



ANNUAL REPORT 2006

For the Year Ended March 31, 2006

Explore
the Engineering
Edge



Profile

Explore the Engineering Edge

In December 2003, Ishikawajima-Harima Heavy Industries Co., Ltd., (the “Company”) celebrated the 150th anniversary of its establishment.

From its beginnings as a shipbuilder, IHI has expanded its operations over the years to cover a widely diversified range of machinery and equipment for use on land, in the sky and in outer space. We have consistently leveraged the accumulated knowledge, know-how and ingenuity of our corporate group to provide inspiration and direction for one new age after another.

Today, at a time of unprecedented demand for innovation and change, we continue to “Explore the Engineering Edge.” This new corporate slogan expresses our commitment to searching the frontiers of engineering, vigorously and unceasingly, for never before imagined possibilities and solutions appropriate to our era.

This commitment is founded on three principles:

- To bring dreams to reality—unlimited enthusiasm for making things of high quality
- To innovate in business and technology—insatiable curiosity and unconventional thinking
- To create new value—an exceptional ability to integrate expertise in various businesses to provide total solutions

At this significant juncture, IHI and our partners and associates around the world look forward to building on the tradition of innovative leadership that sustained our first 150 years of growth and development. We will continue to explore the engineering edge, deploying all the resources and resourcefulness at our disposal to construct a better world.

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Based on our management philosophy of “Using technology for the benefit of society,” IHI Group combines its dynamism, which extends from the land and sea to sky and space, to provide the total solutions that society and the world have come to expect of it.

1. V2500 jet engine at the Mizuho Aero-Engine Works
2. Handing down expertise
3. Finishing touches are made to a bulk carrier ship at IHIMU's Yokohama Shipyard.
4. M-V rocket successfully launches into space. (©JAXA)
5. India's first LNG receiving terminal, built by a consortium in which IHI plays a leading role.
6. Bulk carrier at IHIMU's Yokohama Shipyard.

Cautionary Statements with Respect to Forward-Looking Statements

Statements made in this annual report with respect to IHI's current plans, estimates, strategies and beliefs and other statements that are not historical facts are forward-looking statements about the future performance of IHI. These statements are based on management's assumptions and beliefs in light of the information currently available to it and therefore readers should not place undue reliance on them. IHI cautions that a number of important factors, such as general economic conditions and exchange rates, could cause actual results to differ materially from those discussed in the forward-looking statements.

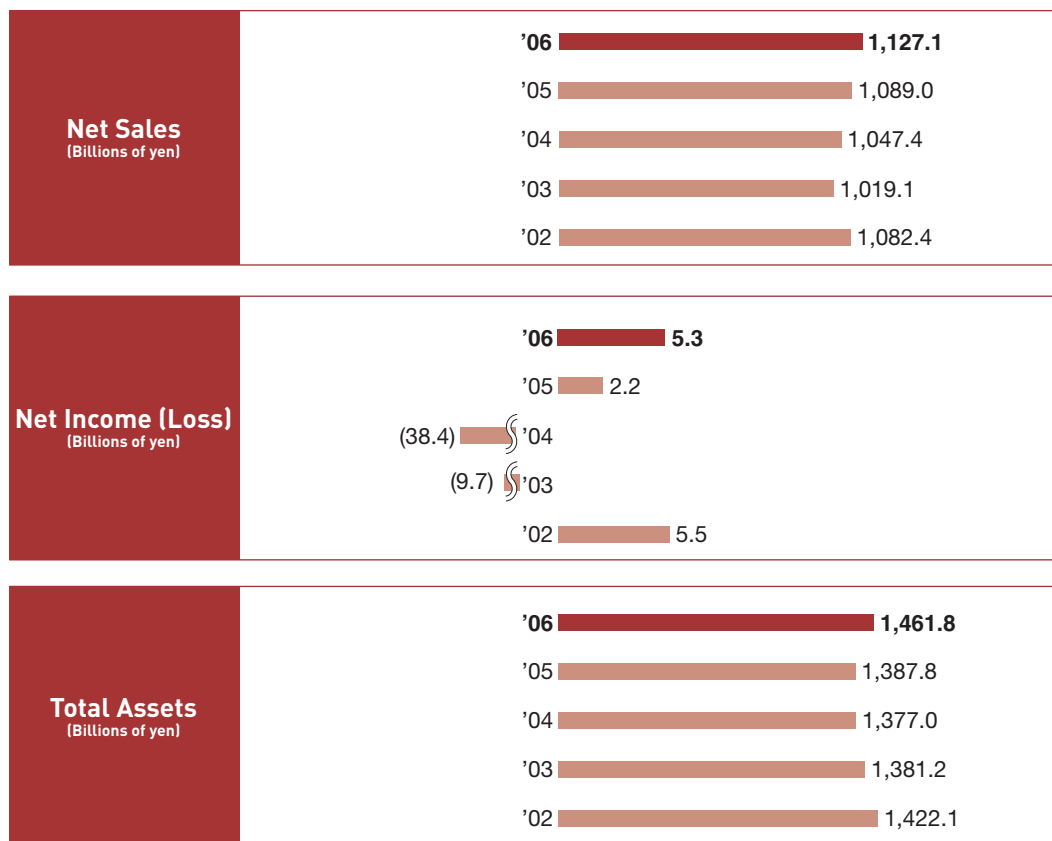
Financial Highlights

Years ended March 31, 2006, 2005 and 2004
Ishikawajima-Harima Heavy Industries Co., Ltd. and Consolidated Subsidiaries

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	2006
Net sales	¥1,127,075	¥1,089,047	¥1,047,441	\$ 9,594,577
Operating income (loss)	21,771	10,619	(23,230)	185,332
Net income (loss)	5,283	2,180	(38,354)	44,973
Total assets	1,461,796	1,387,838	1,377,021	12,443,994
Total shareholders' equity	169,237	153,716	151,550	1,440,683

Amounts per share:	Yen			U.S. dollars
Net income (loss)	¥ 3.93	¥ 1.56	¥ (29.67)	\$ 0.033
Cash dividends	—	—	—	—

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



Figures are for years ended March 31 of respective years.

To Our Shareholders



The Year in Review

In the year ended March 31, 2006, the Japanese economy showed clear signs of recovery, casting off indications of leveling off in the business climate that had carried over from the first half of the year. Exports to China and other countries in Asia rallied, and the trend toward favorable corporate performance was reflected in growth in capital investment and consumer spending. There continued to be high levels of expansion in the global economy, even in the Chinese economy, despite the Chinese government measures to cool down investment activities. In the U.S. economy, there were ongoing concerns caused by soaring crude oil prices, but overall there was satisfactory growth supported by brisk demand. There were signs of economic recovery in Europe, supported by favorable trends in the U.S. and China, as the global economy as a whole displayed strong growth.

The shipbuilding, heavy machinery and plant industries in which the IHI Group is primarily active were supported by domestic capital investment and exports that stemmed from the economic upturn. From the standpoint of orders received, the pace of recovery increased the intensity of sales activity, but from the profit standpoint, the recovery was less pronounced because of the impact of rising costs brought about by soaring prices for raw materials when compared with the material production industries such as iron and steel.

Amid these economic conditions, the IHI Group engaged in business restructuring and made every effort to increase profitability by thoroughly reducing costs. As a result, the IHI Group recorded a 5.7% increase in orders to ¥1,225.6 billion in the year under review. Net sales edged up 3.5% compared with the previous year to ¥1,127.1 billion. As of March 31, 2006, orders on hand totaled ¥1,530.1 billion, an increase of 7.3% from a year earlier.

From the profit and loss standpoint, operating income was ¥21.8 billion, and net income was ¥5.3 billion.

Due to the urgent need for stable management, IHI decided to forego interim dividend payments in the first half of the year, ended September 30, 2005, in continuation from the previous year. In view of the improvement in business performance and thoroughly considering such overriding factors as earnings, the year-end cash dividends are to be ¥2.0 per share, payment of which is to be approved at the annual general shareholders' meeting on June 28, 2006.

Consolidated Performance of Each Segment

Business segment results for the year ended March 31, 2006, are highlighted in the Review of Operations.

Financial Position

With regard to the status of assets, liabilities and equity, as of March 31, 2006, total assets increased ¥74.0 billion compared with the previous year to ¥1,461.8 billion as a result of increases in accounts receivable and inventories. Total liabilities rose ¥58.5 billion year on year to ¥1,272.4 billion, reflecting an increase in accrued expenses.

Shareholders' equity grew ¥15.5 billion to ¥169.2 billion, owing to the posting of a net profit. The balance of interest-bearing debt was ¥447.6 billion, up ¥4.2 billion from the end of the previous year.

Net cash provided by operating activities exceeded ¥3.5 billion, an increase of ¥7.9 billion compared with the previous year, due to such factors as higher net income and other increased current liabilities. Net cash provided by investing activities exceeded ¥3.4 billion, an increase of ¥7.5 billion compared with the previous period, primarily as a result of engaging in the disposal of property. Combining the cash provided by operating and investing activities, free cash flow totaled ¥6.9 billion.

Debt repayments resulted in net cash used in financing activities exceeding ¥12.7 billion, a fall of ¥37.4 billion compared with the previous year's figure for net cash provided by financing activities.

In aggregate, cash and cash equivalents at the end of the year totaled ¥137.4 billion, a decrease of ¥2.3 billion compared with previous year-end.

Outlook for the Year Ending March 31, 2007

The global economy is facing risk factors such as turbulent exchange-rate fluctuations amid a rising trend in crude oil prices and the growing current account deficit in the U.S., but stability is expected to be sustained, pulled along by high growth in the East Asian region centered on China and by the robust U.S. economy.

The Japanese economy, bolstered by steady growth in export orders received from the solid U.S. and Chinese economies, is generally expected to continue its gradual upward momentum from the effects of temporary tax reductions and the presence of fewer factors that would hold back the spread of improvements in corporate performance.

Based on this outlook, IHI estimates consolidated net sales of ¥1,190 billion, operating income of ¥34 billion, and net income of ¥15 billion for the year ending March 31, 2007.

On a non-consolidated basis, the Company is targeting net sales of ¥620 billion, operating income of ¥19 billion and net income of ¥7 billion.

Based on the corporate slogan, "Explore the Engineering Edge," IHI is addressing improvements in profitability and further structural reforms in its efforts to pursue shareholder-centered policies.

We ask for your continued understanding and support.

June 28, 2006



Mototsugu Ito
President and Chief Executive Officer

An Interview with President Ito



What are the fundamental management policies of the IHI Group?

The companies that together form the IHI Group all share the same management philosophy: “Using technology for the benefit of society.” Involved in such business domains as social infrastructure, industrial machinery and transportation systems, IHI produces everything from bridges, materials-handling systems, physical distribution and factory automation systems, iron and steel-making equipment, power plants, chemical plants, ships, jet engines and space-related equipment and others. IHI offers a wide range of products and services that fully support society and industry, and IHI’s management philosophy, which contributes to the making of a prosperous society, thus remains unchanged.

For that reason, “improving customer satisfaction” lies at the heart of IHI’s business activities as the Company builds relationships of trust with its customers throughout its operations. At the same time, the Group works on the advancement of technologies and product quality to fulfill the genuine needs of customers.

What is IHI’s basic policy on dividends?

Management at IHI emphasizes the stable distribution of dividends and determines cash dividends by taking into consideration the level of retained earnings necessary to strengthen the business foundation and to ensure the future stability of dividends.

Could you please explain IHI’s medium-term management strategy (Management Policy 2004) and any issues faced by the Company?

Based on the Management Policy 2004, which was announced in August 2004, IHI positioned the years ended March 31, 2005 and 2006, as a period for rebuilding management and steadily implemented measures to secure corporate growth and earnings.

To enhance the overall quality of our business, we are strengthening our marketing capabilities, ascertaining profits when receiving orders, thoroughly reducing costs especially in procurement, bolstering the project management structure to improve the profitability of projects under construction and implementing measures designed to strengthen competitiveness and improve profitability on an ongoing basis. IHI is also continuing its reform efforts designed to strengthen and expand its key businesses and dispose of or cut back underperforming or low profit businesses.

As part of these measures, the core civil jet engine business is implementing production facility enhancements in response to a global recovery in demand for civil aircraft in its bid to push up profits and establish the IHI name in an expanding market. In another core business, that of vehicular turbochargers, IHI is planning to reinforce manufacturing capabilities at domestic subsidiaries, expand production lines at overseas subsidiaries in Thailand and Italy, develop its global business acumen and improve profitability.

Other business divisions, as part of their plans to bolster competitiveness and management resources, are switching to models that maximize profit. In the Group as a whole, a re-examination of the capabilities and responsibilities of each business's under way.

What are your thoughts on compliance at IHI?

In the period under review, IHI received a judgment on appeal from the Japan Fair Trade Commission with regard to bridge sales activities that violated the Antimonopoly Law. Addressing this matter with the utmost seriousness, the Group places the highest management priority on thorough compliance and establishing an effective compliance structure.

In specific terms, in addition to reforming the specialist compliance unit as an independent Compliance Control Division and broadening the responsibilities of the in-house Compliance Committee, measures will be

vigorously pushed forward to upgrade and expand in-house staff training and improve the internal dissemination of information in combination with more thorough internal audits to ensure observance of the Antimonopoly Law.

Notes:

The amounts shown in this review section have been rounded down to the nearest base unit.



Review of Management Policy 2004

Management Policy 2004, which was formulated and announced publicly in August 2004, guided management reform in the years ended March 31, 2005 and 2006. What was the business climate like during that time?

Given that during the period of management reform we suffered from the negative impact of the soaring prices of raw materials and equipment, which had not been foreseen when the plan was drawn up, the policy can be regarded as something that was basically successful in meeting its targets.

There have been positive and negative aspects to the changing external environment during management reform, the positive aspects including: (1) broadening strength in the global economy; (2) exchange rates moving toward a weaker yen; (3) an upturn in orders brought about by a recovery in capital investment in Japan; as well as (4) interest rates that remained low, and stable commodity prices. Of these, the business environment turned around for logistics systems, including clean distribution systems, automotive industry products such as vehicular turbochargers and vacuum furnaces, energy-related plants and equipment such as LNG processing plants, large-scale reactors, gas engines and others, including civil jet engines.

On the other hand, negative aspects included: (1) reduced budgets for public enterprise; (2) falling values of orders, especially from social infrastructure facilities as a result of more intense competition; (3) soaring prices for resources such as iron ore and crude oil and hence raw materials and equipment; and (4) actualization of country risks such as the deterioration of public safety at overseas sites. These caused a deterioration in the business environment in the public works sector for bridges and gates, while the Shipbuilding and Offshore Operations sector was confronted by steep price increases in steel products, raw materials and equipment. Meanwhile, some overseas plant sites incurred extraordinary costs.

Please tell us something about the principal measures that have been implemented thus far.

Management Policy 2004 centered on the promotion of four core concepts: (1) improving profitability; (2) increasing our competitive edge; (3) reinforcing the management of Group companies; and (4) innovating corporate culture and personnel management.

(1) Improving profitability. With improvements in planning precision by strengthening front loading, standardized coordination, value engineering (VE), design to cost (DTC) and putting 3-D modeling to practical use, fears of dwindling profitability were largely eliminated.

With regard to the disposal or cutting back of underperforming businesses, various companies active in waste disposal, electronic devices, pumps, rolling mills, materials handling equipment and parking systems have either been sold or spun off, and every ounce of profit has been squeezed out of those operations that have been retained. Furthermore, as part of the strengthening and expansion of IHI's core businesses, civil jet engines, vehicular turbochargers, LNG processing plants and physical distribution systems have all undergone a shift in management resources, receiving wide-ranging capital investment and an influx of additional personnel.

(2) Increasing IHI's competitive edge. Alliances have been entered into with Voest-Alpine Industrie-anlagenbau GmbH & Co. of Austria for rolling mills and Aker Kvaerner Inc. of U.S. for LNG plants. Further advances have been made in globalization by undertaking joint ventures in China covering vehicular turbochargers, parking systems and construction machinery, and by establishing sales offices in Russia, as well as the Middle East. Along with the proposal to transfer the core business sales activities of former Singapore subsidiary Jurong Engineering Ltd., by taking advantage of the opening of the new headquarters at the Toyosu IHI Building, IHI has markedly strengthened its competitiveness and given added impetus to IT and the streamlining of operations.



(3) Reinforcing the management of Group companies. To strengthen corporate governance, a Group Corporate Oversight Committee has been newly established, an Integrated Accounting System and New Procurement Management System set up and the sharing of the Group's internal information achieved by IT solutions. To augment the compliance system, a specialist position has been created, reporting system upgrades put in place and maintained, and employee training programs instigated.

(4) Innovating corporate culture and personnel management. Besides putting into effect Companywide activities on an ongoing basis that are aimed at increasing employee awareness, with regard to the nurturing and assignment of personnel, the use of rotational positions has been expanded, internal staff recruitment and free agent (FA) systems introduced and the effective utilization of personnel promoted on a broader scale.

What has the achievement rate been like for measures aimed at management reform?

With regard to the disposal of loss-making plants, cost reductions by the thorough implementation of VE and measures to prevent extraordinary costs from being incurred by implementing the front-loading method, I can only give you an estimate that forecasts an actualization of 80%–90% by the end of March 2007, because of the steep rises in resource and equipment prices that stem from the high cost of raw materials and the country risks that have had a negative impact on Shipbuilding and Offshore Operations and overseas plant projects.

We have strictly implemented controls on reducing procurement and fixed costs by using standardized products and the VE method, but as the increase in steel prices has negatively offset these measures, the achievement level will likely remain at the 60%–70% level at the end of March 2007.

As for the review of IHI's production systems, overhauling the business structure by the selection and concentration on business domains largely in accordance with our plans will have the desired effect and will result in a 100% achievement rate in the same timeframe.

What operating losses have underperforming businesses incurred?

































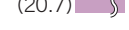








The operating loss in the period ended March 31, 2004 exceeded ¥23 billion, but it is forecast that the few remaining loss-making energy plant-related businesses will have largely eliminated losses by the end of the current year.

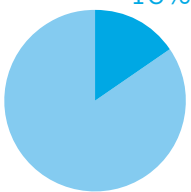
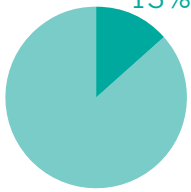
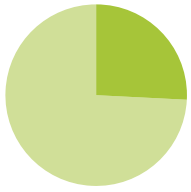
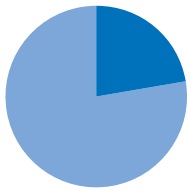
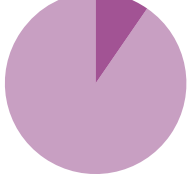
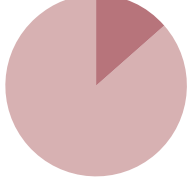
Management Policy 2004 addressed management reform, growth from April 2006 onward and securing profit. What are the priority issues for the year ending March 31, 2007?

In addition to expediting the steady implementation of the above-mentioned measures, Management Policy 2004 sets out ways to make further improvements in profitability for the year ending March 31, 2007, first and foremost by adopting measures to strengthen IHI's production capabilities, augment collaboration between overseas plants, expand into new fields and bolster project management systems in its core civil jet engine, vehicular turbocharger, LNG processing plant and logistics systems businesses. Additional impetus is being given to shifting the focus in Logistics Systems and Structures Operations from public- to private-sector demand. In Shipbuilding and Offshore Operations, reducing raw material prices by common procurement and overhauling and augmenting production systems will help restore profitability, and in Energy and Plant Operations, ongoing measures to reinforce the risk management system are being implemented to secure steady profits. A process to enhance corporate governance is aiming to optimize the strengthening of management throughout the Group as a whole and has the additional roles of clarifying the reorganization of affiliated companies and streamlining support divisions by the sharing of common customer service departments.

Improvements in IHI's financial position will be brought about by ongoing improvements in profitability, a broader scale of cash flow profitability and reducing interest-bearing debt.

