,671**	23,362	**293,698**
	Machinery	**22,132**	10,382	**187,480**
	Construction Machinery	**14,803**	8,828	**125,396**
	Real Estate	**5,314**	5,127	**45,015**
	Electronic Materials and Other Businesses	**14,304**	17,465	**121,169**
	Eliminations	**4,790**	4,795	**40,575**
	Consolidated operating income	**208,624**	220,395	**1,767,251**
Assets:	Iron and Steel	**880,634**	846,890	**7,459,839**
	Wholesale Power Supply	**171,039**	198,548	**1,448,869**
	Aluminum and Copper	**302,297**	267,625	**2,560,754**
	Machinery	**252,769**	235,355	**2,141,203**
	Construction Machinery	**234,947**	215,611	**1,990,233**
	Real Estate	**127,624**	141,304	**1,081,101**
	Electronic Materials and Other Businesses	**73,367**	117,346	**621,491**
	Corporate and Eliminations	**198,893**	51,563	**1,684,820**
	Total	**¥2,241,570**	¥2,074,242	**$18,988,310**

		Millions of yen		Thousands of U.S. dollars (Note 1)
		2007	2006	2007
Depreciation:	Iron and Steel	¥ **45,925**	¥ 40,764	$ **389,030**
	Wholesale Power Supply	**12,484**	12,487	**105,751**
	Aluminum and Copper	**14,278**	13,578	**120,949**
	Machinery	**5,391**	5,321	**45,667**
	Construction Machinery	**4,315**	3,286	**36,552**
	Real Estate	**1,237**	1,514	**10,479**
	Electronic Materials and Other Businesses	**3,097**	2,648	**26,235**
	Corporate and Eliminations	**(40)**	(91)	**(339)**
	Total	**86,687**	79,507	**734,324**
Impairment of fixed assets:	Iron and Steel	**—**	—	**—**
	Wholesale Power Supply	**—**	—	**—**
	Aluminum and Copper	**554**	—	**4,693**
	Machinery	**16**	—	**136**
	Construction Machinery	**—**	—	**—**
	Real Estate	**202**	—	**1,711**
	Electronic Materials and Other Businesses	**—**	—	**—**
	Corporate and Eliminations	**4,002**	—	**33,900**
	Total	**4,774**	—	**40,440**
Capital expenditures:	Iron and Steel	**79,416**	49,636	**672,732**
	Wholesale Power Supply	**622**	149	**5,269**
	Aluminum and Copper	**24,719**	14,672	**209,394**
	Machinery	**6,961**	9,107	**58,967**
	Construction Machinery	**7,668**	5,301	**64,956**
	Real Estate	**1,978**	8,176	**16,756**
	Electronic Materials and Other Businesses	**6,142**	3,041	**52,030**
	Corporate and Eliminations	**6,143**	2,237	**52,037**
	Total	¥ **133,649**	¥ 92,319	$ **1,132,141**

Corporate assets of ¥239,960 million ($2,032,698 thousand) and ¥279,696 million at March 31, 2007 and 2006, respectively, principally consisted of assets of the administration departments of the Company.

As mentioned in “1. Basis of Presenting Consolidated Financial Statements,” the principal depreciation method for machinery and equipment has been changed from the straight-line method to the declining-balance method.

As a result, compared with the straight-line method, operating costs and expenses were ¥4,161 million ($35,248 thousand) more in the Iron and Steel segment, ¥693 million ($5,870 thousand) more in the Aluminum and Copper segment and ¥167 million ($1,415 thousand) more in the Machinery segment.

Accordingly, operating income in the above segments decreased by the same amount respectively.