IHI at a Glance

		Net Sales	Operating Income
	Logistics Systems and Structures Operations	(Billions of yen) '06  185.5 '05  188.2 '04  202.8 '03  216.9 '02  208.9	(Billions of yen) (2.8)  '06 (3.2)  '05 '04  2.3 '03  4.0 (3.0)  '02
	Industrial Machinery Operations	(Billions of yen) '06  162.4 '05  144.0 '04  129.7 '03  105.5 '02  129.3	(Billions of yen) '06  7.5 '05  2.1 (3.8)  '04 (1.3)  '03 '02  2.2
	Energy and Plant Operations	(Billions of yen) '06  311.1 '05  314.9 '04  268.9 '03  273.7 '02  321.7	(Billions of yen) '06  7.0 '05  6.8 (19.7)  '04 '03  2.2 '02  17.4
	Aero-Engine and Space Operations	(Billions of yen) '06  269.5 '05  238.4 '04  241.4 '03  243.9 '02  239.5	(Billions of yen) '06  16.5 '05  13.0 '04  9.3 '03  10.2 '02  6.9
	Shipbuilding and Offshore Operations	(Billions of yen) '06  116.2 '05  122.1 '04  118.0 '03  113.3 '02  108.3	(Billions of yen) (8.6)  '06 (13.6)  '05 (20.7)  '04 '03  4.7 (0.1) '02
	Other Operations	(Billions of yen) '06  163.2 '05  162.1 '04  173.1 '03  161.4 '02  161.5	(Billions of yen) '06  1.7 '05  4.9 '04  8.8 '03  5.2 '02  5.3

Orders	'06 Net Sales by Segment	Group Companies		Main Products
(Billions of yen) '06 158.5 '05 185.5 '04 183.8 '03 172.6 '02 168.0	 15%	Ishikawajima Transport Machinery Ishikawajima Construction Materials Ishikawajima Ship & Chemical Plant ★Kansai Segment Kanto Segment	IHI SA Technology Niigata Transys PC Bridge IHI Logistics Technology ISMIC Nishi-nihon Sekkei Engineering	<ul style="list-style-type: none"> ● Material handling systems ● Physical distribution and factory automation systems ● Parking systems ● Bridges ● Construction materials ● and others
(Billions of yen) '06 140.4 '05 129.4 '04 121.1 '03 99.1 '02 80.2	 13%	Voith IHI Paper Technology Ishikawajima Iwakuni Seisakusho Ishikawajima Industrial Machinery Ishikawajima Seiki ★Kondo Iron Works ★Turbo Systems United ● JH Corporation IHI Metaltech Ishikawajima Machinery Engineering	Ishikawajima Mass-Produced Machinery IHI Charging Systems International GmbH IHI Charging Systems International S.p.A. IHI Turbo America IHI Turbo (Thailand) Ishikawajima Hanyoki Service Ishikawajima Compressor Service	<ul style="list-style-type: none"> ● Iron and steel manufacturing equipment ● Turbochargers ● Mass-produced machinery ● and others
(Billions of yen) '06 310.6 '05 331.8 '04 324.9 '03 209.6 '02 189.2	 26%	IHI Packaged Boiler Kotobuki Iron Works Niigata Power Systems PT Cilegon Fabricators NICO Precision Kanamachi Purification Plant Energy Service Nagoya Plastic Handling Ishikawajima Kankyo Engineering	Ishikawajima Inspection & Instrumentation Ishikawajima Plant Engineering & Construction Ishikawajima Plant Construction ★FELGUERA-IHI S.A. ☆IHI ENGINEERING AUSTRALIA JURONG ENGINEERING ISHI POWER SDN. BHD. JURONG ENGINEERING (PHILIPPINES) INC.	<ul style="list-style-type: none"> ● Boilers ● Gas turbines ● Components for nuclear power plants ● Environmental control systems ● Storage facilities ● and others
(Billions of yen) '06 246.8 '05 234.0 '04 220.6 '03 219.4 '02 244.4	 22%	IHI Aerospace Ishikawajima Precision Castings IHI Master Metal Galaxy Express INC Engineering IHI Aerospace Engineering Ishikawajima Jet Service		<ul style="list-style-type: none"> ● Jet engines ● Space-related equipment ● and others
(Billions of yen) '06 218.0 '05 143.3 '04 142.0 '03 118.1 '02 124.6	 10%	IHI Marine United IHI Amtec IHI Kure Marine Construction IHI Marine		<ul style="list-style-type: none"> ● Shipbuilding ● Ship repairs ● Offshore structures ● and others
(Billions of yen) '06 151.3 '05 135.2 '04 146.7 '03 141.6 '02 136.2	 14%	IHI Scube Ishikawajima Kougyo ★Kaisho Shipping ● ★Tachihi Kaihatsu ● Chiba Warehouse TFI Corporation Tokyo-Wan Tochi ☆IHI Logistics Ishikawajima Technical Training Institution IHI Construction Machinery	Ishikawajima Shibaura Machinery ☆San-Etsu ★New Tachikawa Aircraft Star Farm Machinery Manufacturing Diesel United IHI Trading Ishikawajima Construction Machinery Sales ISHIKAWAJIMA EUROPE B.V. IHI INC.	<ul style="list-style-type: none"> ● Diesel engines ● Agricultural machinery ● Construction machinery ● Financing and service ● and others

Notes: Unmarked companies are consolidated subsidiaries

☆: Non-consolidated subsidiary

★: Affiliated company (● : companies accounted for by the equity method)

Review of Operations

Logistics Systems and Structures Operations

In Logistics Systems and Structures Operations, the overall orders environment in Japan remained extremely harsh, with public spending on a downward spiral and increased private-sector spending buffeted by intense price competition amongst rival companies. There were also steep price rises for steel and other materials, as well as delivery delays.

Under these conditions, despite IHI's efforts, orders for the segment declined 14.6% compared with the previous fiscal year to ¥158.5 billion, and sales decreased to ¥185.5 billion. As a result, orders on hand as of March 31, 2006 totaled ¥176.9 billion, a year-on-year fall of 18.7%. Operating loss was ¥2.8 billion, owing to such factors as the worsening profitability of transportation machinery.

Automated People Mover (APM) Transit System Vehicles for Hong Kong International Airport Completed

In December 2005, in cooperation with subsidiary Niigata Transys Co., Ltd. (NTS), IHI completed an order from Hong Kong International Airport by delivering 12 vehicles for an APM transit system that stretches approximately 750 meters between the concourse and the passenger terminal building. This was the first overseas delivery of vehicles for the Group's APM transit system.

IHI is proactively broadening its sales activities in its new transportation business by developing and proposing more competitive systems for both existing airport terminal expansion projects and the many new airports planned all over the world.



New APM transit system vehicle for Hong Kong International Airport

Longest Cable-Stayed Bridge in Vietnam Completed

Binh Bridge (1,280 meters long, 22.5 meters wide, with 101.6 meter-high towers), the longest cable-stayed bridge in Vietnam, was ordered from IHI in July 2002 and was completed and opened in May 2005. The bridge was built across the Cam River that flows west to east through Haiphong, Vietnam's third largest city, which lies approximately 100 kilometers east of the capital, Hanoi. Intended to increase distribution efficiency by improving transportation convenience, the revitalization of the Vietnamese economy is expected to result from Binh Bridge's completion. And with the completion of the bridge, IHI has once again demonstrated to the world what it can achieve with its advanced technical capabilities. Continuing to draw on these capabilities is part of IHI's policy to proactively develop bridge-marketing activities both in Japan and overseas.



Binh Bridge after completion

CSC (Taiwan) Orders Two Iron Ore/Coal Continuous Ship Unloaders for Kaohsiung Steel Works

IHI received a turnkey order from China Steel Corporation (CSC), the sole and thus biggest integrated steel maker in Taiwan, for two iron ore and coal bucket elevator-type continuous ship unloaders (just one of which is capable of discharging 3,000 tons of iron ore or 2,100 tons of coal in one hour) for the Kaohsiung Steel Works. Operations are planned to commence in December 2006.

CSC intends to further improve the efficiency of the specialized iron ore and coal raw material unloading wharf within Kaohsiung Steel Works and has taken the bold course of replacing two existing grab-type ship unloaders among the total of six with two continuous ship unloaders.

Including this order, the number of orders for IHI's continuous ship unloader has climbed to a total of 51, 36 for the Japanese market and 15 for overseas. The Company boasts the largest share of the global market for bucket elevator-type continuous ship unloaders and will redouble its marketing efforts to expand sales at home and overseas.



Iron Ore/Coal Continuous Ship Unloaders

Industrial Machinery Operations

Industrial Machinery Operations performed comparatively well, with vehicular turbochargers and industrial machinery continuing to enjoy buoyant demand as private-sector investment levels remained high.

Under these circumstances, and as a result of vigorous marketing efforts, orders advanced 8.5% to ¥140.4 billion. Sales in this segment rose 12.8% compared with the previous year to ¥162.4 billion. As a result, orders on hand as of March 31, 2006 decreased 2.9% year on year to ¥85.2 billion, and operating income of ¥7.5 billion recorded a significant increase compared with the previous year.

Cumulative Production Volume at IHI Turbo Thailand (ITT) Surpasses 1 Million Units

IHI Turbo Thailand (ITT), a joint venture with Toyota Motor Corporation that manufactures and sells turbochargers, has achieved a cumulative production volume of 1 million units since the plant commenced full-scale operations in 2003.

Of IHI's six turbocharger-manufacturing plants, ITT has increased its production capacity to an outstanding degree. In response to the expanding demand for turbochargers, not only was a second plant built in August, but the original plant was also enhanced, with plans to double the current production capacity.

IHI also plans to increase annual production capacity in Japan and overseas plants other than ITT up to 3.5 million units, 1.5 times of the current level, in the fiscal year ending March 31, 2008.



ITT building and turbocharger

Completion of Two More Large-Sized Transfer Presses for High-Tech Automobile Plants in U.S.

IHI delivered two large-sized, crossbar transfer presses for producing automobile panels to Hyundai Motor Manufacturing Alabama, LLC (HMMA), the South Korean automaker's high-tech facility in the U.S.

Capable of exerting 5,400 tons of pressure, the large-model AC servo-driven crossbar transfer presses coupled with an automated palletizer system (automatic panel loading system) represent a state-of-the-art facility. As the core of HMMA's first finished car assembly facility in North America, operations are progressing smoothly with a production target of 300,000 units per year.

This brought to 12 the total number of IHI large-sized transfer press lines delivered to the southern U.S. (Mississippi, Louisiana, Georgia and Alabama), where new plant construction is continuing.



The large-sized Transfer Press

JH Completes 100th Environmentally Friendly Acetylene Vacuum Carburizing Furnace

JH Corporation (JH), a wholly owned IHI subsidiary that manufactures heat treatment furnaces for industries and vacuum deoxygenator with solvent, completed and delivered its 100th acetylene vacuum carburizing furnace to THK Manufacturing of China (Liaoning) Co., Ltd. JH has received orders for a total of 130 of this type of furnace.

JH developed the acetylene vacuum carburizing furnace in 1996 and acquired patents in Japan, U.S., Canada, the EU, South Korea, Taiwan, Thailand and China. The furnace, which has a complex shape that enables uniform carburization and suppresses soot and smoke emissions, has been earning plaudits.

It is expected that there will be further growth in orders for acetylene vacuum carburizing furnaces from the automobile, bearing, construction as well as other industries, because these furnaces emit no greenhouse gases (primarily CO₂), and sales are being proactively pursued with the aim of adding orders for 50 more furnaces within the next year.

In July 2006, a party will be held at a JH facility to commemorate the completion of a tunnel-type continuous vacuum carburizing furnace. With this, JH will confirm its position as industry leader for superior vacuum carburizing furnaces that are useful for the industrial and global environments alike and will complete its lineup by adding multi-cell, high-volume V-MALS continuous vacuum carburizing furnaces and smaller lot, high-volume VCCO tunnel-type continuous vacuum carburizing industrial furnaces to JH's batch-type, fully automated vacuum carburizing furnaces.



Acetylene Vacuum Carburizing Furnace

Energy and Plant Operations

In Energy and Plant Operations, challenging conditions persisted in the Japanese market for energy and nuclear power equipment. Overseas sales of coal-fired boilers increased and showed signs of promise for the first time. Plant-related equipment, in which large-scale capital investment increased in both Japan and overseas, performed comparatively well.

Under these operating conditions, and despite aggressive marketing efforts, orders fell 6.4% compared with the previous year to ¥310.6 billion, and year-on-year segment sales edged down to ¥311.1 billion. Accordingly, orders on hand rose 4.0% to ¥496.6 billion, and the segment recorded an increase in operating income of 4.3% to ¥7.0 billion.

Large-Scale Thermal Power Project in Malaysia

IHI won a contract for a large-scale thermal power project in Malaysia. The coal-fired power project will have a power generation capacity of 1,400 MW (two 700 MW units) and include a coal-handling facility. The power plant will be owned and operated by Jimah Energy Ventures Sdn. Bhd. of Malaysia. IHI will participate in the construction of the power plant as part of a consortium led by Sumitomo Corporation.

In 2003, IHI won a contract for another coal-fired power project, the Tanjung Bin Power Project (three 700 MW units) in Malaysia, also as part of a consortium with Sumitomo Corporation.

In addition to these projects in Malaysia, IHI also won contracts for thermal power projects in the U.S. (720 MW) and Australia (200 MW).



Steam drum for the Tanjung Bin Power Project in Malaysia

Order Received to Expand India's First LNG Receiving Terminal

The consortium of IHI, Toyo Engineering Corporation (TEC), Toyo Engineering India, ITOCHU Corporation and Mitsui & Co., Ltd. recently received an order from Petronet LNG Ltd. (Head office: New Delhi) to expand and enlarge the Dahej LNG receiving terminal. The engineering, procurement and construction (EPC) contract covers an LNG vaporization delivery facility, including a fourth LNG storage tank (above-ground storage-type tank with 148,000 m³ of volume) and a vaporized gas treatment plant to double the terminal's capacity. Construction work is scheduled for completion at the end of 2008.



LNG receiving Terminal

World's Highest Electrical Efficiency for Large-Class 5,800 kW Gas Engine

The large-class 5,800 kW 28AG gas engine newly developed by IHI and Niigata Power Systems Co., Ltd. has achieved 47.6% efficiency, making it the most efficient in its class in the world. Surpassing the previous highest mark by more than 1%, fuel consumption can be reduced 2.3%, which results in a saving of approximately ¥7.6 million in annual fuel costs.

Furthermore, this engine can reduce CO₂ emissions by more than 430 tons a year (equivalent to the CO₂ emissions of a 10-ton truck running 250,000 km), so the 28AG is not only highly efficient but also an environmentally friendly gas engine.



Niigata "18V 28AG" gas engine

Aero-Engine and Space Operations

In Aero-Engine and Space Operations, in the defense sector, harsh conditions continued under the adverse impact of budget reductions for front-line defense equipment. In the civil aviation sector, passenger traffic continued its upward trend, spurred on by the recovery in the global economy with resultant expansion in the civil aero-engine market, despite concerns about the effect of higher jet fuel prices on the management of airline companies as a result of soaring crude oil prices and intensification of competition on prices brought about by deregulation. Steady progress was made with the development of the GENx jet engine for the next-generation, mid-sized civil aircraft projects under way at the Boeing Company and Airbus. Orders for this engine are expected to expand.

Against this backdrop, IHI made concerted efforts, and as a result, gained orders for F100 engine components for the Japan Defense Agency, civil sector orders for the V2500, CF34, and GE90, as well as for GENx engines and components. Adding the orders for related equipment, total orders came to ¥246.8 billion, an increase of 5.5% compared with the previous year. Sales in the segment gained a healthy 13% to ¥269.5 billion, and orders on hand as of March 31, 2006 fell to ¥330.9 billion. Operating income grew 26.5% to ¥16.5 billion.

Development of Latest Jet Engine for Next-Generation Passenger Aircraft Proceeding Smoothly

The new GENx jet engine, on which IHI is working as a joint development program partner with General Electric Company of U.S., surpassed its target output by producing 80,500 pounds of thrust at a ground-running test facility in March 2005.

IHI has an approximate 15% share in the design, development and manufacture of the GENx engine. With development proceeding smoothly, the plan is to gain engine type approval in 2007 and commence commercial aircraft operations on Boeing's next-generation 787 passenger aircraft in 2008.

The GENx engine, which incorporates cutting-edge technologies, will be installed on the B787 and A350 that are currently under development. As the order books for these state-of-the-art, next-generation passenger aircraft are filling up, airlines from all over the world have placed orders for the GENx engine, which stood at a healthy 575 units as of April 1, 2006.

Successful First Flight for Satellite Engine

An overseas satellite equipped with a liquid apogee engine (LAE) exported by IHI Aerospace (IA) for commercial application was launched for the first time and successfully placed in geostationary orbit on November 22, 2005 (Japan time).

The IA LAE delivered for this satellite has the world's highest specific impulse, resulting in excellent satellite systems that are lighter in weight and have longer operational lives. The development of this LAE was started in 2000, and the first flight unit was delivered to an overseas satellite manufacturer in 2001.

This LAE demonstrated its high-performance capabilities during the orbital raising maneuvers of the 2005 launch. Based on the success of this mission, sales of IA LAE and attitude control thrusters to domestic and overseas customers will be increased.

IHI Delivers Gas Turbine Co-generation Facility

IHI has delivered a gas turbine co-generation facility (output 5,060 kW) specifically designed for privately owned electrical power utility companies to Ividen Co., Ltd.'s Ogaki Plant. The completion ceremony held on July 29, 2005, was attended by Ividen representatives, Mr. Kenichiro Tani, Vice President of Aero-Engine and Space Operations of IHI and Mr. Hideyuki Tsukada, General Manager of Chubu Branch of IHI (present Associate Director and Vice President of Industrial Machinery Operations of IHI).

The facility delivered on this occasion is equipped with an IM400 IHI-FLECS engine. The special feature of this generating facility, which involved the transfer of technology that is central to IHI's expertise in aero-engines, is its ability to respond to seasonal variations in steam and electricity demand.

This completion supplements the start of operations at an IHI-manufactured furnace that is currently under construction in response to an expected rise in electricity demand. Gifu Prefecture is one of the leading prefectures in terms of implementing environmental measures, and its environmental regulations aim to control gas emissions (to an atmospheric refractive index of less than 50,000 Nm³), so by making proposals covering every aspect of the facility's manufacture, IHI was able to gain a follow-on order for two more gas turbines for Ividen's Aoyagi Plant.

IHI has conducted research into jet engines and gas turbines derived from aero-engines for more than 60 years. Making full use the manufacturing technologies and know-how accumulated over those years, IHI will be bidding for gas turbine generating facility contracts with its proprietary systems far into the future.



First development test-bed aircraft for the GENx engine



The liquid apogee engine (LAE)



Gas turbine co-generation facility

Shipbuilding and Offshore Operations

In Shipbuilding and Offshore Operations, overall demand for new-build ships remained strong owing to an ongoing resurgence of sea-borne trade worldwide. Furthermore, revisions to the new regulations such as the new common structural rules led to increased order volumes.

Under these conditions, IHI received orders for 25 new ships, comprising six large-scale tankers, eight large-scale container ships, nine bulk carriers and two coastal trade vessels totaling 2,970,000 deadweight tons. Adding orders for ship repair and maintenance, total orders came to ¥218.0 billion, a significant increase from the previous fiscal year. Sales fell 4.8% to ¥116.2 billion with the completion of a total of 15 ships of 1,920,000 deadweight tons, including three large-scale tankers, three large-scale container ships, eight bulk carriers and one naval vessel.

As a result, as of March 31, 2006, orders on hand amounted to ¥405.2 billion, a steep increase compared with the previous year, including orders for 50 ships totaling 6,670,000 deadweight tons. This segment posted an operating loss of ¥8.6 billion, owing to deteriorating profits from new-build ships caused by such factors as the rise in steel prices.

Delivery of Defense Destroyer at Yokohama Shipyard

In February 2006, the delivery ceremony of the defense destroyer SUZUNAMI took place at IHI Marine United Inc. (IHIMU) Yokohama Shipyard. SUZUNAMI was ordered by the Japan Defense Agency under the fiscal 2001 (the year ended March 31, 2002) budget plan.

The multipurpose defense destroyer SUZUNAMI is the fifth ship of the TAKANAMI class (4,600 displacement tons, planned in 1998) equipped with the latest weapon systems and with a smaller crew complement, the accommodation for which is much improved compared with previous classes. SUZUNAMI will be one of the important defense destroyers in the Japan Maritime Self Defense Force fleet.

IHIMU Yokohama Shipyard has been and will continue to be a key facility for naval shipbuilding and repairs, as well as for high-value mercantile shipbuilding.



Delivery ceremony for the defense destroyer SUZUNAMI

Japan's First Electric-Powered Ships Equipped with Contra-Rotating Propellers Ordered

IHI Marine United Inc. (IHIMU) recently received two orders for a general cargo/fuel oil carrier and a chemical tanker, to which electric-power propulsion system with line-shaft contra-rotating propellers have been applied for the first time in Japan. The two electric-powered ships will be constructed based on the national program of "Super Eco-Ships," to improve energy efficiency and reduce the greenhouse effect in the field of coastal shipping.

From now on, IHIMU will contribute to the modernization of Japan's coastal shipping by developing more efficient electric-powered vessels and supplying contra-rotating propeller systems. The electric-powered ships with contra-rotating propellers will be a solution to the environmental problem by its excellent energy-saving effects and this will help the safer ship operation.



An example of the contra-rotating propeller

87,000 MTDW Type Over-Panamax Bulk Carrier Delivered, First of a New Vessel Class to be Completed

IHI Marine United Inc. (IHIMU) delivered an 87,000 MTDW over-panamax bulk carrier to Malaysian Bulk Carriers Sdn. Bhd. The vessel has been named ALAM PADU.

With the growth in global ocean freight in recent years has come strong demand for bulk carriers capable of simultaneously and efficiently carrying combined loads such as grain, iron ore and coal. A special feature of the ALAM PADU is its seven cargo holds, which have been designed and built to the shipowner's requirements. IHIMU has received orders for 13 vessels of this class and plans to continue building them at its Yokohama Shipyard.

There has been strong demand for bulk carriers in recent years, and IHIMU is also developing proactive sales initiatives to position its future lineup to best advantage.



87,000 MTDW over-panamax bulk carrier

Other Operations

In Other Operations, the favorable conditions in construction machinery that had carried over from the previous period combined with an increase in orders placed for diesel engines arising from the influx of new-build ship orders. Under these circumstances and as a result of extensive proactive marketing activities, orders in this segment increased 11.9% compared with the previous year to ¥151.3 billion. Sales in this segment edged up to ¥163.2 billion.

Consequently, there was a significant increase in orders on hand, which stood at ¥35.2 billion as of March 31, 2006. There was a commensurate fall in operating income to ¥1.7 billion.

Accelerated Utilization of Electronically Controlled Engines for New-Build Cargo Ships

IHI Marine United Inc. (IHIMU) decided to install RT-flex (6RT-flex50) marine engines manufactured by IHI-affiliate Diesel United, Ltd. (DU) in the eight 56,300 MDTW Future-56 bulk carriers that are under series construction. IHIMU also decided on RT-flex (7RT-flex84T-D) engines for the 300,000 MDTW tankers (VLCCs) it plans to complete for Japanese shipping companies.

Thanks to their electronic control system, which was developed by Wärtsilä, RT-flex marine diesel engines display enhanced, environment-friendly performance, improved cost effectiveness when in low fuel consumption mode and, by switching between modes, reduce the amount of harmful substances such as nitrogen oxide and black smoke in their emissions.

DU's RT-flex engines have amassed a total of nearly 60 orders and hold the top share in the diesel engine market in Japan. IHIMU and DU are together proposing the volume production and installation of clean engines that are environment friendly and capable of responding to demands for tighter emission controls.



RT-flex marine diesel engine

Cumulative Total of Crawler Cranes Delivered to Terex Cranes (The American Crane Corporation) Reaches 300

IHI Construction Machinery Limited (IK) has delivered a cumulative total of 300 OEM-supplied crawler cranes to Terex Cranes (The American Crane Corporation) since the first shipment in February 1992.

Known as lattice-boom crawler cranes, these mobile cranes are used for lifting work on construction sites and at ports and can also be fitted with buckets for basic construction work involving excavation.

To commemorate reaching the 300th delivery milestone, key personnel from Terex Cranes were invited to a party held on October 24, 2005. At the celebrations, Terex Cranes President and C.E.O Steve Filipov gave a speech in which he said that IK had supplied machines that had exceeded expectations and more than satisfied their requirements and that Terex Crane was eager to use the rock-solid partnership to extend the business ties toward the next landmark delivery target. The fruitful gathering helped to buttress the relationship of trust that exists between the two companies.

In addition to supplying reliable products to all of its customers, IK looks forward to advancing the cumulative total of crawler cranes delivered to 500 units, or even 1,000 units.



HC Series lattice-boom crawler cranes

Ishikawajima Shibaura Machinery Jointly Develops 1 kW-Class PEFC with Shizuoka Gas, Takagi Industrial

Ishikawajima Shibaura Machinery Co., Ltd. (ISM) teamed up with Shizuoka Gas Company, Ltd. and Takagi Industrial Co., Ltd., which is active in hot water boiler systems, to develop a 1 kW polymer electrolyte fuel cell (PEFC) system that converts natural gas for domestic use.

In the space of two years, ISM developed the fuel cell system's stack and hydrogen converter, Takagi's responsibilities covered the collection of the system's exhaust gases for regeneration as an energy source for the boiler, and Shizuoka Gas provided test facilities and offered proposals for its effective utilization as town gas. When installed in a home, the system will be capable of reducing heating and lighting costs by between ¥40,000 and ¥50,000 a year.

The first demonstration version was installed in a standard home in November 2005 and will take part in a large-scale, nationwide, monitored demonstration from 2007. At this time, it attains a thermal efficiency of 30% at maximum output and realizes a total thermal efficiency of 75% when exhaust-heat regeneration is included. ISM is undertaking the development of performance upgrades concurrently with that of a modified, more potent converter that offers significant cost reductions, which it plans to utilize on the equipment from 2008.

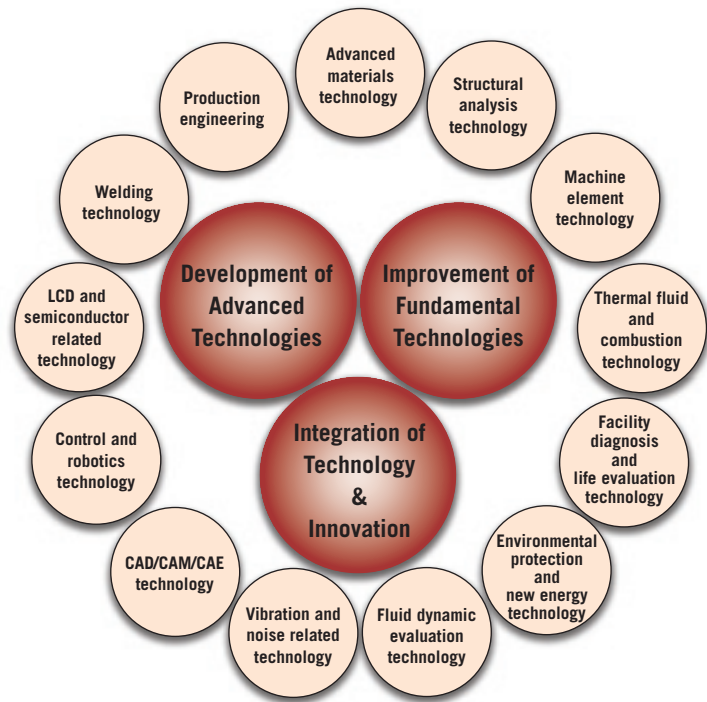


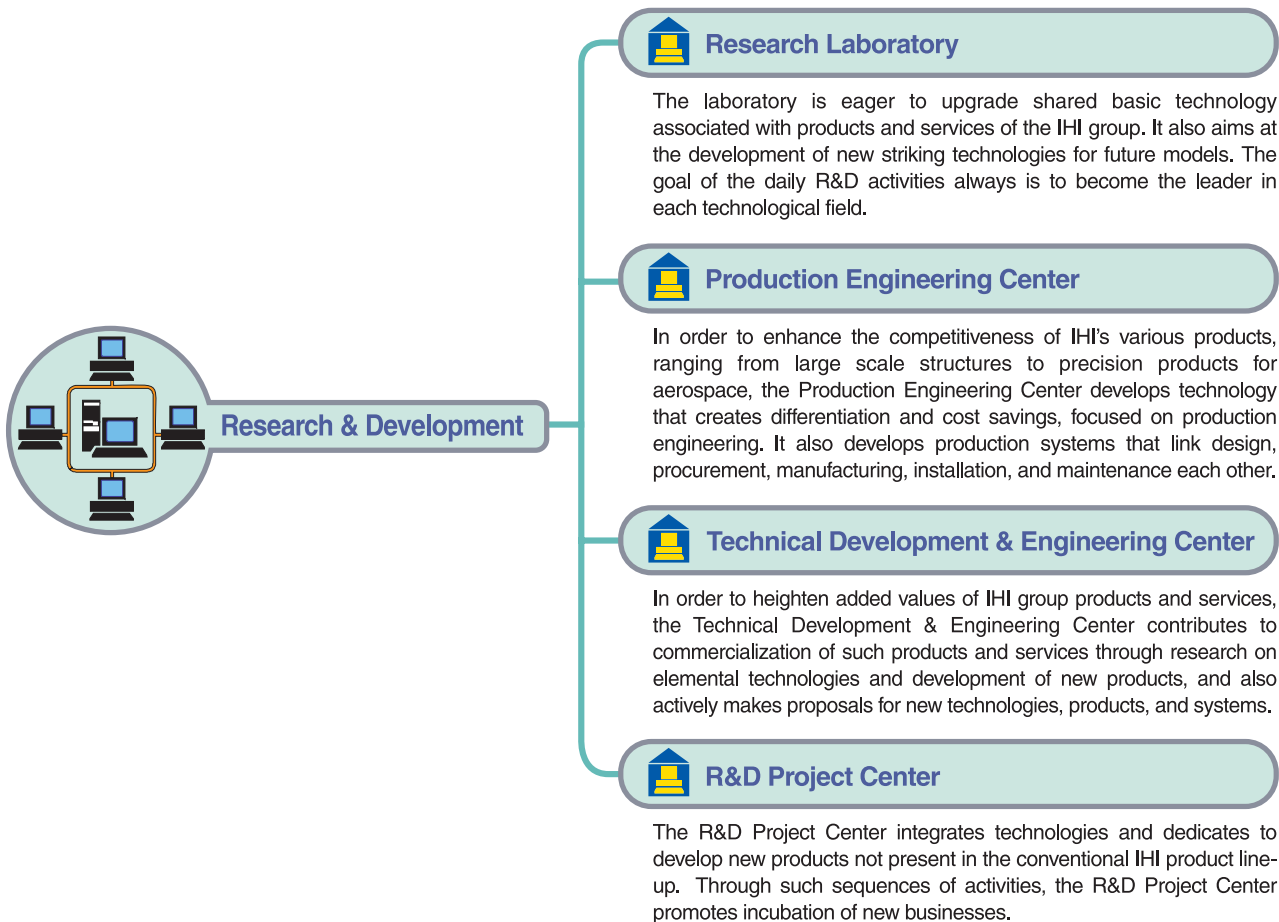
Polymer Electrolyte Fuel Cell (PEFC) system

Research and Development Highlights

R&D Policy

IHI conducts research and development with three basic goals: “to pioneer new fields of leading-edge technologies,” “to advance common fundamental technologies,” and “to integrate technologies to develop new types of products.” By making constant efforts to increase efficiency, reliability and durability, while reducing the burden on the environment, we have achieved steady results that are leading to greater contributions to society through new technologies. Research and development is the foundation of IHI.





Topics

Development of Nondestructive Evaluation Technology and Structural Life Extension Method

As many structures in Japan were intensively built during the period of rapid economic growth in the 1960s, the aging process of buildings is rapidly gaining prominence, and thus maintenance technologies to ensure structural safety and integrity are becoming critical issues both socially and financially. Consequently, basic technologies are being developed and streamlined for the building maintenance industry to organize processes for damage investigation, remained life evaluation, maintenance and repair, as well as reinforcement, in order to systematize as total engineering technologies for large-scale, aging welded structures (those that cannot be returned to a factory for maintenance and repair).

In the nondestructive evaluation technologies field, which mainly detects cracks and corrosion that have arisen in parts of complex structures and narrow areas that are inaccessible by hand, the development of monitoring technologies has permitted maintenance and repair assessments. Moreover, the technology repaired without disassembling a structure was established by developing a special welding torch to a narrow part. The welding construction conditions over a difficult material (high lamellar tear risk material) of repair welding were established as technologies that extend service life.



(Above) Surface flaw inspection of narrow space using a small probe.

(Below) View of special welding torch equipment.

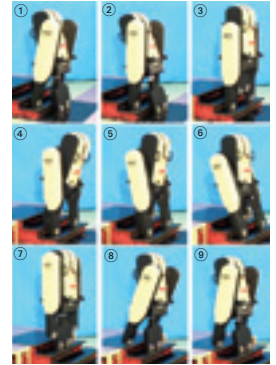
IMR-Type1: Leg-Wheeled Type Mobile Robot

To counteract the aging population combined with the diminishing number of children and labor shortages, as well as the intensification of international rivalries caused by the rise of Asian countries, and against the backdrop of hopes for national survival through industrialization, expectations for innovative “service providing robots” are growing.

Consequently, IHI has developed a hybrid-type mobile robot-prototype that will provide services, for example, patrol and surveillance work around offices and factories where early adoption of this type of robots is expected. It is a hybrid-type mobile robot with three legs and wheels at the tip of each leg. It can move stably and quickly by its wheels on the flat floor indoors. In addition, it can walk like a human by employing its three legs to go up and down stairs, and to pass through grooves.

To control sophisticated complex motions, a distributed control system has been developed. This control system within the robot is made up of two MPU boards and thirteen microprocessor boards, among which effective communications between each board are maintained.

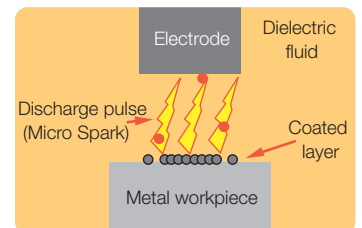
It performed patrol and surveillance demonstrations for the general public over mockup courses including stairs and a slope at the Aichi Expo 2005 “Prototype Robot Exhibition” and “2005 International robot exhibition.”



(Above) Motion pictures stills of IMR-Type1
(Below, left) IMR-Type1 on stage of Aichi Expo 2005
(Below, right) Closer look at IMR-Type1

Micro Spark Coating

Functional coating and cladding techniques for metal products include chemical vapor deposition (CVD), physical vapor deposition (PVD), plating, plasma spraying and welding. These techniques involve high equipment costs, and their methods, which rely on specialized expertise, are ill-suited to line production. Furthermore, they necessitate cleaning and masking pre-treatments and processes such as masking removal afterward. IHI and Mitsubishi Electric Corporation have developed Micro Spark Coating, a revolutionary technique that solves the problems with these existing technologies. This technique, which has revolutionized electric discharge technology, uses electrodes cast from metal and ceramic coating material powder, enabling products with stably built-up coating and cladding, as well as high-quality and high-functionality coatings on metal workpieces. As the technique eliminates the need for experienced technicians and pre-treatments, it assists in production line automation and contributes to cost reductions. An anti-fretting wear coating applied using this technique contributed to the ground running testing of a production jet engine and displayed the exceptional performance advantages it offers compared with the existing methods in a demanding environment. Preparations to apply it on an actual aircraft are currently under way, but further R&D is being implemented to enable use of the technique on general industrial components.



A discharge pulse (pulsing at approximately 10,000 times per second) between an electrode and a metal workpiece attaches molten material shed from the electrode to coat the workpiece.

World's Highest Generation Efficiency Achieved with 5,800 kW-Class, Large-Sized Gas Engine

The large-sized 28AG gas engine (5,800 kW output) for generator, research into which was jointly conducted by Niigata Power Systems Co., Ltd. (NPS) and IHI, achieved 47.6% (including 5% tolerance) power generation efficiency, which is the highest in the world for this engine class.

Development proceeded with IHI's Research & Development being primarily responsible for the analysis carried out by numerical simulation and element testing, while NPS conducted tests on the various elements that link the 6- and 18-cylinder engines. The key points in achieving the world's highest generation efficiency include the optimization of the intake and exhaust valve timing, the fuel supply system and combustion chamber specifications. The environment in which the unparalleled efficiency level was achieved within a short space of time reinforces the technical prowess and know-how in gas engine production that NPS has amassed and came as a result of the higher-level amalgamation of IHI's experience in gas engine development, analysis and capabilities in elemental technology. Over and above increasing generation efficiency by more than 1% compared with previous highest efficiency of gas engines (more than 2% compared with existing model gas engine of the same type in Japan), the higher generation efficiency has resulted in fuel consumption being reduced by approximately 2.3% and ¥7.6 million in fuel costs saved per annum. Enabling CO₂ emissions to be reduced by 430 tons a year, the 28AG is a high-efficiency gas engine that demonstrates a remarkably high regard for the environment.

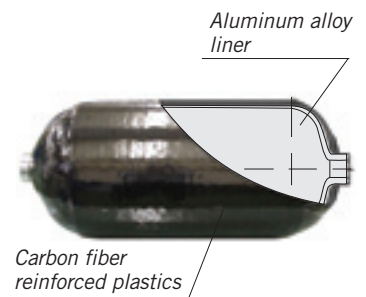


Large-sized gas engine
 Engine type: Niigata18V28AG
 Output: 5,500/5,800 kW
 Speed: 720/750 min⁻¹

Development of High-Pressure Hydrogen Tank

The environment-friendly fuel cell vehicles (FCVs) being developed by automakers are one example of the ongoing progress that has a hydrogen-based society of the future firmly in mind. Storing hydrogen under pressure as a method of storing FCV hydrogen is reasonably close to reaching fruition now, but to make full use of this technology will necessitate a tank capable of withstanding pressures as high as 350 atmospheres as a key component. Furthermore, from the fuel economy improvement point of view, a lightweight tank is required.

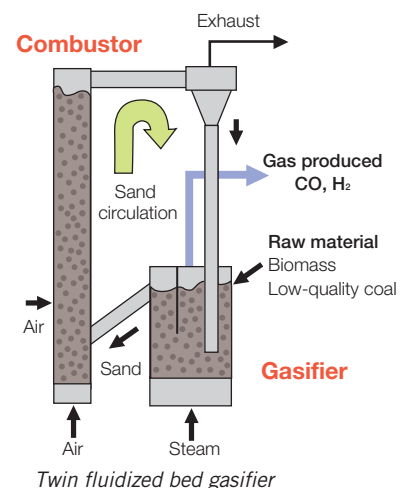
Consequently, IHI is drawing on the technologies it has accumulated in the aerospace field to conduct research into a tank, the external parts of which are constructed of carbon fiber reinforced plastics and the internal parts of aluminum alloy, with the aim of realizing a lightweight hydrogen tank featuring superior pressurization performance. At present, durability and impact feature assessments are being carried out on an actual tank, for installation on an FCV in the near future, with the aim of receiving certification from the High Pressure Gas Safety Institute of Japan.



High-pressure hydrogen tank

Twin Fluidized Bed Gasifier Development

Amid forecasts of soaring crude oil and natural gas prices, as well as dwindling resources, it is hoped that technologies will be established to generate electricity efficiently and to convert liquid fuels by using biomass fuel and as yet underutilized, low-quality coal. A twin fluidized bed gasification process, which produces highly efficient, low-cost gas stock for power generation and liquefaction from low-grade fuels, is currently under development. This gasification process comprising twin fluidized furnace: a gasifier and a combustor has brought about the development of circulating fluidized bed boiler technologies in which gas converted by a gasifier causes a reaction between the raw material and steam, heat being supplied to the gasifier by a combustor that uses sand as a medium. As the operation is carried out at low temperatures and at atmospheric pressure without using pure oxygen, it provides unique benefits to produce low-cost gas for electricity and liquefaction compared with other gasification process methods. Wide-ranging basic testing, simulation and pilot-scale trials have paid off, with the continuous production of high-quality gas with a high calorific value.



IHI Intellectual Properties

(As of March 31, 2006)

Basic Policy on Intellectual Property

Based on the Management Policy 2004, IHI is concentrating efforts on strengthening its intellectual property (IP) competitiveness by means of the following three measures.

- (1) Promote IP activities while coordinating with business strategies and R&D strategies
- (2) Carry out thorough IP risk management
- (3) Invigorate IP activities in each business operation and improve internal organizational structures

Outcome of Focus on Selected Businesses

The focus on selected businesses was stated in the Management Policy 2004. The measures taken since the Management Policy 2004 was announced brought about the following substantive, concrete results.

- **Businesses that have aimed to improve profitability through intensive distribution of management resources**

Clean logistics systems, vehicular turbochargers, LNG receiving terminals, jet engines

- **Businesses that have been reorganized through transfer to affiliates**

Material handling equipment

→Transfer of business to Ishikawajima Transport Machinery Co., Ltd. (IUK)

Parking systems

→Transfer of business to IUK and Ishikawajima Construction Machinery Co., Ltd. (IKK)

- **Business alliance**

Rolling mills

→General agreement concluded with Voest Alpine Industrie AG (VAI) of Austria

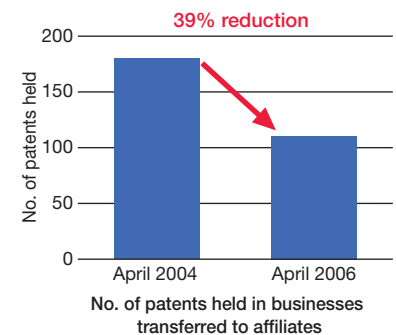
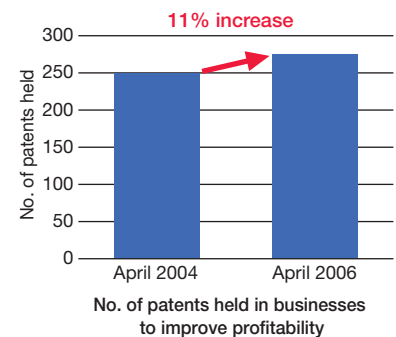
- **Business that has been scaled down or liquidated**

Pumps

→Sold to Ebara Corporation

Since three factors—business, R&D and intellectual property activities—were coordinated, the focus on selected businesses led to a focus on selected intellectual properties, with the same results.