(2) Geographic Area

		Millions of yen	Thousands of U.S. dollars (Note 1)
		2007	2007
Sales to outside customers:	Japan	¥1,707,605	$14,465,100
	Other areas	202,691	1,716,992
	Total	1,910,296	16,182,092
Intersegment sales:	Japan	94,366	799,373
	Other areas	12,437	105,354
	Total	106,803	904,727
Total sales:	Japan	1,801,971	15,264,473
	Other areas	215,128	1,822,346
	Total	2,017,099	17,086,819
Operating costs and expenses:	Japan	1,608,223	13,623,236
	Other areas	200,244	1,696,264
	Eliminations	(106,795)	(904,659)
	Consolidated operating costs and expenses	1,701,672	14,414,841
Operating income:	Japan	193,748	1,641,237
	Other areas	14,883	126,073
	Eliminations	(7)	(59)
	Consolidated operating income	208,624	1,767,251
Assets:	Japan	1,833,390	15,530,623
	Other areas	207,453	1,757,331
	Corporate and Eliminations	200,727	1,700,356
	Total	¥2,241,570	$18,988,310

The principal area in other areas is Asia.

Geographic segment information is presented for the year ended March 31, 2007, since sales to outside customers in the Japan segment was less than 90% of total sales to outside customers.

Corporate assets of ¥239,960 million ($2,032,698 thousand) principally consisted of assets of the administration departments of the Company.

As mentioned in "1. Basis of Presenting Consolidated Financial Statements," the principal depreciation method for machinery and equipment has been changed from the straight-line method to the declining-balance method.

As a result, compared with the straight-line method, operating costs and expenses were ¥5,021 million ($42,533 thousand) more and operating income decreased by the same amount in the Japan segment.

(3) Overseas Sales

Overseas sales for the years ended March 31, 2007 and 2006 were as follows:

		Percentages of 2007 consolidated net sales	Millions of yen		Thousands of U.S. dollars (Note 1)
			2007	2006	2007
Overseas sales:	Asia	18.1%	¥344,825	¥255,645	$2,921,008
	Other areas	11.4	218,042	165,228	1,847,031
	Total	29.5%	¥562,867	¥420,873	$4,768,039

Overseas sales consisted of export sales of the Company and its 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: North America

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 (the "Group") as of March 31, 2007 and 2006, and the related consolidated statements of income for the years then ended, the consolidated statement of changes in net assets for the year ended March 31, 2007, the consolidated statement of stockholders' equity for the year ended March 31, 2006, and the consolidated statements of cash flows for the years ended March 31, 2007 and 2006, 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 consolidated subsidiaries as of March 31, 2007 and 2006, 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 1 to the consolidated financial statements, effective April 1, 2005, the Group has changed the principal method of valuation for inventories in the Iron and Steel, Wholesale Power Supply, and Aluminum and Copper segments.
(2) As discussed in Note 1 to the consolidated financial statements, effective April 1, 2006, the Group has changed the principal method of calculating depreciation for machinery and equipment.
(3) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2006, the Group has adopted a new accounting standard for the presentation of net assets in the balance sheet.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2007 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 26, 2007

Directors, Corporate Auditors, and Corporate Officers (As of June 26, 2007)

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
Keiji Koyama

Senior Managing Director
Takashi Matsutani

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
Tomoyuki Kaya*

Executive Officer
Koichi Onishi

Senior Officers
Keiichi Murase
Terumichi Abe
Takanori Kominami
Ikuhiro Yamaguchi
Yasunobu Kumon

Officers
Hironobu Yoshida
Masayasu Kimura
Hiroya Kawasaki
Hiroyoshi Tsumura

● Welding Company

Senior Managing Director
Isao Aida **

Officer
Tsuyoshi Kasuya

● Aluminum and Copper Company

Senior Managing Director
Hiroyuki Nakayama **

Executive Officer
Hideo Ohgi

Senior Officers
Tetsu Takahashi
Ryosuke Shimomura
Seiichi Nagai

● Machinery and Engineering Company

Executive Vice President and Representative Director
Shigeto Kotani **

Executive Officer
Kazuo Shigekawa

Senior Officers
Jun Tanaka
Shuzo Mohri

Outside Directors

Atsushi Nakano
Yukio Doi

Statutory Auditors

Toru Asaoka
Toshinori Okoshi
Taku Morota
Takasuke Kaneko

* Head of the Iron and Steel Sector

** President of the internal company

Domestic and Overseas Offices

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Sales Offices
Hokkaido .... (Sapporo)
Tohoku ....(Sendai)
Niigata .... (Niigata)
Hokuriku ....(Toyama)
Shikoku .... (Takamatsu)
Chugoku ....(Hiroshima)
Kyushu ....(Fukuoka)
Okinawa .... (Naha)