To give an example, if a comparison is made of the number of patents held in each principal business unit as of April 1, 2004, published in the Management Policy 2004, with the number held on April 1, 2006, it reveals that the number of patents held in the four business units in which profitability improvement was planned increased by 11%, and patents held in the two business units that had been transferred to affiliates had been reduced by 39%.



Identify Key Businesses

The key businesses seen as having significant future growth potential and that will fully utilize IHI's core technologies are as follows:

- Clean logistics systems which play an active part in flat panel display production
- New vehicular turbochargers
- Twin fluidized bed gasifier that manufacture syngas for gas to liquid (GTL), etc.
- Revolutionary coating and cladding technology known as Micro Spark Coating* that enhances the anti-fretting properties of jet engine turbine blades

Concerning the breakthroughs these technologies have been creating, IHI will continue to apply for and acquire IP rights in Japan and overseas by painstakingly scrutinizing global business developments in accordance with IP strategies, as the root of competitiveness lies in technological differentiation, which must be safeguarded by IP rights.

(*) Joint patent application with Mitsubishi Electric Corporation

New Business Types

There is a fifth category besides the four listed in the Management Policy 2004. Within this fifth category are included technologies that fall into the future new business category and common-basis technologies, such as welding, that cross over between some business units. Representative examples of flourishing technologies are ozone-related equipment and superconducting motors. The basic details concerning these technologies follow.

Ozone-Related Equipment

Based on the electrical discharge, mechatronic and bio-related technologies, more than 150 patents related to disinfection, sterilization and deodorization as applied technologies, as well as ozone gas and ozone water generation, have been applied for, with patent rights to over 50 of them already processed and with some of them already incorporated in product commercialization.

These products are found in the sterilization equipment for a wide range of items used in hospitals, in cleaning equipment for endoscopes and other types of medical equipment, in nursing care facilities, washrooms, dining facilities and car interiors. Business development is undertaken in collaboration with Ishikawajima Shibaura Machinery Co., Ltd. (ISM), an IHI affiliate company.



Sterilization device for slippers

Superconducting Motor

IHI plays a coordinating role in an industry-university joint research group (made up of IHI, Sumitomo Electric Industries Co., Ltd., Taiyo Nippon Sanso Corporation, Nakashima Propeller Co., Ltd., Niigata Power Systems Co., Ltd., Hitachi, Ltd., Prof. Hidehiko Sugimoto of Fukui University and Fuji Electric Systems Co., Ltd.) that has developed the world's first liquid nitrogen-cooled superconducting motor.

This motor's features are its compactness, light weight and high efficiency, and it has potential applications not only for ships, but also for various types of equipment used onshore, where its energy-saving effects will contribute to the reduction of greenhouse gas emissions.

IHI liaises closely with the research group in the proactive pursuit of patent applications, including many for the superconducting motor, as well as the ship propulsion system and various onshore items of equipment to which this technology has been applied.



Superconducting motor installed in a ship propulsion unit

Risk Management

With regard to employees' inventions, the Revised Patent Law that came into effect on April 1, 2005, commented that "reasonable remuneration" be made on the basis of "a voluntary agreement" between an employer and an employee. IHI, too, drew up revisions to its Rules Regarding Industry Property Rights, which were presented to its employees at briefing sessions held throughout the Company, and after agreement revised the rules that have also been applied since April 1, 2005. The salient points of the in-house revisions were the introduction of a transparent and easy-to-understand system that ensures that the Company listens to the opinions of inventors, and an increase in the amount of the incentive award from April 1, 2003, capped at ¥100 million. Both of these revisions aim to give inventors an added incentive.

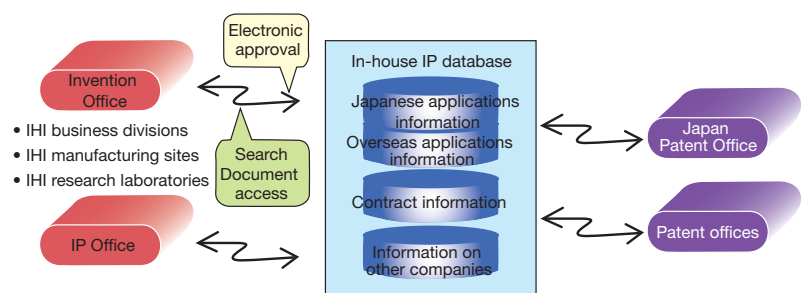
Each company in the IHI Group is promoting its own separate regulatory provisions.

Intellectual Property Governance and Management Systems

The IP Dept. implements IP policies throughout the Company and works closely with a Chief Intellectual Property Officer (CIPO) assigned to the head office of each operation.

In addition, an IP Liaison Officer with IP Dept. work experience is based at each central office to assist the CIPO, to act as a bridge between each operation's head office and the IP Dept. and to carry out IP activities utilizing his specialist knowledge in accordance with each operation's IP guidelines.

The introduction of information technology (IT) into the IP management system has been vigorously pursued. Using a system introduced in 2003, the electronic information interchange between each operation's head office and the IP Dept., combined with electronic approvals in the patent application process and the like, has served to increase the speed and accuracy of the procedures. Further improvements and the construction of a framework that incorporates external patent offices in a seamless system are being pursued.



Environmental Efforts

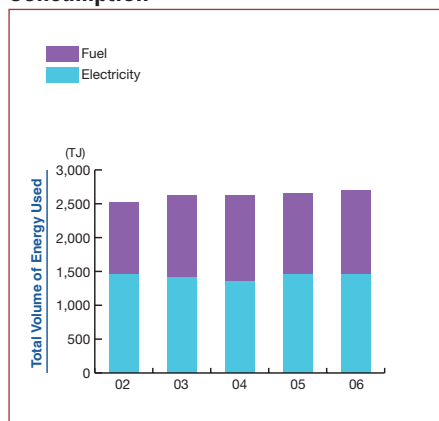
Topics

IHI makes concerted efforts to reduce waste volume and to improve recycling as part of its environmental management system.

Through measures targeting zero waste, IHI achieved zero emissions in its plant operations in Yokohama district in March 2004, as well as at three aero-engine works (Mizuho, Tanashi and Soma) that are part of the Aero-Engine and Space Operations in September 2004. IHI completed the process by recycling 100% of the waste at all of its manufacturing sites in March 2006 when plant operations in the Aichi, Aioi and Kure districts achieved zero emissions with regard to waste headed to final disposal.

IHI's Approach to Reducing Environmental Impact and Protecting the Environment Through Production Activities

Volume of Electricity and Fuel Consumption



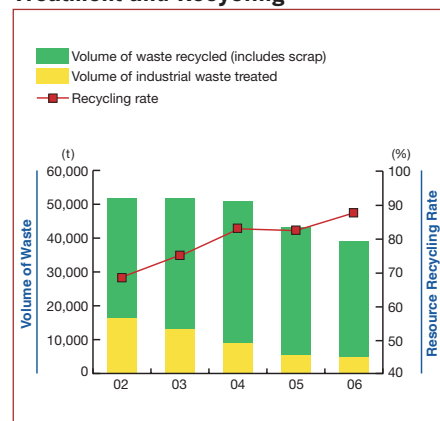
Trends in Total Volume of Energy Used

During the fiscal year ended March 31, 2006, IHI's total energy consumption, in terms of electricity and fuel used, rose 2.0% compared with the previous fiscal year due to an increase in operations. IHI is working to achieve targets for reducing energy consumption within the framework of its environmental management system.

Note: Total energy consumption is the sum of purchased electricity (excluding private electric generation) and fuels consumed. Fuel consumption volume includes fuels for private electric generators.

Note: Figures are for years ended March 31 of respective years.

Volume of Waste Generation, Treatment and Recycling

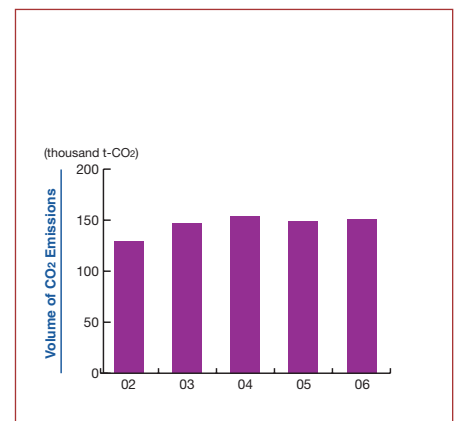


Results in Processing and Recycling Waste

The volume of waste generated by IHI's works and offices declined 9.4% year on year. As a result of the zero emission activities, the recycling ratio increased 5.3 percentage points compared with the previous fiscal year, to 87.5%.

Note: The volume of waste generated is the total volume of waste treated and waste recycled. Scrap sold with a market value is also included.

Volume of CO₂ Emissions



Trends in Volume of CO₂ Emissions

In the fiscal year ended March 31, 2006, fuel consumption volume was largely unchanged from the previous fiscal year, but CO₂ emissions for the period under review increased 1.6% year on year, to 151,500 tons (41,300 tons using carbon conversion), reflecting the slight increase in the amount of purchased electricity.

Management of Chemical Substances

In the fiscal year ended March 31, 2006, most of the chemical substances emitted mainly into the atmosphere comprised xylene, toluene and ethylbenzene, which are used as paint solvents for ships and bridges.

To reduce emissions of these chemical substances, IHI focused efforts on installing catalytic combustion equipment in paint facilities, using water-soluble paint that does not include solvents, using airless paint guns and reducing the volume of paint waste.

IHI Group Product Lineup

Logistics Systems and Structures Operations



Container cranes



Continuous unloaders



Automated warehousing systems



Parking systems



Bridges



Gates



Shield machines



Automated people movers

Material handling systems

- Container cranes
- Unloaders
- Stackers
- Reclaimers
- Coal handling systems
- All-weather material handling systems
- Electric overhead traveling cranes
- Level luffing cranes
- Jib climbing cranes
- Floating cranes
- Deck cranes
- Electric hoists

Physical distribution and factory automation systems

- Automated warehousing systems
- Storage systems
- Conveyor transfer systems
- Sorting systems
- Equipment for physical distribution systems
- Handling & storage system for clean rooms

Parking systems and products for civil use

- Parking systems
- Moving walkways

Bridges and steel structures

- Bridges
- Pedestrian bridges
- Gates for river and sea coast
- Immersed tunnels
- Hybrid caissons
- Aircraft maintenance facilities
- Boarding bridges
- Floating breakwaters
- Steel structures for buildings

Tunneling machinery

- Shield machines
- Automatic segment assembling systems

Construction materials

- Reinforced concrete segments

Transportation systems

- Automated people mover
- Light rail transit/light rail vehicle
- Rolling stock
- Snow plows

Disaster prevention systems

- Seismic isolation floor systems
- Mass damper systems

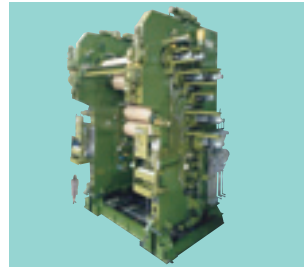
Industrial Machinery Operations



Blast furnace plants



Vacuum heat treatment furnaces



Calender line for rubber & plastic



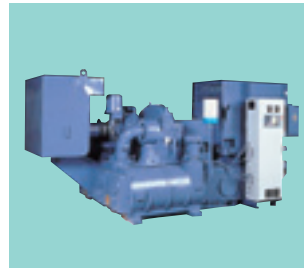
Transfer feed presses



LNG reciprocating compressors



Automotive turbochargers



Turbo compressors



Screw decanter centrifuges

Industrial machinery

- Blast furnace plants
- Rolling mills
- Industrial furnaces
- Pulp and paper production plants
- Presses
- Rubber/plastic processing machines
- Advanced materials processing equipment
- Vacuum heat treatment facilities
- Compressors

Mass-produced machinery

- Turbochargers
- Superchargers
- Centrifuges
- Multi-piled disc dehydrators
- Filters
- Dewatering equipment
- Compressors
- Lubricating systems
- High-temperature heating systems

Energy and Plant Operations



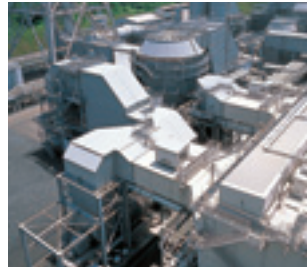
Boilers for power plants



Industrial boilers



Reactor pressure vessel



Air pollution prevention systems



LNG receiving terminals



LPG plants



Ion implanter system (ISDR)



Gas engines

Energy

Boilers for power plants
Industrial boilers
Fluidized-bed combustion boilers
Waste-heat recovery boilers
Coal gasification combined cycle power facilities
Diesel power generation systems
Cogeneration systems
Wind power generation systems
Fuel cells
Solar cell systems

Components for nuclear power plants

Components for nuclear power plants
Radioactive waste management systems
Primary containment vessels
Reactor pressure vessels

Environmental control and disaster prevention systems

Solid waste treatment systems
Critical water and hydrothermal reaction equipment
Air pollution prevention systems
Wastewater treatment systems

Storage systems and process plants

LNG receiving terminals
Oil and gas processing plants
Chemical plants
Pharmaceutical plants
Cement plants
Ultrafine grinding mills
Chemical plant equipment
Cooling towers
Desalination plants

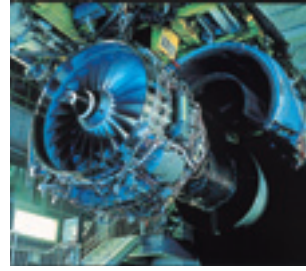
Semiconductor, LCD panel equipment and R&D facilities

Semiconductor and LCD panel equipment
X-ray inspection equipment
Electron sterilization systems
Robots
Simulators
Preventative maintenance systems
Optical and beam technology equipment
R&D facilities
Experiment facilities

Power systems and others

Diesel engines
Gas engines
Gas turbines
Generating sets
Steerable propellers

Aero-Engine and Space Operations



V2500 turbofan engines



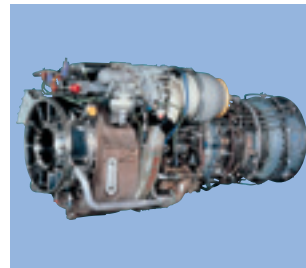
CF34 turbofan engines



GE90 turbofan engines



F110 turbofan engines



T700 turboshaft engines



Gas turbine power plants



GX launch vehicle (image)
(©JAXA)



International space station KIBO
(©JAXA)

Jet engines

Turbofan engines
Turboshaft engines
Turbojet engines
Turbo-prop engines
Jet engine maintenance
Jet engine test cells
Jet engine parts

Gas turbine power generation systems

Gas turbine power generation systems

Space development

Rockets
Rocket propulsion systems
Rocket control systems
Satellite propulsion systems
Satellite control systems
Equipment for utilization of space environments
Space station-related equipment
Ground test facilities
Ground support facilities

Others

Noise reduction systems

Shipbuilding and Offshore Operations



Very large crude oil carriers



SPB-type LNG carriers



Container ships



Bulk carriers



Passenger car ferries



Naval vessels



Side drag suction hopper dredgers with spilt oil recovery devices



Floating LPG production, storage, and offloading facility

Ships (Shipbuilding)

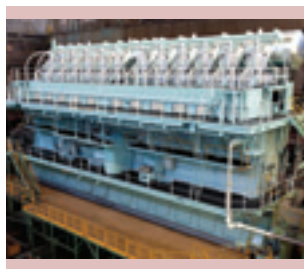
- Oil tankers
- LNG/LPG carriers
- Container ships
- Bulk carriers
- Passenger ships and ferries
- Naval vessels
- Coast guard ships
- Research vessels
- Work vessels
- Dredgers
- Oil recovery ships
- Pollution prevention ships

Ship repairs

Offshore structures

- Offshore development equipment
- LPG/LNG FPSO units
- LPG FSO units

Other Operations



Diesel engines



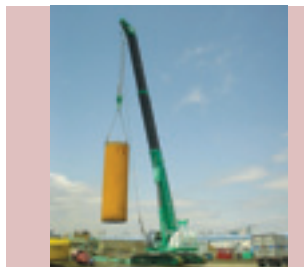
Agricultural machines



Refuse compactors



Mini excavators



Crawler cranes



Lawn management machines



Ceiling-mounted deodorizing systems



Computer systems

Engines

- Diesel engines
- Gasoline engines

Agricultural machinery

- Tractors
- Tractor implements
- Lawn maintenance machinery
- Refuse compactors

Construction machinery

- Excavators
- Crawler/ all-terrain cranes
- Concrete batching and mixing plants
- Concrete pumps

Equipment for civil use

- Ozone deodorizers
- Dishwashers
- Disaster prevention equipment
- Water-purifying equipment

Financing and service industry

Information and control technology

Others

IHI Group Facilities

Parent Company



Soma Aero-Engine Works

Products & services: Parts of jet engines, gas turbines and space development equipment
 Certificates: JIS Q 9100 (including JIS Q 9001/ISO 9001), FAA Repair Station and ISO 14001



Tanashi Aero-Engine Works

Products & services: Parts of jet engines, gas turbines and space development equipment
 Certificates: JIS Q 9100 (including JIS Q 9001/ISO 9001), JIS Q 14001 (ISO 14001) and ISMS



Mizuho Aero-Engine Works

Products & services: Assembly and overhauling of jet engines, gas turbines, space development equipment and defense system
 Certificates: JIS Q 9100 (including JIS Q 9001/ISO 9001), FAA Repair Station, Approval Certificate (Maintenance Organization) (EASA), ISO 14001 and ISMS



Sunamachi Works

Products & services: Bridges, gates, steel structures, offshore structures and airport facilities
 Certificate: JIS Q 9001 (ISO 9001)



Yokohama Nuclear & Chemical Components Works

Products & services: Reactor pressure vessels, containment vessels, heat exchangers for nuclear power plants, reactors and towers for chemical plants
 Certificates: ASME(N, NPT, U, U2, NA, NS, N3, S), ISO 9001 and ISO 14001



Yokohama Machinery Works

Products & services: Rolling mills, presses, paper and plastic machinery and rotating machinery
 Certificates: ISO 9001 and ISO 14001



Aichi Works

Products & services: Bridges, shield tunneling machines, deck machinery and steel structures
 Certificates: ISO 9001, ISO 14001, AISC (Cbr, F, P1) and Deck Cranes Manufacturers (NK)



Aioi Works

Products & services: Boilers, pressure vessels for chemical plants and prefabricated piping systems
 Certificates: ISO 9001, ISO 14001 and ASME(S, U, U2)



Aioi Workshop

Products & services: Steel structures and offshore structures
 Certificates: ISO 9001 and ISO14001



Aioi Casting Workshop

Products & services: Casting products for machinery
 Certificates: ISO 14001 and Casting products manufacturer (LRS, NK, DNV, CR, GL, BV)



Kure Aero-Engine & Turbo Machinery Works

Products & services: Parts of gas turbine power plants, jet engines and gas turbines
 Certificates: JIS Q 9100 (including JIS Q 9001/ISO 9001), FAA Repair Station and ISO 14001



Kure Shingu Works

Products & services: Bridges, gates, steel structures and equipment for chemical plants
 Certificates: ISO 9001 and ISO 14001

Affiliates



IHI Marine United
Yokohama Shipyard
Products & services: Naval vessels, cruise ships, special cargo vessels and repairing
Certificates: ISO 9001 (JIS Q 9001) and ISO 14001 (JIS Q 14001)



IHI Marine United
Kure Shipyard
Products & services: Shipbuilding, conversion and repairing
Certificates: ISO 9001 (JIS Q 9001), NK and ISO 14001 (JIS Q 14001)



IHI Aerospace
Tomioka Plant
Products & services: Launch vehicles, other space equipment systems and defense rocket systems
Certificates: JIS Q 9100 (including JIS Q 9001/ISO 9001), ISO 14001 and ISMS



Ishikawajima Shibaura Machinery
Matsumoto Factory
Products & services: Compact tractors and engines
Certificates: ISO 9001 and ISO 14001



Ishikawajima Mass-Produced Machinery
Tatsuno Works
Products & services: Turbochargers, compressors, hydraulic motors and aircraft parts
Certificates: JIS Q 9100, ISO 9001 (JIS Q 9001), ISO 14001, QS 9000, DNV, LR, ABS, BV, KR and CCS



IHI Construction Machinery
Yokohama Plant
Products & services: Mini excavators, hydraulic shovels, crawler cranes, batching plants and others
Certificates: ISO 9001 (JIS Q 9001) and ISO 14001 (JIS Q 14001)



Niigata Power Systems
Ohta Plant
Products & services: Diesel engines, gas engines, dual-fuel engines and Z-peller propulsion systems
Certificates: ISO 9001 and ISO 14001



Niigata Transys
Niigata Works
Products & services: Rolling stocks, automated people movers, light-rail vehicles and snow plows
Certificate: ISO 9001 (JIS Q 9001)



Star Farm Machinery Manufacturing
Chitose Works
Products & services: Hay and grass harvesting equipment



Ishikawajima Iwakuni Seisakusho
Iwakuni Works
Products & services: Blast furnace shells and tops, vacuum furnaces, new material producing furnaces and electric arc furnaces
Certificate: ISO 9001



Ishikawajima Industrial Machinery
Motomiya Works
Products & services: Stock preparation machinery and systems
Certificate: ISO 9001



PT Cilegon Fabricators (INDONESIA)
Products & services: Boilers, steel structures, container cranes and pressure vessels
Certificates: ISO 9001 and ASME (S, U, PP)



IHI Turbo America (U.S.A.)
Products & services: Vehicular turbochargers and superchargers
Certificates: ISO 9001 and QS 9000



IHI Turbo (Thailand) (THAILAND)
Products & services: Vehicular turbochargers
Certificates: ISO 14001 and QS 9000

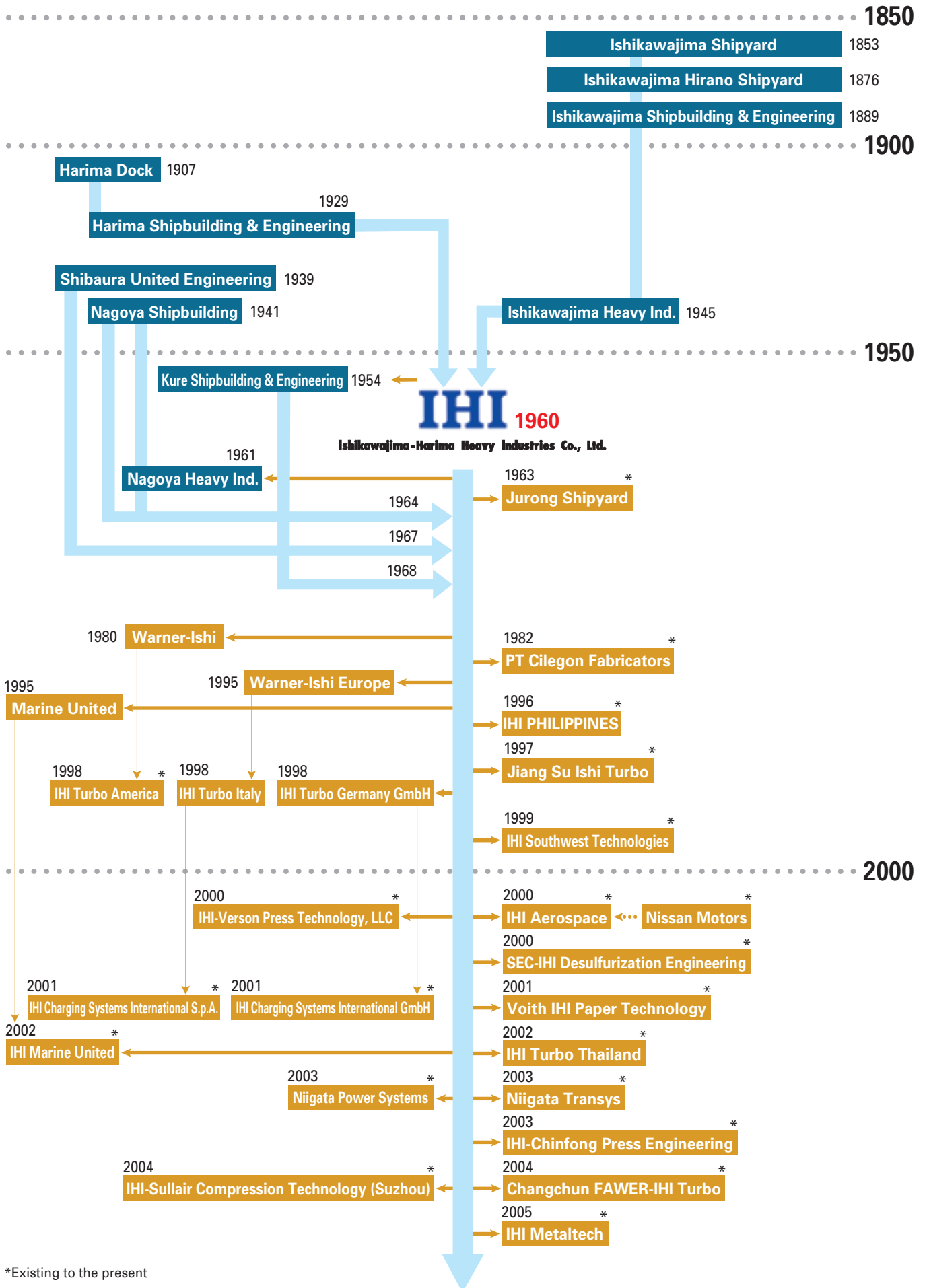


IHI Charging Systems International (ITALY)
Products & services: Vehicular turbochargers
Certificates: ISO 9001, AVSO, QS 9000, VDA 6.1 and ISO/TS 16949



Jiang Su Ishi Turbo (CHINA)
Products & services: Vehicular turbochargers
Certificates: ISO 9002 and ISO/TS 16949

History of IHI



*Existing to the present

Timeline of IHI

1800s	<p>1853 Established Ishikawajima Shipyard</p> <p>76 Established Ishikawajima Hirano Shipyard</p> <p>89 Established Ishikawajima Shipbuilding & Engineering Co., Ltd., Tokyo (Ishikawajima S&E)</p>
1900s	<p>1907 Established Harima Dock Co., Ltd.; later renamed to Harima Shipbuilding & Engineering (Harima S&E) and merged with the Company</p> <p>39 Established Shibaura United Engineering Co., Ltd. (SUECO), to produce rolling mills, through a joint venture with Toshiba and United Engineering & Foundry in U.S.; later merged with the Company</p> <p>41 Established Nagoya Shipbuilding Co., Ltd. (Nagoya Shipbuilding); later merged with the Company</p> <p>45 Changed Company name to Ishikawajima Heavy Industries Co., Ltd. (Ishikawajima Heavy Ind.)</p>
1950s	<p>1954 Established Kure Shipbuilding & Engineering Co., Ltd. (Kure S&E); later merged with the Company</p>
1960s	<p>1960 Merged Ishikawajima Heavy Ind. and Harima S&E; inaugurated Ishikawajima-Harima Heavy Industries Co., Ltd. (IHI)</p> <p>61 Established Nagoya Heavy Ind.</p> <p>63 Established Jurong Shipyard Ltd. (JSL) in Singapore</p> <p>64 Merged Nagoya Heavy Ind. and Nagoya Shipbuilding</p> <p>67 Merged with Shibaura United Engineering</p> <p>68 Merged with Kure S&E</p>
1970s	<p>1971 Established IHI Engineering Australia Pty. Ltd. (IEA)</p> <p>72 Established Ishikawajima Europe BV (IE) in the United Kingdom</p> <p>74 Established IHI Marine BV (IMBV) in the Netherlands</p> <p>75 Established Felguera-IHI SA (FI) in Spain</p> <p>77 Established IHI Marine Engineering Singapore Private Ltd.</p> <p>77 Established IHI INC. in U.S.</p>
1980s	<p>1980 Established Warner-Ishi Corp. (WI) in a joint venture with Borg-Warner Automotive Inc. in U.S.</p> <p>82 Established IHI (HK) Limited (IHL) in Hong Kong</p> <p>82 Established PT Cilegon Fabricators</p> <p>88 Established Diesel United, Ltd. in a joint venture with Sumitomo Heavy Industries Ltd. (SHI)</p>
1990s	<p>1992 Established IHI Europe Ltd. (IEL) in the United Kingdom</p> <p>95 Established IHI Technical Consulting Co., Ltd. (ITCC) in Taiwan</p> <p>95 Established Marine United Inc. (MU), which performs engineering for ships and naval vessels with SHI</p> <p>95 Established Warner-Ishi Europe S.p.A. (WIE) in Italy</p> <p>96 Established IHI PHILIPPINES, INC. (IPI) in the Philippines</p> <p>97 Established Jiang Su Ishi Turbo Company Ltd. (JIT) in China</p> <p>98 Established the Environmental Technical Center</p> <p>98 Established IHI Turbo Germany GmbH., in Germany</p> <p>98 Established IHI Turbo America, as a successor of Warner Ishi</p> <p>98 Established IHI Turbo Italy, as a successor of Warner Ishi Europe</p> <p>99 Established IHI Southwest Technologies, Inc. in the United States to undertake nondestructive inspections</p> <p>99 Established two subsidiaries to engage in industrial waste processing business</p>
2000s	<p>2000 Established joint venture with The Broken Hill Proprietary Company Limited (BHP) of Australia and Nucor Corporation of U.S. to license strip-casting technology</p> <p>00 Purchased Nissan Motor's Aerospace and Defense Divisions and established IHI Aerospace Co., Ltd.</p> <p>00 Integrated three construction companies into Ishikawajima Plant Construction Co., Ltd.</p> <p>00 Established IHI-Verson Press Technology, LLC, in the United States</p> <p>00 Established SEC-IHI Desulfurization Engineering Co., Ltd. in China</p> <p>01 Established joint venture Voith IHI Paper Technology Co., Ltd. in Japan</p> <p>01 Established joint venture IHI Charging Systems International GmbH, as a successor of IHI Turbo Germany</p> <p>01 Established Beijing Municipal Ishikawajima Shield Engineering Limited Company; joint venture for manufacturing & selling shield tunneling machines</p> <p>01 IHI Turbo Italy became a subsidiary company of IHI Charging Systems International GmbH, and renamed to IHI Charging Systems International S.p.A.</p> <p>02 Established joint venture IHI Turbo (Thailand), for manufacturing & selling turbochargers.</p> <p>02 Project formulated for redevelopment of land at site of former plant in Toyosu district of Tokyo</p> <p>02 Shipbuilding & Offshore Operations spun off as a separate company, IHI Marine United Inc.</p> <p>03 Established Niigata Power Systems Co., Ltd. and Niigata Transys Co., Ltd. to take over and carry on a portion of the business of Niigata Engineering Co., Ltd.</p> <p>03 Aerospace development operations integrated with IHI Aerospace Co., Ltd.</p> <p>03 Established IHI-Chinfong Press Engineering Co., Ltd.</p> <p>04 Established Changchun FAWER-IHI Turbo Co., Ltd.</p> <p>04 Established IHI-Sullair Compression Technology (Suzhou) Co., Ltd.</p> <p>05 Established IHI Metaltech Co., Ltd.</p>

Corporate Governance and Compliance

(As of June 28, 2006)

Basic Philosophy on Corporate Governance

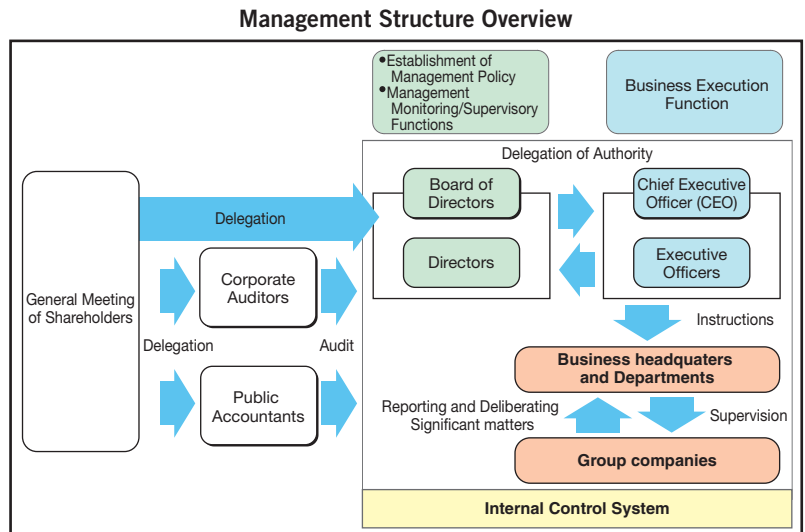
IHI defines corporate governance as a system designed to maximize corporate value by increasing the efficiency of management to leverage the Company's capabilities as much as possible.

To establish and strengthen a system of excellent corporate governance, IHI aims to enhance its compliance structure based on the necessity for a system to observe internal decision-making and business execution that is made in accordance with laws, regulations and acceptable procedures.

Corporate Governance Measures

1. Management Organization

- IHI has 13 directors, one of which is an outside director.
- IHI has five auditors, three of which are outside auditors.
- There are no conflicts of interest between IHI and its outside director or outside auditors.
- IHI has 24 executive officers, 11 of which also serve as directors, who form the core management in charge of business execution.
- The Management Committee supports the decision-making and business execution of the Chief Executive Officer (CEO), who designates members of the committee.



2. Internal Controls and Risk Management

- IHI has strengthened its auditing structure for evaluating contractual and technological risks prior to accepting an order through the establishment of the Contract Legal Department and the Technology Evaluation Committee.
- To prevent a worsening in profitability after accepting an order, IHI is concentrating efforts on enhancing its project management structure for processes, costs and quality in its business divisions and departments to eradicate unprofitable projects.
- IHI has established the Compliance Committee and opened a compliance hotline as an internal communications channel. To increase awareness of compliance issues, IHI distributes its Compliance Guide and also holds training sessions for all its directors and employees.
- Having received a judgment on appeal from the Japan Fair Trade Commission with regard to bridge sales activities that violated the Antimonopoly Law, the Group places the highest management priority on thorough compliance and establishing an effective compliance structure.
- Basic guidelines have been established with the aim of contributing to the improvement of corporate values and increasing the effectiveness of corporate governance. The ongoing maintenance of an internal system provides checks and balances to ensure adequate oversight of all IHI directors and employees, business groups and auditors.

3. Audits

- Within the Internal Auditing Department, IHI has established the Auditing Office with 12 auditors as an organization under the direct control of the president. IHI conducts audits of all business activities from the perspectives of compliance and fairness of business execution.
- Auditors oversee business execution by interviewing directors and attending meetings of the Board of Directors and the Management Committee in accordance with auditing policies set by the Board of Auditors.
- Auditors regularly exchange information and opinions with the independent auditors and receive reports on auditing results.
- Auditors exchange information and periodically receive reports from the Auditing Office.

4. Director's Bonuses

The bonuses paid to directors and auditors in the year under review are set out. (Table at right)

Category	Directors	Auditors	Total
Bonuses based on company Articles of Association or General Meeting of Shareholders' decision	¥241 million	¥43 million	¥284 million
Allowances for retirement benefits based on General Meeting of Shareholders' decision	¥306 million	¥28 million	¥335 million
Total	¥548 million	¥71 million	¥619 million

Note: The bonuses paid to directors in the year under review were less the portion payable for concurrent positions held.

5. Company Auditors

IHI employs Ernst & Young ShinNihon as its independent auditor. The names of the Certified Public Accountants (CPAs) affiliated with the independent auditor and the number of continuous years they have audited IHI are as follows:

Fumio Takahashi (one year)

Tatsutaro Ishitsuka (14 years*)

Takeshi Akimoto (three years)

*the independent auditor has voluntarily introduced an alternate system for managing partners in advance of the enactment of the CPA Law and self-governing stipulations of the Japanese Institute of Certified Public Accountants. The independent auditor intends to implement the system at a time determined by its independently formulated plan.

In addition, IHI has 11 CPAs and 13 accounting assistants involved in accounting audits.

IHI and its subsidiaries pay compensation to the independent auditor. (Table at right)

Total compensation paid to independent auditor	Payment
1. Total compensation paid to independent auditor by IHI and its subsidiaries	¥266 million
2. Of the amount in 1., above, total compensation paid for audit certification according to Article 2-1 of the Certified Public Accountant Law	¥257 million
3. Of the amount in 2., above, compensation paid to the independent auditor by IHI	¥49 million

Note: As the agreement between IHI and its independent auditor makes no distinction between auditor compensation based on the laws concerning special exemptions to the Commercial Code regarding corporate auditors of corporations and auditor compensation based on the Securities Exchange Law, the amount in 3., above, represents a total of these amounts, as in actual practice they cannot be distinguished.

Corporate Officers

(As of June 28, 2006)

President



Mototsugu Ito
(Chief Executive Officer)

Executive Vice Presidents



Isao Nakao
(Senior Executive Officer)



Teiichi Tamaki
(Senior Executive Officer)



Yukiya Nakagawa

Board Directors



Yasuo Shinohara
(Managing Executive Officer)



Yasuhiro Inagawa
(Managing Executive Officer)



Koichiro Kuwabara
(Managing Executive Officer)



Yasuyuki Watanabe
(Managing Executive Officer)



Kazuaki Kama
(Managing Executive Officer)



Jun'ichi Sato
(Managing Executive Officer)



Toshiro Takei
(Managing Executive Officer)



Yuji Hiruma
(Managing Executive Officer)



Fumio Sato

Corporate Auditors

Hiroyoshi Hiraga

Teruo Naruoka

Takeo Inokuchi

Kiyooki Shimagami

Nobuo Ohashi

Executive Officers

Mototsugu Ito

Isao Nakao

Yasuo Shinohara

Jun'ichi Sato

Motoki Yoshinaga

Toshihiko Ohsumi

Teruo Shimizu

Teiichi Tamaki

Yasuhiro Inagawa

Toshiro Takei

Sakae Ando

Kimiaki Gotoh

Makoto Serizawa

Koichiro Kuwabara

Yuji Hiruma

Mutsumi Maruyama

Mitsukatsu Asaoka

Tamotsu Saito

Yasuyuki Watanabe

Kuniaki Hongo

Masaki Hatagawa

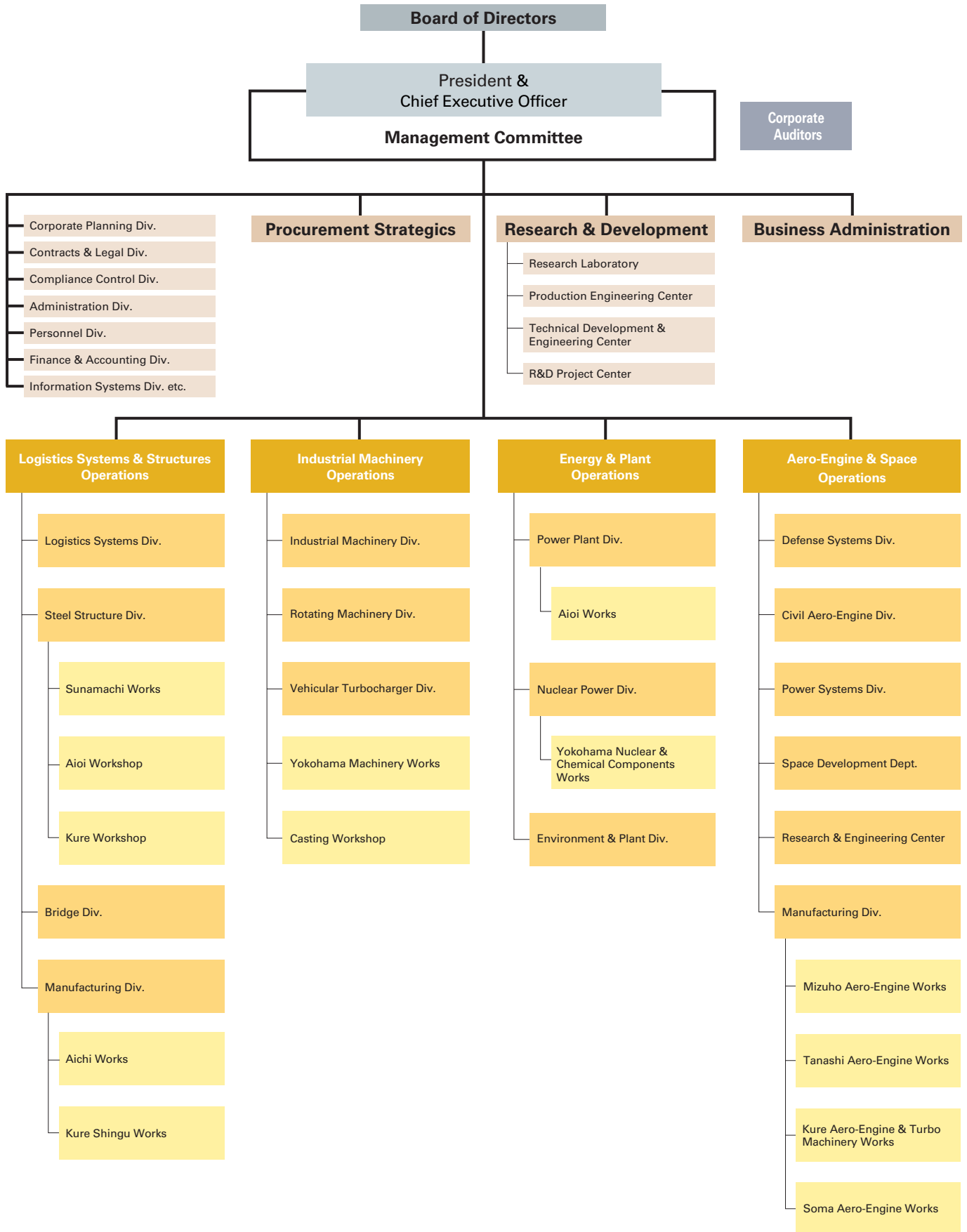
Kazuaki Kama

Yoshiaki Shimojo

Kazuo Tsukahara

Organization

(As of July 1, 2006)