Research Laboratory
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Shanghai 200020 PEOPLE'S REPUBLIC OF CHINA
Phone: (021) 6415-4977 Fax: (021) 6415-9409

Investor Information (As of March 31, 2007)

Founded .... September 1905

Incorporated .... June 1911

Employees .... 9,048 (Consolidated 31,828)

Fiscal Year .... April 1 – March 31

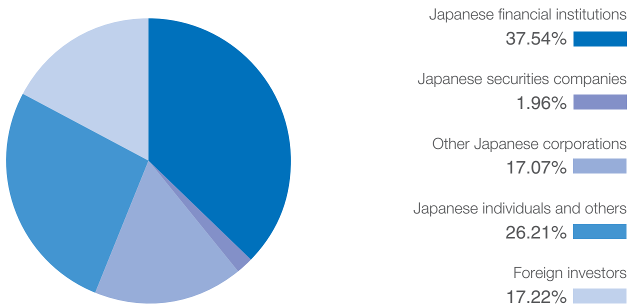
Ordinary General Meeting of Stockholders .. June of each year

Authorized and Issued Share Capital

Authorized: .... 6,000,000,000 shares

Issued: .... 3,115,061,100 shares

Distribution of Shares



Principal Stockholders

At March 31, 2007, the ten largest stockholders of the Company Stockholdings were as follows:

	Thousands of shares	Percent
Japan Trustee Services Bank, Ltd. (Trust Account)	158,700	5.09
The Master Trust Bank of Japan, Ltd. (Trust Account)	150,008	4.82
Nippon Life Insurance Company	125,311	4.02
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	52,335	1.68
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	47,347	1.52
Japan Trustee Services Bank, Ltd. (Trust Account 4)	42,561	1.37
Sojitz Corporation	42,016	1.35

*The Company's holdings of treasury stock (63,890 thousand shares) are not included in the above figures.

Directors' and Corporate Auditors' Stockholdings

The following is a list of the directors and corporate auditors and their stockholdings in the Company at June 26, 2007.

	Number of shares owned
Koshi Mizukoshi	255,000
Yasuo Inubushi	123,000
Hiroshi Sato	145,000
Shigeto Kotani	103,000
Keiji Koyama	71,000
Tomoyuki Kaya	62,000
Hiroyuki Nakayama	71,000
Takashi Matsutani	98,000
Isao Aida	76,000
Atsushi Nakano	–
Yukio Doi	–
Toru Asaoka	107,000
Toshinori Okoshi	45,000
Taku Morota	39,000
Takasuke Kaneko	25,000

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

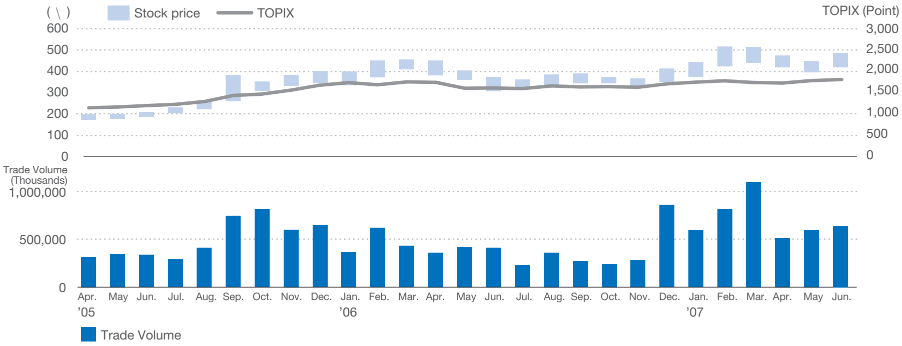
Mitsubishi UFJ Trust and Banking Corporation
4-5, Marunouchi 1-chome, Chiyoda-ku, TOKYO 100-8212 JAPAN

Independent Auditors

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

Common Stock Price Range

Tokyo Stock Exchange (High / Low)



Information

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