Directory

(As of July 1, 2006)

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Financial Section

Years ended March 31
Ishikawajima-Harima Heavy Industries Co., Ltd., and Consolidated Subsidiaries

Consolidated Six-Year Summary

	Millions of yen					
	2006	2005	2004	2003	2002	2001
For the year:						
Net sales	¥1,127,075	¥1,089,047	¥1,047,441	¥1,019,061	¥1,082,402	¥1,114,817
Cost of sales	986,666	962,127	950,136	878,260	932,415	951,290
Gross profit	140,409	126,920	97,305	140,801	149,987	163,527
Operating income (loss)	21,771	10,619	(23,230)	24,640	27,233	39,947
Income (loss) before income taxes and minority interests	22,165	15,112	(39,001)	(6,521)	11,487	18,148
Net income (loss)	5,283	2,180	(38,354)	(9,672)	5,539	9,205
At year-end:						
Total assets	¥1,461,796	¥1,387,838	¥1,377,021	¥1,381,240	¥1,422,110	¥1,481,841
Current assets	1,005,974	937,250	905,325	875,264	886,738	943,852
Net property, plant and equipment	226,071	234,887	246,406	287,096	307,677	295,775
Current liabilities	774,037	752,951	744,218	741,404	791,496	825,103
Long-term liabilities	498,362	460,960	461,574	447,870	427,087	439,179
Total shareholders' equity	169,237	153,716	151,550	171,323	187,589	201,349
Amounts per share (yen):						
Net income (loss)	¥ 3.93	¥ 1.56	¥ (29.67)	¥ (7.57)	¥ 4.27	¥ 7.09
Cash dividends	2.00	—	—	1.50	3.00	3.00
Shareholders' equity	130.36	118.40	116.73	131.96	144.47	155.06
Other data:						
Number of employees	23,364	21,847	22,768	23,575	22,980	24,311
Number of shares issued (millions)	1,298	1,298	1,298	1,298	1,298	1,298
Ratios:						
Return on average assets (%)	0.37	0.16	(2.78)	(0.69)	0.38	0.64
Return on average equity (%)	3.27	1.43	(23.76)	(5.39)	2.85	5.06
Total shareholders' equity ratio (%)	11.58	11.08	11.01	12.40	13.19	13.59

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Financial Review

Operating Results

During the year under review, IHI's consolidated net sales increased 3.5% to ¥1,127.1 billion. Although declining year-on-year sales were recorded in three business segments—logistics systems and structures operations, energy and plant operations, and shipbuilding and offshore operations—these were offset by sales growth in all of the other segments, with that for aero-engine and space operations achieving a 13.0% increase. Overseas sales moved up 11.7% to ¥379.6 billion, representing 33.7% of consolidated net sales. Domestic sales decreased 0.2% to ¥747.5 billion, accounting for 66.3% of consolidated net sales, compared with 68.8% during the last year.

Cost of sales as a percentage of net sales softened from 88.3% in the previous year to 87.5%. Gross profit, accordingly, rose 10.6% to ¥140.4 billion. Selling, general and administrative expenses rose 2.0% to ¥118.6 billion and as a percentage of net sales were 10.5%, edging down from 10.7% in the last fiscal year. As a result of the foregoing, the Company recorded operating income of ¥21.8 billion, compared with ¥10.6 billion in the previous year.

From an industry segment performance standpoint, sales of logistics systems and structures operations totaled ¥169.7 billion, representing 15.1% of net sales. This segment posted an operating loss of ¥2.8 billion. In industrial machinery operations, sales amounted to ¥145.2 billion, making up 12.9% of net sales. Operating income for the segment was ¥7.5 billion. In energy and plant operations, sales were ¥297.6 billion, or 26.4% of net sales. Operating income for the segment was ¥7.0

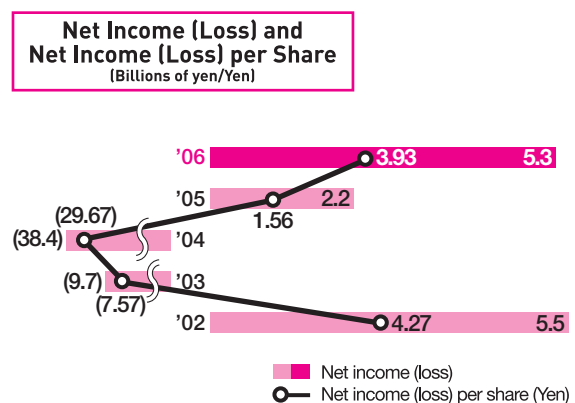
billion. Aero-engine and space operations recorded sales of ¥264.5 billion, accounting for 23.5% of net sales. Operating income for the segment was ¥16.5 billion. Sales in the shipbuilding and offshore operations segment were ¥114.9 billion, or 10.2% of net sales. Operating loss totaled ¥8.6 billion. Other operations turned in sales of ¥135.2 billion, which was 12.0% of net sales. Operating income in this segment was ¥1.7 billion.

Interest expense outpaced interest and dividend income by ¥0.4 billion, compared with an excess of ¥0.3 billion in the previous year. Other, net, income was ¥0.8 billion, compared with other, net, income of ¥4.8 billion in the previous year. The Company recorded income before income taxes and minority interests of ¥22.2 billion, adding ¥7.1 billion to that of the prior year.

Current income taxes jumped 96.6% to ¥14.3 billion, and deferred income taxes of ¥2.8 billion were recorded, compared with ¥5.3 billion in the previous year. IHI posted net income of ¥5.3 billion, compared with ¥2.2 billion in the previous year. Consequently, net income per share was ¥3.93. Based on these results, IHI decided to resume cash dividends of ¥2.0 per share for the year under review.

Cash Flows

Net cash provided by operating activities was ¥3.5 billion, compared with net cash used in operating activities of ¥4.4 billion in the previous year. Principal sources of cash included depreciation and amortization of ¥29.8 billion and income before income taxes and minority interests of ¥22.2 billion. The main uses of



cash were changes in operating assets and liabilities of ¥33.0 billion and gain on sale of marketable and investment securities of ¥18.5 billion.

Net cash provided by investing activities was ¥3.4 billion, compared with net cash used in investing activities of ¥4.1 billion in the previous year. The largest sources of cash were proceeds from sale of property, plant and equipment of ¥25.6 billion and proceeds from marketable and investment securities of ¥21.7 billion, and the largest use of cash was purchases of property, plant and equipment and intangible fixed assets of ¥30.3 billion.

Net cash used in financing activities totaled ¥12.7 billion, compared with net cash provided by financing activities of ¥24.7 billion in the previous year. The principal uses of cash were repayment of long-term debt of ¥45.6 billion and expenditures for redemption of debentures of ¥25.0 billion. The most significant sources of cash were proceeds from issuance of long-term debt of ¥44.5 billion and proceeds from issuance of debentures of ¥35.0 billion.

As a result of the factors outlined above, cash and cash equivalents, end of year, totaled ¥137.4 billion, marking a slight drop from the ¥139.7 billion posted in the previous year.

Financial Position

IHI's basic financial strategy is to maintain a sound financial position by covering investments with funds from operating activities, supplemented by external financing on an as-needed basis. IHI made capital expenditures of ¥33.7 billion during the

year under review. Depreciation and amortization totaled ¥29.8 billion, and interest-bearing debt (defined as short-term loans, current portion of long-term loans and debentures, long-term loans and debentures, and other interest-bearing debt) edged up 1.0% to ¥447.6 billion.

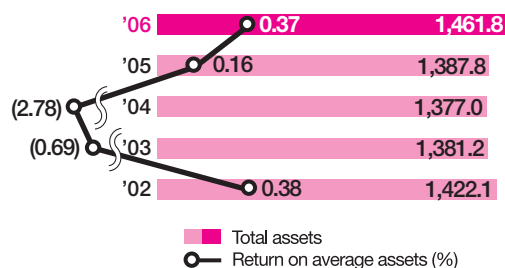
Marketable securities soared 80.9% to ¥21.0 billion, while cash and time deposits decreased 13.4% to ¥105.2 billion, and deferred income taxes in current assets plummeted 18.2% to ¥26.2 million. Moreover, trade receivables increased 7.4% to ¥356.5 billion. Together with the aforementioned increase in marketable securities and an increase in the allowance for doubtful receivables, there was a 7.3% expansion in current assets to ¥1,006.0 billion.

Net property, plant and equipment slipped 3.8% to ¥226.1 billion. Total investments rose 6.3% to ¥208.4 billion due to an increase in investment securities. As a result of these developments, total assets grew 5.3% to ¥1,461.8 billion.

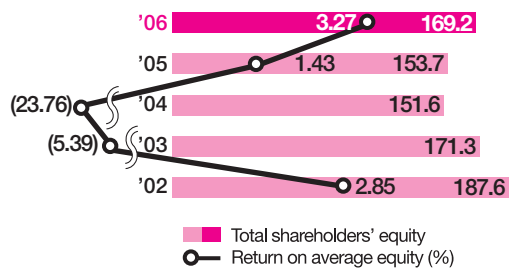
Total current liabilities increased 2.8% to ¥774.0 billion, chiefly as a result of a reduction in short-term loans and current portion of long-term loans and debentures, compensating for an increase in accrued expenses. Total long-term liabilities increased 8.1% to ¥498.4 billion, owing mainly to debentures. Total shareholders' equity grew 10.1% to ¥169.2 billion, due primarily to unrealized holding gain on other securities.

Note: Figures in the Financial Review are in billions of yen, rounded to the nearest first decimal place and exclude intersegment sales and transfers.

Total Assets and Return on Average Assets
(Billions of yen/%)



Total Shareholders' Equity and Return on Average Equity
(Billions of yen/%)



Consolidated Balance Sheets

March 31, 2006 and 2005
Ishikawajima-Harima Heavy Industries Co., Ltd., and Consolidated Subsidiaries

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
ASSETS			
Current assets:			
Cash and time deposits (Note 8)	¥ 105,243	¥ 121,588	\$ 895,914
Trade receivables (Note 8)	356,469	331,924	3,034,554
Marketable securities (Note 3)	20,995	11,609	178,726
Less allowance for doubtful receivables	(4,840)	(4,092)	(41,202)
Inventories (Notes 4 and 8)	409,020	370,943	3,481,910
Deferred income taxes (Note 9)	26,202	32,029	223,053
Other	92,885	73,249	790,712
Total current assets	1,005,974	937,250	8,563,667
Property, plant and equipment (Notes 5, 6 and 8):			
Buildings and structures	231,429	234,884	1,970,112
Machinery and equipment	374,234	372,926	3,185,784
Land (Note 13)	79,769	87,447	679,058
Construction in progress	3,821	3,362	32,527
Less accumulated depreciation	(463,182)	(463,732)	(3,942,981)
Net property, plant and equipment	226,071	234,887	1,924,500
Intangible assets:			
Software	14,237	14,002	121,197
Consolidated adjustment accounts	310	442	2,639
Other	6,793	5,277	57,827
Total intangible assets	21,340	19,721	181,663
Investments:			
Investment securities (Notes 3 and 8)	130,356	112,132	1,109,696
Deferred income taxes (Note 9)	36,391	43,550	309,790
Other	50,731	50,050	431,864
Less allowance for doubtful receivables	(9,067)	(9,752)	(77,186)
Total investments	208,411	195,980	1,774,164
Total assets	¥1,461,796	¥1,387,838	\$ 12,443,994

The accompanying notes to the consolidated financial statements are an integral part of these statements.

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Trade payables	¥ 295,026	¥ 289,134	\$ 2,511,501
Short-term loans (Notes 7 and 8)	109,528	126,858	932,391
Current portion of long-term loans and debentures (Notes 7 and 8)	52,998	69,708	451,162
Accrued expenses	40,768	25,555	347,050
Advances from customers	151,067	143,565	1,286,005
Accrued income taxes	10,595	5,238	90,193
Allowance for employees' bonuses	18,812	17,977	160,143
Reserve for guaranteed contracts	12,123	9,359	103,201
Reserve for losses on sales contracts	22,216	20,627	189,121
Other	60,904	44,930	518,464
Total current liabilities	774,037	752,951	6,589,231
Long-term liabilities:			
Long-term loans and debentures (Notes 7 and 8)	281,782	246,818	2,398,757
Allowance for employees' retirement benefits (Note 16)	150,336	150,088	1,279,782
Deferred tax liabilities from revaluation of land (Note 13)	3,694	4,092	31,446
Other (Note 7 and 8)	62,550	59,962	532,477
Total long-term liabilities	498,362	460,960	4,242,462
Minority interests in consolidated subsidiaries	20,160	20,211	171,618
Contingent liabilities (Note 11)			
Shareholders' equity:			
Common stock			
Authorized: 3,300,000,000 shares			
Issued: 1,298,495,152 shares	64,925	64,925	552,694
Capital surplus	10,200	10,200	86,831
Retained earnings	44,814	41,596	381,493
Revaluation reserve for land (Note 13)	4,591	5,487	39,083
Unrealized holding gain on other securities	46,220	34,301	393,462
Foreign exchange translation adjustments	(1,465)	(2,757)	(12,471)
Less treasury stock, at cost	(48)	(36)	(409)
Total shareholders' equity	169,237	153,716	1,440,683
Total liabilities and shareholders' equity	¥1,461,796	¥1,387,838	\$ 12,443,994

Consolidated Statements of Income

Years ended March 31, 2006 and 2005
Ishikawajima-Harima Heavy Industries Co., Ltd., and Consolidated Subsidiaries

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Net sales	¥1,127,075	¥1,089,047	\$ 9,594,577
Cost of sales (Note 10)	986,666	962,127	8,399,302
Gross profit	140,409	126,920	1,195,275
Selling, general and administrative expenses (Note 10)	118,638	116,301	1,009,943
Operating income	21,771	10,619	185,332
Other income (expense):			
Interest and dividend income	4,392	4,379	37,388
Interest expense	(4,775)	(4,714)	(40,649)
Other, net (Note 12)	777	4,828	6,615
Income before income taxes and minority interests	22,165	15,112	188,686
Income taxes:			
Current	(14,273)	(7,259)	(121,503)
Deferred	(2,809)	(5,313)	(23,912)
Income before minority interests	5,083	2,540	43,271
Minority interests in income (loss) of consolidated subsidiaries	200	(360)	1,702
Net income	¥ 5,283	¥ 2,180	\$ 44,973
		Yen	U.S. dollars (Note 1)
Amounts per share (Note 18):			
Net income	¥ 3.93	¥ 1.56	\$ 0.033
Cash dividends	2.00	—	0.017

The accompanying notes to the consolidated financial statements are an integral part of these statements.

Consolidated Statements of Shareholders' Equity

Years ended March 31, 2006 and 2005
Ishikawajima-Harima Heavy Industries Co., Ltd., and Consolidated Subsidiaries

	(Thousands)			(Millions of yen)					
	Number of shares of common stock	Common stock	Capital surplus	Retained earnings	Revaluation reserve for land	Unrealized holding gain on other securities	Foreign exchange translation adjustments	Treasury stock, at cost	
Balance at March 31, 2004	1,298,495	¥ 64,925	¥ 10,200	¥ 38,909	¥ 5,487	¥ 33,907	¥ (1,851)	¥ (27)	
Net income for the year	—	—	—	2,180	—	—	—	—	
Increase resulting from inclusion of subsidiaries in consolidation	—	—	—	660	—	—	—	—	
Change for the year	—	—	—	—	—	394	(906)	—	
Purchase of treasury stock	—	—	—	—	—	—	—	(9)	
Sales of treasury stock	—	—	—	0	—	—	—	0	
Bonuses to directors and corporate auditors	—	—	—	(153)	—	—	—	—	
Balance at March 31, 2005	1,298,495	64,925	10,200	41,596	5,487	34,301	(2,757)	(36)	
Net income for the year	—	—	—	5,283	—	—	—	—	
Reversal of revaluation reserve for land	—	—	—	743	(896)	—	—	—	
Decrease resulting from inclusion of subsidiaries in consolidation	—	—	—	(24)	—	—	—	—	
Decrease resulting from removed subsidiaries	—	—	—	(2)	—	—	—	—	
Cash dividends	—	—	—	(2,596)	—	—	—	—	
Change for the year	—	—	—	—	—	11,919	1,292	—	
Purchase of treasury stock	—	—	—	—	—	—	—	(12)	
Sales of treasury stock	—	—	—	0	—	—	—	0	
Bonuses to directors and corporate auditors	—	—	—	(186)	—	—	—	—	
Balance at March 31, 2006	1,298,495	¥ 64,925	¥ 10,200	¥ 44,814	¥ 4,591	¥ 46,220	¥ (1,465)	¥ (48)	

(Thousands of U.S. dollars) (Note 1)

Balance at March 31, 2005	\$ 552,694	\$ 86,831	\$ 354,099	\$ 46,710	\$ 291,998	\$(23,470)	\$(306)
Net income for the year	—	—	44,973	—	—	—	—
Reversal of revaluation reserve for land	—	—	6,325	(7,627)	—	—	—
Decrease resulting from inclusion of subsidiaries in consolidation	—	—	(204)	—	—	—	—
Decrease resulting from removed subsidiaries	—	—	(17)	—	—	—	—
Cash dividends	—	—	(22,099)	—	—	—	—
Change for the year	—	—	—	—	101,464	10,999	—
Purchase of treasury stock	—	—	—	—	—	—	(103)
Sales of treasury stock	—	—	0	—	—	—	0
Bonuses to directors and corporate auditors	—	—	(1,584)	—	—	—	—
Balance at March 31, 2006	\$ 552,694	\$ 86,831	\$ 381,493	\$ 39,083	\$ 393,462	\$(12,471)	\$(409)

The accompanying notes to the consolidated financial statements are an integral part of these statements.

Consolidated Statements of Cash Flows

Years ended March 31, 2006 and 2005
Ishikawajima-Harima Heavy Industries Co., Ltd., and Consolidated Subsidiaries

Millions of yen

Thousands of
U.S. dollars (Note 1)

	2006	2005	2006
Operating Activities:			
Income before income taxes and minority interests	¥ 22,165	¥ 15,112	\$ 188,686
Depreciation and amortization	29,797	31,156	253,656
Amortization of long-term prepaid expenses	3,321	2,813	28,271
Increase in allowance for bad debts	901	535	7,670
Increase (decrease) in allowance for employees' bonuses	653	(95)	5,559
Increase in reserve for guaranteed contracts	2,764	2,090	23,529
Increase (decrease) in accrued losses on sales contracts	1,589	(19,050)	13,527
Decrease in accrued employees' retirement allowances	(53)	(2,169)	(451)
Interest and dividends income	(4,392)	(4,379)	(37,388)
Interest expense	4,775	4,714	40,649
Gain on foreign exchange	(7)	(20)	(60)
Gains on disposal of property, plant and equipment	(12,490)	(7,351)	(106,325)
Losses on impairment of fixed assets	13,269	—	112,956
Gains on sales of marketable and investment securities	(18,509)	(15,301)	(157,564)
Losses on valuation of marketable and investment securities and golf club memberships	814	1,532	6,929
Equity in gains of affiliates	(1,441)	(1,474)	(12,267)
Changes in operating assets and liabilities:			
Notes and accounts receivable	(25,645)	(27,310)	(218,311)
Advances received	6,076	9,282	51,724
Inventories	(23,196)	26,868	(197,463)
Advance payments	(11,315)	(6,620)	(96,322)
Notes and accounts payable	1,804	3,494	15,357
Accrued expenses	9,229	—	78,565
Deposits from tenants	973	(1,215)	8,283
Other current assets	2,673	(1,143)	22,756
Other current liabilities	12,163	1,129	103,542
Accrued consumption taxes	(5,752)	(1,106)	(48,966)
Directors' and corporate auditors' bonuses	(200)	(205)	(1,703)
Subtotal	9,966	11,287	84,839
Interest and dividends received	4,460	2,811	37,967
Interest paid	(4,650)	(4,649)	(39,585)
Income taxes paid	(6,278)	(13,857)	(53,443)
Net cash provided by (used in) operating activities	3,498	(4,408)	29,778
Investing Activities:			
Net decrease (increase) in time deposits due in more than three months	658	(248)	5,601
Purchases of marketable and investment securities	(542)	(1,479)	(4,614)
Proceeds from sale of marketable and investment securities	21,692	20,811	184,660
Purchases of property, plant and equipment and intangible fixed assets	(30,306)	(31,868)	(257,989)
Proceeds from sale of property, plant and equipment	25,580	12,854	217,758
Payments for disposal of property, plant and equipment	(2,768)	(1,137)	(23,563)
Expenditure for acquisition of business	(1,592)	—	(13,552)
Net (increase) decrease in short-term loan receivables	(65)	109	(553)
Increase in long-term loan receivables	(727)	(405)	(6,189)
Decrease in long-term loan receivables	113	565	962
Increase in other non-current assets	(8,557)	(1,371)	(72,845)
Decrease in other fixed liabilities	(100)	(1,931)	(852)
Net cash provided by (used in) investing activities	3,386	(4,100)	28,824

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Financing Activities:			
Net decrease in short-term debt	¥ (21,290)	¥ (386)	\$ (181,238)
Proceeds from issuance of long-term debt	44,500	60,570	378,820
Repayment of long-term debt	(45,574)	(30,241)	(387,963)
Proceeds from issuance of debentures	35,000	15,000	297,949
Expenditures for redemption of debentures	(25,000)	(20,000)	(212,820)
Increase in treasury stock	(12)	(9)	(102)
Increase in treasury stock of subsidiaries in consolidation	(5)	(3)	(43)
Dividends paid to minority interests	(362)	(277)	(3,082)
Net cash (used in) provided by financing activities	(12,743)	24,654	(108,479)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	376	(496)	3,201
Net (decrease) increase in Cash and Cash Equivalents	(5,483)	15,650	(46,676)
Cash and Cash Equivalents, Beginning of Year	139,684	122,738	1,189,104
Increase in Cash and Cash Equivalents due to Newly Consolidated Subsidiaries	3,212	1,296	27,343
Decrease in Cash and Cash Equivalents due to Exclusion from Scope of Consolidation	(31)	—	(264)
Cash and Cash Equivalents, End of Year	¥137,382	¥139,684	\$1,169,507

Note: A reconciliation of cash and cash equivalents to the amounts shown in the consolidated balance sheets is as follows:

	Millions of yen	
	2006	2005
Cash and Cash Equivalents, Beginning of Year:		
Cash and time deposits	¥121,588	¥117,970
Time deposits due in more than three months	(1,511)	(1,263)
Convertible time deposits included in marketable securities	5,000	—
Commercial paper including marketable securities	6,608	4,500
Investment trust including marketable securities	1	32
Sales under agreement to repurchase included in other current assets (short-term loans)	7,998	1,499
Cash and Cash Equivalents	¥139,684	¥122,738

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2006	2005	2006
Cash and Cash Equivalents, End of Year:			
Cash and time deposits	¥105,243	¥121,588	\$ 895,914
Time deposits due in more than three months	(853)	(1,511)	(7,261)
Convertible time deposits included in marketable securities	5,000	5,000	42,564
Commercial paper included in marketable securities	15,994	6,608	136,154
Investment trust included in other current assets	5,999	—	51,068
Investment trust included in marketable securities	—	1	—
Sales under agreement to repurchase included in other current assets (short-term loans)	5,999	7,998	51,068
Cash and Cash Equivalents	¥137,382	¥139,684	\$1,169,507

Notes to the Consolidated Financial Statements

1. Basis of financial statements

The accompanying consolidated financial statements of Ishikawajima-Harima Heavy Industries Co., Ltd. (the "Company") and consolidated subsidiaries (together the "Companies") have been prepared from the financial statements filed with the Prime Minister as required by the Japanese Securities and Exchange Law in accordance with accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards. Certain reclassifications have been made in the accompanying consolidated financial statements to facilitate understanding by readers outside Japan.

2. Significant accounting policies

(a) Scope of consolidation

The consolidated financial statements for the years ended March 31, 2006 and 2005 include the accounts of the Company and 85 and 57 subsidiaries, respectively.

For the years ended March 31, 2006 and 2005, 49 and 55 subsidiaries, respectively, were excluded from the scope of the consolidation. The exclusion of these subsidiaries has not had a material effect on the consolidated financial statements.

(b) Application of the equity method of accounting

The consolidated financial statements for the year ended March 31, 2006 and 2005, included 25 and 12 affiliates, respectively, in the scope of the application of the equity method of accounting.

For the years ended March 31, 2006 and 2005, investments in 49 and 55 unconsolidated subsidiaries, respectively, and 36 and 35 affiliates, respectively, for both years were stated at cost because they did not have a material effect on the consolidated financial statements.

(c) Consolidated subsidiaries having different fiscal year-ends

As Star Farm Machinery Mfg. Co., Ltd. closes its books of account annually on September 30, it prepares its interim financial statements for consolidation as of March 31.

IHI Inc. and its 4 subsidiaries, IHI Turbo America Co., IHI Turbo (Thailand) Co., Ltd., IHI Charging System International GmbH, IHI Charging System International S.p.A, ISHIKAWAJIMA EUROPE B.V., JURONG ENGINEERING LIMITED and its 19 subsidiaries and PT Cilegon Fabricators close their books of account on December 31. But no particular financial reports are prepared for consolidation to match the parent company's fiscal year. However, certain adjustments are made for the important transactions occurring from their settlement day to March 31.

(d) Sales recognition

Net sales of projects with construction lasting more than two years and revenue of more than ¥3 billion have been recorded using the percentage-of-completion method.

(e) Allowance for doubtful receivables

The allowance for doubtful receivables is provided based on historical default rates, plus additional estimated amounts to cover specific uncollectible receivables.

The Company has prepared the consolidated statements of shareholders' equity for the purpose of inclusion in this report, although such statements are not customarily prepared in Japan.

The U.S. dollar amounts are included solely for convenience and are stated, as a matter of arithmetical computation only, at the rate of U.S.\$1=¥117.47, the rate of exchange prevailing on March 31, 2006. These translations should not be construed as representations that the Japanese yen amounts actually represent, or have been or could be converted into U.S. dollars at that or any other rate.

(f) Inventories

Finished goods, work in process and contracts in process are stated principally at identified cost, and raw materials and supplies are stated at the lower of cost or market, cost being determined by the moving-average method.

(g) Securities

Held-to-maturity securities are either amortized or accumulated to face value by the straight-line method.

Investment securities in unconsolidated subsidiaries and affiliates are stated at cost as determined by the moving-average method.

Other securities with market prices available are carried at market value as of the balance-sheet date, with the cost of sale computed by the moving-average method. The difference between the acquisition cost and the carrying value of other securities, including unrealized gains and losses, is recognized as a component of the shareholders' equity under "Unrealized holding gain on other securities."

Other securities without market prices available are stated at the cost by the moving-average method.

(h) Property, plant and equipment and intangible assets

Depreciation of plant and equipment is principally computed by the declining-balance method.

However, depreciation of lend-lease properties, certain assets of consolidated subsidiaries and buildings (excluding building fixtures) acquired after April 1, 1998, are computed by the straight-line method. Amortization of intangible assets is computed by the straight-line method. Software for internal use is amortized using the straight-line method over a useful life of five years.

(i) Impairment of fixed assets

Effective from the year ended March 31, 2006, The Companies have adopted a new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standards for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the Financial Accounting Standard Implementation Guidance No.6, "Implementation Guidance on Accounting Standards for Impairment of Fixed Assets" (issued by the Accounting Standards Board of Japan on October 31, 2003).

As a result, income before income taxes declined by ¥13,209 million. And this change did not have a material effect on operating income.

In addition, the accumulated impairment amount is amortized against each asset in accordance with revised accounting policies for preparing financial statements.

(j) Leases

Non-cancelable lease transactions of the Companies are accounted for by the operating lease accounting method regardless of whether such leases are classified as operating or finance leases, except that lease agreements which stipulate the transfer of ownership of the leased property to the lessee are accounted for as finance leases.

(k) Financial instruments

The Companies do not hold derivative financial instruments for trading purposes. Derivative financial instruments held by the Companies are composed principally of foreign exchange contracts to hedge currency risk and interest rate swaps to hedge interest rate risk.

Japanese GAAP provides for two general accounting methods for hedging financial instruments. One method is to recognize the changes in fair value of a hedging instrument in earnings in the period of the change as a gain or loss together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. The other method is to defer the gain or loss over the period of the hedging contract together with the offsetting loss or gain deferral of the hedged items. The Company and its consolidated subsidiaries have adopted the latter accounting method, if applicable.

With respect to forward foreign exchange contracts, however, the Companies recognize changes in fair value of a hedging instrument in earnings in the period of the change as a gain or loss together with the offsetting loss or gain on the hedged item attributable to the risk being hedged.

The amounts of interest income or expense under the swap agreements are accrued and recognized as interest related to the assets and liabilities over the contract period.

The Companies have entered into primarily interest-rate swap agreement and forward foreign exchange contracts, in order to hedge interest rate and foreign exchange risks.

The Companies use the above-defined method consistently throughout the hedge period, to assess at inception of the hedge and on an ongoing basis whether the ineffective part of the hedge is expected.

(l) Allowance for employees' bonuses

For payment of employees' bonuses, the allowance for employees' bonuses is provided for in the amount that is expected to be paid.

(m) Reserve for guaranteed contracts

To provide for guaranteed project expenses, the reserve for guaranteed contract is recorded as an estimate of future expenditures based on historical experience.

(n) Employees' retirement benefits

Allowance for employees' retirement benefits are provided for based on the projected retirement benefits obligation and the pension fund assets.

Actuarial losses (gains) are amortized (accumulated) from the following year using the straight-line method over a certain number of years within the average remaining work period of employees.

Past service costs are amortized using the straight-line method over a certain number of years within the average remaining work period of employees.

(o) Foreign currency translations

The assets, liabilities, income and expenses of overseas subsidiaries are translated at the exchange rates prevailing at the balance-sheet date. Translation differences are included as minority interests in consolidated subsidiaries and a component of foreign exchange translation adjustments in shareholders' equity.

(p) Accrued losses on sales contracts

Among sales orders on hand at the balance sheet date, for projects in which the estimated cost is expected to exceed the amount of the sales order by a wide margin, accrued losses on sales contracts are recognized at the estimated aggregate amount of such losses.

(q) Income taxes

Deferred tax assets and liabilities are determined based on the differences between financial reporting and the tax bases of the assets and liabilities, and are measured using the enacted tax rates and laws, announced by the year-end.

(r) Elimination of intercompany investments and relevant shareholders' equity

At the date of acquisition, the cost of the Companies' investment in a subsidiary is allocated to the subsidiary's individual identifiable assets and liabilities on the basis of their fair value. Any difference between the cost of the Companies' investment and the Companies' share in the amount allocated to individual identifiable assets and liabilities is amortized through the estimated effective period of the investment, with the exception that when the amount of the resulting difference is immaterial, it is charged or credited to income as incurred.

(s) Appropriations of retained earnings

Appropriations of retained earnings with respect to each year ended March 31 are retroactively reflected in the consolidated financial statements for each applicable period on the assumption that the shareholders' approval relating to such appropriations is retroactively effective at each year end.

(t) Cash and cash equivalents

The Companies substantially consider all highly liquid low-risk investments purchased with original maturities of three months or less to be cash equivalents.

(u) Amounts per share

Net income per share of common stock is computed by dividing net income available to common stockholders by the weighted

average number of shares of common stock outstanding during each period. Shareholders' equity is computed based on the number of shares of common stock outstanding at each

balance sheet date. Cash dividends per share shown for each period in the consolidated statements of income represent the dividends applicable to the respective year.

3. Marketable securities and investment securities

A summary of other securities with stated market prices at March 31, 2005, is as follows:

	Millions of yen		
	2005		
	Acquisition cost	Amount recorded in the balance sheet	Difference
Other securities whose market prices exceed their acquisition cost recorded in the balance sheet:			
Equity securities	¥26,037	¥83,941	¥57,904
Debt securities	—	—	—
Other	—	—	—
Subtotal	¥26,037	¥83,941	¥57,904
Other securities whose market prices do not exceed their acquisition cost recorded in the balance sheet:			
Equity securities	¥ 1,236	¥ 1,207	¥ (29)
Debt securities	—	—	—
Other	—	—	—
Subtotal	¥ 1,236	¥ 1,207	¥ (29)
Total	¥27,273	¥85,148	¥57,875

A summary of other securities with stated market prices at March 31, 2006, is as follows:

	Millions of yen			Thousands of U.S. dollars		
	2006			2006		
	Acquisition cost	Amount recorded in the balance sheet	Difference	Acquisition cost	Amount recorded in the balance sheet	Difference
Other securities whose market prices exceed their acquisition cost recorded in the balance sheet:						
Equity securities	¥22,962	¥101,032	¥ 78,070	\$ 195,471	\$ 860,066	\$ 664,595
Debt securities	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	¥22,962	¥101,032	¥ 78,070	\$ 195,471	\$ 860,066	\$ 664,595
Other securities whose market prices do not exceed their acquisition cost recorded in the balance sheet:						
Equity securities	¥ 1,207	¥ 932	¥ (275)	\$ 10,275	\$ 7,934	\$ (2,341)
Debt securities	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	¥ 1,207	¥ 932	¥ (275)	\$ 10,275	\$ 7,934	\$ (2,341)
Total	¥24,169	¥101,964	¥ 77,795	\$ 205,746	\$ 868,000	\$ 662,254

A summary of other securities which were sold in the years ended March 31, 2006 and 2005, is as follows:

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			2006		
	Selling prices	Amount of gain on sales	Amount of loss on sales	Selling prices	Amount of gain on sales	Amount of loss on sales	Selling prices	Amount of gain on sales	Amount of loss on sales
Other securities	¥21,692	¥18,524	¥2	¥20,811	¥15,314	¥13	\$184,660	\$157,691	\$17

A summary of securities without stated market prices at March 31, 2006 and 2005, is as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
	Amount recorded in the balance sheet	Amount recorded in the balance sheet	Amount recorded in the balance sheet
Held-to-maturity securities:			
Commercial paper	¥15,994	¥ 6,608	\$136,154
Other securities:			
Negotiable certificates of deposit	5,000	5,000	42,564
Bond investment trusts	1	1	9
Unlisted equity securities except for those traded on the over-the-counter market	18,454	16,853	157,095

The contractual maturities of held-to-maturity securities as of March 31, 2006 and 2005 are as follows:

	Millions of yen						Thousands of U.S. dollars		
	2006			2005			2006		
	Due within one year	Due after one year through five years	Due after five years through ten years	Due within one year	Due after one year through five years	Due after five years through ten years	Due within one year	Due after one year through five years	Due after five years through ten years
Debt securities:									
Public bonds	¥ —	¥ —	¥ —	¥ —	¥ —	¥ —	\$ —	\$ —	\$ —
Corporate bonds	—	—	—	—	—	—	—	—	—
Commercial paper	15,994	—	—	6,608	—	—	136,154	—	—
Other	—	—	—	—	—	—	—	—	—
Other:	—	—	—	—	—	—	—	—	—
Negotiable certificates of deposit	5,000	—	—	5,000	—	—	42,564	—	—
Other	—	—	—	—	—	—	—	—	—
Debt securities:	—	—	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—	—	—
Total	¥20,994	¥ —	¥ —	¥11,608	¥ —	¥ —	\$178,718	\$ —	\$ —

4. Inventories

Inventories at March 31, 2006 and 2005, are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
	Finished goods	¥ 19,714	¥ 20,837
Contracts in process	44,306	259,635	377,169
Work in process	61,906	35,314	526,994
Raw materials and supplies	283,094	55,157	2,409,925
Total	¥409,020	¥370,943	\$3,481,910

5. Depreciation of plant and equipment

Depreciation of most plant and equipment is computed by the declining-balance method; however, the Company and certain consolidated subsidiaries partially adopt the straight-line method.

The estimated useful lives for depreciation of major items of plant and equipment are summarized as follows:

March 31	Years	
	2006	2005
Buildings and structures:		
Metal-frame manufacturing buildings	31-38	31-38
Building berths	24	24
Docks	45	45
Machinery and equipment	10-13	10-12

6. Losses on impairment of fixed assets

(a) The groups of assets for which the Companies recognized impairment losses for the year ended March 31, 2006 are as follows.

Use	Location	Type of assets	Millions of yen	The method to calculate
Assets for business	Inashiki city, Ibaragi and others	Land and building, etc	854	use value
Assets for rent	Chuo-ku, Tokyo and others	Land and building, etc	7,485	use value or net sales value
Idle assets	Brazil and others	Land and building, etc	4,930	net sales value

(b) The method to group the assets

Assets are grouped mainly by each works, and each asset for rent or idle asset is treated as one of groups.

(c) The circumstances in that impairment loss was recognized

Some of the assets groups, its business profit had gone down or its market price had come down, the Companies reduced the book value of such assets group to the recoverable amounts.

(d) The method to calculate the recoverable amounts

The recoverable amounts were calculated with either the net sales value of these assets which was adjusted reasonably, such as the price of expert opinion, assessment for fixed asset tax and etc, or use value (discount rate which is mainly 5.0%).

(e) Impairment losses

The amount of impairment losses for the year ended March 31, 2006 was ¥13,269 million (\$112,956 thousand) and consisted of the following.

	Millions of yen	Thousands of U.S. dollars
	2006	2006
Land	¥12,182	\$ 103,703
Buildings etc	1,087	9,253
Total	¥13,269	\$ 112,956

7. Short-term bank loans, long-term loans and debentures

The weighted interest rates on short-term bank loans were 0.87 percent at March 31, 2006, and 0.66 percent at March 31, 2005.

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

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Banks and insurance companies, bearing interest rates from 0.1 percent to 4.3 percent	¥179,351	¥174,469	\$1,526,781
Government-owned banks, bearing interest rates from 0.7 percent to 5.4 percent	21,819	18,126	185,741
National and local government agencies, bearing interest rates at 0.3 percent	351	425	2,988
Debentures, bearing interest rates from 0.6 percent to 1.8 percent	123,000	113,000	1,047,076
Others, bearing interest rates from 0.8 percent to 3.6 percent	10,259	10,506	87,333
Less current portion	(52,998)	(69,708)	(451,162)
Net long-term loans and debentures	¥281,782	¥246,818	\$2,398,757

The aggregate annual maturities of long-term loans and debentures at March 31, 2006, are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Year ending March 31,		
2007	¥ 52,998	\$ 451,162
2008	109,732	934,128
2009	48,697	414,548
2010	58,126	494,816
2011 and after	65,227	555,265
Total	¥334,780	\$2,849,919

8. Assets pledged as collateral

The following assets were pledged as collateral at March 31, 2006 and 2005:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Cash and time deposits	¥ 550	¥ 564	\$ 4,682
Trade receivables	651	661	5,542
Inventories	4	2	34
Buildings and structures	4,017	4,253	34,196
Machinery and equipment	3,575	3,757	30,433
Land	21,677	24,492	184,532
Investment securities	6,168	7,699	52,507
Total	¥36,642	¥41,428	\$311,926
Property, plant and equipment pledged as industrial factory foundation included in the above assets:			
Buildings and structures	¥ 1,912	¥ 1,755	\$ 16,276
Machinery and equipment	3,077	3,203	26,194
Land	10,651	11,684	90,670
Total	¥15,640	¥16,642	\$133,140

The obligations collateralized by the forementioned assets at March 31, 2006 and 2005, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Short-term loans	¥ 7,828	¥ 9,026	\$ 66,638
Long-term loans	11,822	14,722	100,638
Other long-term liabilities	15,544	16,297	132,324
	¥ 35,194	¥ 40,045	\$ 299,600

9. Deferred tax assets and liabilities

Significant components of the Companies' deferred tax assets and liabilities at March 31, 2006 and 2005, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Allowances for employees' bonuses	¥ 6,930	¥ 7,300	\$ 58,994
Reserve for losses on sales contracts	8,720	8,390	74,232
Reserve for guaranteed contracts	4,752	3,764	40,453
Allowances for employees' retirement benefits	59,480	57,511	506,342
Allowances for doubtful receivables	3,171	3,538	26,994
Losses on valuation of contracts in process	—	2,676	—
Adjustment for taxable income on percentage-of-completion basis	2,243	2,368	19,094
Elimination of unrealized profits	3,851	4,032	32,783
Net loss carried forward	8,155	18,512	69,422
Losses on valuation of investment securities	4,976	4,395	42,360
Losses on impairment of fixed assets	5,722	—	48,710
Other	19,274	11,367	164,076
Valuation allowance	(35,457)	(29,076)	(301,839)
	91,817	94,777	781,621
Deferred tax liabilities:			
Differed gains on sales of property, plant and equipment	339	347	2,886
Unrealized holding gain on other securities	31,718	23,582	270,009
Other	696	457	5,925
	32,753	24,386	278,820
Net deferred tax assets	¥ 59,064	¥ 70,391	\$ 502,801

10. Research and development expenses

Research and development expenses, included in product cost, and selling, general and administrative expenses, were ¥21,603 million (\$183,902 thousand) and ¥21,207 million for the years ended March 31, 2006 and 2005, respectively.

11. Contingent liabilities

Contingent liabilities for trade notes receivable discounted and endorsed in the ordinary course of business amounted to ¥6,723 million (\$57,232 thousand) and ¥5,697 million at March 31, 2006 and 2005, respectively.

Contingent liabilities for guarantees of debts of unconsolidated subsidiaries and others amounted to ¥6,611 million (\$56,278 thousand) and ¥15,168 million at March 31, 2006 and 2005, respectively.

Contingent liabilities arising from similar guarantees of debts amounted to ¥21,681 million (\$184,566 thousand) and ¥22,914 million at March 31, 2006 and 2005, of which ¥18,871 million (\$160,645 thousand) and ¥19,744 million at March 31, 2006 and 2005, respectively, were for employee housing loans which were secured by life insurance and loan insurance, and therefore, the Companies were at low risk.

Contingent liabilities arising from obligation to repurchase receivables sold by the Companies amounted to ¥448 million (\$3,814 thousand) at March 31, 2006.

12. Other income (expense)—other, net

Other income (expense)—other, net, consists of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Gains on sales of securities	¥ 18,509	¥ 15,301	\$ 157,564
Gain on foreign exchange	1,113	895	9,475
Idle-assets administrative expenses	(1,162)	(1,571)	(9,892)
Losses on disposal of property, plant and equipment	(8,513)	(3,098)	(72,470)
Equity in gains of unconsolidated subsidiaries and affiliates	1,441	1,474	12,267
Provision for employees' retirement allowances for prior period	—	(4,414)	—
Losses on impairment of fixed assets	(13,269)	—	(112,956)
Losses on valuation of stock of affiliated company	(675)	—	(5,746)
Losses on valuation of investment securities	—	(1,532)	—
Reversal profit from allowance for doubtful receivables	973	—	8,283
Gains on sale of property, plant, land and equipment	19,988	8,067	170,154
Gain on sale of the beneficiary rights to the trusts of Yokohama-South Distribution Center	—	2,382	—
Losses relating to violation of antitrust laws	(1,870)	—	(15,919)
Counterinsurgency expenses at overseas construction sites	(1,500)	—	(12,769)
Restructuring-related losses	(7,386)	(5,867)	(62,876)
Other, net	(6,872)	(6,809)	(58,500)
Total	¥ 777	¥ 4,828	\$ 6,615

The loss of ¥2,915 million (\$24,815 thousand) and ¥1,267 million in the above "Loss on disposal of property, plant and equipment" for 2006 and 2005 are related to the Toyosu area development project.

And the gain of ¥19,762 million (\$168,230 thousand) in the above "Gain on sale of property, plant, land and equipment" for 2006 is land selling of Tanashi Aero-Engine Plant.

13. Revaluation of land

In accordance with the "Law Concerning Revaluation of Land" enacted on March 31, 1998, two of the consolidated subsidiaries revalued land for business.

The Companies recorded the effect on the revaluation, after deducting deferred tax liabilities on land which were recorded as long-term liabilities, and minority interests which was included in minority interests in consolidated subsidiaries.

Book value of land before revaluation	¥2,532 million
Book value of land after revaluation	¥12,567 million
Dates of revaluation	March 31, 2000 and September 30, 2000

The difference between the market value of land at the end of the year that was revalued in the previous year and book value after revaluation was ¥4,857 million (\$41,347 thousand) and ¥4,220 million at March 31, 2006 and 2005, respectively.

14. Leases

(a) Finance leases (Lessee)

The following pro forma amounts represent the acquisition costs, accumulated depreciation, accumulated impairment loss and net book value of the leased property as of March 31, 2006 and 2005, which would have been reflected in the balance sheets if finance lease accounting had been applied to the finance leases currently accounted for by the operating lease accounting method:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Acquisition costs:			
Buildings and structures	¥ 180	¥ 180	\$ 1,532
Machinery and equipment	19,986	19,041	170,137
Software	898	770	7,645
Total	¥21,064	¥19,991	\$179,314
Accumulated depreciation:			
Buildings and structures	¥ 119	¥ 99	\$ 1,013
Machinery and equipment	11,556	10,321	98,374
Software	503	366	4,282
Total	¥12,178	¥10,786	\$103,669
Accumulated Impairment loss:			
Buildings and structures	¥ —	¥ —	\$ —
Machinery and equipment	5	—	43
Software	—	—	—
Total	¥ 5	¥ —	\$ 43
Net book value:			
Buildings and structures	¥ 61	¥ 81	\$ 519
Machinery and equipment	8,425	8,720	71,720
Software	395	404	3,363
Total	¥ 8,881	¥ 9,205	\$ 75,602

Concerning the above finance lease transactions, the lease payments, reversal of allowance for impairment losses on leased property, estimated depreciation cost which is mainly calculated as ten-ninths of the amount computed by the declining-balance method over the respective lease terms and assuming a 10% scrap value, estimated interest expense and losses on impairment of leased property for the years ended March 31, 2006 and 2005, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Lease payments	¥3,443	¥3,114	\$29,310
Reversal of allowance for impairment losses on leased property	11	—	94
Estimated depreciation cost	2,953	3,051	25,138
Estimated interest expense	378	381	3,218
Losses on impairment of leased property	13	—	111

Future minimum lease payments subsequent to March 31, 2006 and 2005, for finance leases accounted for as operating leases are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Within one year	¥ 3,077	¥ 2,902	\$ 26,194
Thereafter	9,053	9,691	77,066
Total	¥ 12,130	¥ 12,593	\$ 103,260

(b) Operating leases (Lessee)

Future minimum lease payments subsequent to March 31, 2006 and 2005, for non-cancelable operating leases are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Within one year	¥ 2,942	¥ 710	\$ 25,045
Thereafter	26,670	1,328	227,036
Total	¥ 29,612	¥ 2,038	\$ 252,081

(c) Finance leases (Lessor)

The following amounts are the acquisition costs, accumulated depreciation and net book value of property leased to others under finance leases at March 31, 2006 and 2005, to which the Companies have adopted the operating lease accounting method:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Acquisition costs:			
Buildings and structures	¥2,041	¥2,041	\$17,375
Machinery and equipment	3,420	2,399	29,113
Total	¥5,461	¥4,440	\$46,488
Accumulated depreciation:			
Buildings and structures	¥ 423	¥ 338	\$ 3,601
Machinery and equipment	674	402	5,738
Total	¥1,097	¥ 740	\$ 9,339
Net book value:			
Buildings and structures	¥1,618	¥1,703	\$13,774
Machinery and equipment	2,746	1,997	23,376
Total	¥4,364	¥3,700	\$37,150

Concerning the above finance leases, the lease payments, depreciation cost and estimated interest income for the years ended March 31, 2006 and 2005, are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Recorded lease payments	¥733	¥955	\$6,240
Recorded depreciation cost	589	591	5,014
Estimated interest income, assuming that the finance lease accounting had been adopted	333	350	2,835

Future minimum lease payments subsequent to March 31, 2006 and 2005, for finance lease transactions accounted for by the operating lease accounting method are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Within one year	¥ 521	¥ 360	\$ 4,435
Thereafter	4,187	3,494	35,643
Total	¥4,708	¥3,854	\$40,078

(d) Operating leases (Lessor)

Future minimum lease payments subsequent to March 31, 2006 and 2005, for non-cancelable operating leases were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Within one year	¥ 37	¥ —	\$ 315
Thereafter	402	—	3,422
Total	¥ 439	¥ —	\$ 3,737

Impairment losses on leased property were not recognized.

15. Derivatives

(a) Foreign currency

The Companies had no outstanding forward foreign exchange contracts in the years ended March 31, 2006 and 2005, as hedge accounting was applied to all derivative transactions.

(b) Interest rate

As of March 31, 2006, notional amounts, market prices and valuation gains/losses for derivative transactions were as follows:

	Millions of yen				Thousands of U.S. dollars			
	Notional amount	Over one year	Market prices	Valuation loss	Notional amount	Over one year	Market prices	Valuation loss
Interest-rate swaps								
Receipts floating payments fixed	¥18,898	¥18,898	¥(410)	¥(410)	\$160,875	\$160,875	\$(3,490)	\$(3,490)
Payments floating receipts fixed	¥18,898	¥18,898	¥168	¥168	\$160,875	\$160,875	\$1,430	\$1,430
Total	¥37,796	¥37,796	¥(242)	¥(242)	\$321,750	\$321,750	\$(2,060)	\$(2,060)

16. Retirement benefits

The Company and domestic subsidiaries have defined benefit pension plans, and certain overseas subsidiaries have lump-sum retirement payment plans. In addition, an employee, if eligible, may receive additional payments under the plans.

The following information is a summary of the plans:

March 31	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation	¥(178,761)	¥(189,503)	\$(1,521,759)
Fair value of plan assets	3,509	3,316	29,872
Funded status	(175,252)	(186,187)	(1,491,887)
Unrecognized actuarial losses	23,316	34,452	198,485
Unrecognized past service costs	1,600	1,647	13,620
Obligation recognized in the consolidated balance sheet	¥(150,336)	¥(150,088)	\$(1,279,782)
Allowance for employees' retirement benefits	¥(150,336)	¥(150,088)	\$(1,279,782)

Components of net periodic pension cost:

Year ended March 31	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service cost benefits earned during the year	¥ 9,549	¥ 9,674	\$ 81,289
Interest cost on projected benefit obligation	3,649	3,822	31,063
Expected return on assets	(29)	(30)	(247)
Amortization of transition obligation	—	4,409	—
Amortization of actuarial losses	3,714	3,353	31,617
Amortization of past service costs	155	25	1,319
Additional payments	1,030	171	8,768
Net periodic pension cost	¥ 18,068	¥ 21,424	\$ 153,809

	2006	2005
Assumptions used in the actuarial calculation were:		
Actuarial cost method:	Projected unit credit method	Projected unit credit method
Discount rate:	2.00%	2.00%
Expected rate of return:	1.50%	1.50%
Amortization period for past service costs (within the employees' average remaining years of service):	13 years	13 years
Amortization period for actuarial losses (within the employees' average remaining years of service):	13 years	13 years
Amortization period for transition obligation:	—	5 years

17. Segment information

(a) Industry segments

Industry segment information of the Companies for the years ended or as of March 31, 2006 and 2005, is shown below:

Millions of yen									
Year ended or as of March 31, 2006	(1)	(2)	(3)	(4)	(5)	(6)	Total	Eliminations and Corporate	Consolidated
Sales and operating income:									
Sales to outside customers	¥ 169,714	¥ 145,188	¥ 297,625	¥ 264,452	¥ 114,869	¥ 135,227	¥1,127,075	¥ —	¥1,127,075
Intersegment sales and transfers	15,783	17,167	13,490	4,999	1,352	27,999	80,790	(80,790)	—
Total	185,497	162,355	311,115	269,451	116,221	163,226	1,207,865	(80,790)	1,127,075
Operating expenses	188,259	154,818	304,070	252,997	124,869	161,510	1,186,523	(81,219)	1,105,304
Operating income (loss)	¥ (2,762)	¥ 7,537	¥ 7,045	¥ 16,454	¥ (8,648)	¥ 1,716	¥ 21,342	¥ 429	¥ 21,771
Assets, depreciation expense and capital expenditures:									
Assets	¥ 165,838	¥ 122,689	¥ 303,159	¥ 332,112	¥ 141,506	¥ 243,187	¥1,308,491	¥ 153,305	¥1,461,796
Depreciation expense	1,227	3,082	4,699	11,452	2,818	3,119	26,397	3,446	29,843
Capital expenditures	2,281	4,798	3,259	10,865	1,760	7,130	30,093	3,568	33,661

Millions of yen									
Year ended or as of March 31, 2005	(1)	(2)	(3)	(4)	(5)	(6)	Total	Eliminations and Corporate	Consolidated
Sales and operating income:									
Sales to outside customers	¥ 176,247	¥ 124,520	¥ 301,221	¥ 233,190	¥ 120,957	¥ 132,912	¥1,089,047	¥ —	¥1,089,047
Intersegment sales and transfers	11,953	19,449	13,712	5,188	1,161	29,198	80,661	(80,661)	—
Total	188,200	143,969	314,933	238,378	122,118	162,110	1,169,708	(80,661)	1,089,047
Operating expenses	191,384	141,877	308,176	225,366	135,671	157,192	1,159,666	(81,238)	1,078,428
Operating income (loss)	¥ (3,184)	¥ 2,092	¥ 6,757	¥ 13,012	¥ (13,553)	¥ 4,918	¥ 10,042	¥ 577	¥ 10,619
Assets, depreciation expense and capital expenditures:									
Assets	¥ 176,377	¥ 104,736	¥ 275,443	¥ 274,827	¥ 139,767	¥ 213,433	¥1,184,583	¥ 203,255	¥1,387,838
Depreciation expense	2,039	3,649	3,891	10,785	3,002	4,999	28,365	2,791	31,156
Capital expenditures	1,394	3,582	2,817	10,104	1,704	6,904	26,505	1,809	28,314

Thousands of U.S. dollars									
Year ended or as of March 31, 2006	(1)	(2)	(3)	(4)	(5)	(6)	Total	Eliminations and Corporate	Consolidated
Sales and operating income:									
Sales to outside customers	\$ 1,444,743	\$ 1,235,958	\$ 2,533,626	\$ 2,251,230	\$ 977,858	\$ 1,151,162	\$ 9,594,577	\$ —	\$ 9,594,577
Intersegment sales and transfers	134,358	146,139	114,838	42,556	11,509	238,350	687,750	(687,750)	—
Total	1,579,101	1,382,098	2,648,463	2,293,786	989,367	1,389,512	10,282,327	(687,750)	9,594,577
Operating expenses	1,602,613	1,317,936	2,588,491	2,153,716	1,062,986	1,374,905	10,100,647	(691,402)	9,409,245
Operating income (loss)	\$ (23,512)	\$ 64,161	\$ 59,973	\$ 140,070	\$ (73,619)	\$ 14,607	\$ 181,680	\$ 3,652	\$ 185,332
Assets, depreciation expense and capital expenditures:									
Assets	\$ 1,411,748	\$ 1,044,428	\$ 2,580,736	\$ 2,827,207	\$ 1,204,614	\$ 2,070,205	\$11,138,938	\$ 1,305,056	\$12,443,994
Depreciation expense	10,445	26,236	40,002	97,489	23,989	26,552	224,713	29,335	254,048
Capital expenditures	19,418	40,844	27,743	92,492	14,983	60,696	256,176	30,374	286,550

Notes: i The Companies operate in six industry segments as follows:

- (1) *Logistics Systems and Structures Operations*
Material handling systems, physical distribution and factory automation systems, parking systems, bridges and others
- (2) *Industrial Machinery Operations*
Iron and steel manufacturing equipment, vehicular turbochargers, mass-produced machinery and others
- (3) *Energy and Plant Operations*
Boilers, gas turbines, components for nuclear power plants, environmental control systems, storage facilities and others
- (4) *Aero-Engine and Space Operations*
Jet engines, space-related equipment and others
- (5) *Shipbuilding and Offshore Operations*
Shipbuilding, ship repairs, offshore structures and others

(6) Other Operations

Diesel engines, agricultural machinery, construction machinery, construction materials, financing and services, marine transport and others

ii Operating expenses were entirely allocated to each industry segment.

iii Corporate assets, which amounted to ¥294,484 million (\$2,506,887 thousand) and ¥298,148 million as of March 31, 2006 and 2005, respectively, mainly consisted of cash, time deposits, marketable securities and insurance premiums paid of the Company and deferred income taxes.

iv Consolidated operating expenses represent cost of sales and selling, general and administrative expenses shown in the accompanying consolidated statements of income.

v Effective from the year ended March 31, 2006, the Company has adopted a new accounting standard for impairment of fixed assets. (See Note 2 (i)) This change does not have a material effect on the Segment information.

(b) Overseas sales

Year ended March 31, 2006	Millions of yen					
	Europe	Asia	North America	Central and South Americas	Others	Total
Overseas sales	¥52,596	¥127,613	¥120,440	¥10,650	¥68,294	¥379,593
Overseas sales as a percentage of consolidated net sales	4.7%	11.3%	10.7%	0.9%	6.1%	33.7%

Year ended March 31, 2005	Millions of yen					
	Europe	Asia	North America	Central and South Americas	Others	Total
Overseas sales	¥49,097	¥85,014	¥95,449	¥53,194	¥57,112	¥339,866
Overseas sales as a percentage of consolidated net sales	4.5%	7.8%	8.8%	4.9%	5.2%	31.2%

Year ended March 31, 2006	Thousands of U.S. dollars					
	Europe	Asia	North America	Central and South Americas	Others	Total
Overseas sales	\$447,740	\$1,086,346	\$1,025,283	\$ 90,661	\$581,374	\$3,231,404

Note: The countries included in each segment are as follows:

(1) Europe.....U.K., Germany, France, Italy, Ireland, Greece, Bulgaria, etc.

(2) Asia.....China, Taiwan, South Korea, Hong Kong, Thailand, Vietnam, Singapore, Malaysia, Indonesia, Philippines, India, Sri Lanka, etc.

(3) North America.....U.S.A., Canada

(4) Central and South Americas.....Brazil, Panama, etc.

18. Amounts per share

Year ended March 31	Yen		U.S. dollars
	2006	2005	2006
Net income	¥ 3.93	¥ 1.56	\$0.033
Cash dividends	2.00	—	0.017
Shareholders' equity	130.36	118.40	1.11

Report of Independent Auditors

Certified Public Accountants

Hibiya Kokusai Bldg.
2-2-3, Uchisaiwai-cho
Chiyoda-ku, Tokyo 100-0011
C.P.O. Box 1196, Tokyo 100-8641

Phone: 03-3503-1100

Fax: 03-3503-1197

The Board of Directors

Ishikawajima-Harima Heavy Industries Co., Ltd.

We have audited the accompanying consolidated balance sheets of Ishikawajima-Harima Heavy Industries Co., Ltd. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ishikawajima-Harima Heavy Industries Co., Ltd. and consolidated subsidiaries at March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

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

As discussed in Note 2(i) to the consolidated financial statements, effective April 1, 2006, Ishikawajima-Harima Heavy Industries Co., Ltd. and consolidated subsidiaries adopted the accounting standard for impairment of fixed assets.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1.

Ernst & Young Shin Nihon

June 28, 2006

Corporate Data

(As of March 31, 2006)

Head Office

Ishikawajima-Harima Heavy Industries Co., Ltd.
Toyosu IHI Building, 1-1, Toyosu 3-chome,
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Fax: +81-3-6204-8800
Internet home page: <http://www.ihl.co.jp/index-e.html>

Founded

1853

Incorporated

1889

Number of Employees (Non-Consolidated)

6,866

Transfer Agent

The Chuo Mitsui Trust and Banking Company, Ltd.

Consolidated Subsidiaries

84

Non-Consolidated Subsidiaries

49

Affiliates

60* (Note*: Includes 26 affiliates applying the equity method of accounting)

Stock Exchange Listings

Tokyo, Osaka, Nagoya, Fukuoka, Sapporo

Shares Outstanding

1,298,495,152

Number of Shareholders

114,008

Independent Auditors

Ernst & Young ShinNihon

Major Shareholders

Japan Trustee Services Bank, Ltd. (Standing proxy: Toshiba Corporation)* ¹	4.26%
The Daiichi Mutual Life Insurance Company	4.15%
Japan Trustee Services Bank, Ltd. (Holder in Trust)	3.56%
Mizuho Bank, Limited (Standing proxy: Trust & Custody Services Bank, Ltd.)* ²	3.36%
Nippon Life Insurance Company	2.62%
The Master Trust Bank of Japan, Ltd. (Holder in Trust)	2.17%
Sumitomo Life Insurance Company	2.04%
Mitsui Sumitomo Insurance Co., Ltd.	1.71%
IHI Customer Stock Ownership Association	1.64%
Chase Manhattan Bank GTS Clients Account escrow	1.61%

*¹ The shares of Ishikawajima-Harima Heavy Industries Co., Ltd. stock held by Toshiba Corporation are part of that company's retirement benefit trust and are deposited as trust assets at Mitsui Asset Trust and Banking Co., Ltd. Retirement Benefit Trust (for Toshiba Corporation). Voting rights for the shares are exercised in accordance with Toshiba Corporation instructions.

*² The shares of Ishikawajima-Harima Heavy Industries Co., Ltd. stock held by Mizuho Bank, Ltd. are part of that company's retirement benefit trust and are deposited as trust assets at Mizuho Trust & Banking Co., Ltd. Retirement Benefit Trust (for Mizuho Bank, Ltd.). Voting rights for the shares are exercised in accordance with Mizuho Bank, Ltd. instructions.

Investor Relations

If you have any questions or would like copies of any of our reports, please contact:

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Stock Performance of IHI and Average Trading Volume Per Day

