KAWASAKI HEAVY INDUSTRIES, LTD. ANNUAL REPORT 2000

# 2000 annual report

KAWASAKI HEAVY INDUSTRIES, LTD.

# Profile

Founded in 1878, Kawasaki Heavy Industries, Ltd. (KHI) is a leading comprehensive manufacturer of transportation equipment and industrial goods in the world. With a broad technological base that encompasses land, sea and air, KHI manufactures ships, rolling stock, aircraft and jet engines, refuse incinerators, industrial plants, steel structures and various manufacturing equipment and systems. KHI also produces such world-famous consumer products as Kawasaki brand motorcycles and Jet Ski® personal watercraft.

## Contents



Cover: *Max* Series E4 Shinkansen
*(featured on page 11)*

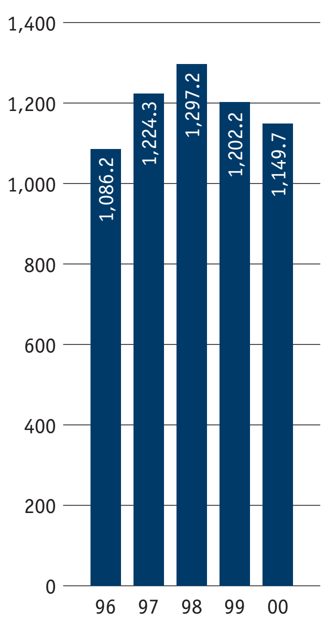
# Financial Highlights

Kawasaki Heavy Industries, Ltd. and consolidated subsidiaries
Years ended March 31, 2000, 1999 and 1998

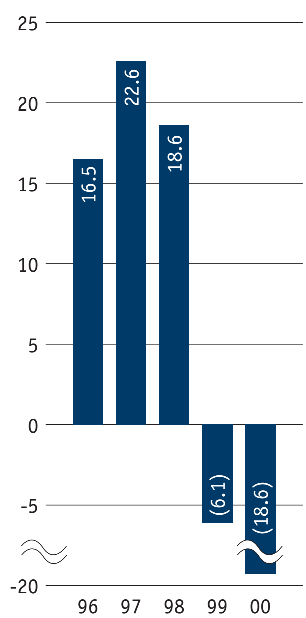
| | Millions of yen | | | Thousands of U.S. dollars |
|---|---|---|---|---|
| | **2000** | 1999 | 1998 | **2000** |
| For the year: | | | | |
| Net sales | **¥ 1,149,698** | ¥ 1,202,189 | ¥ 1,297,212 | **$10,830,881** |
| Net income (loss) | **(18,632)** | (6,132) | 18,556 | **(175,525)** |
| Capital expenditure | **37,513** | 40,428 | 42,928 | **353,396** |
| Depreciation and amortization | **35,081** | 34,607 | 32,416 | **330,485** |
| At year-end: | | | | |
| Total assets | **1,206,806** | 1,204,857 | 1,222,906 | **11,368,874** |
| Total shareholders' equity | **174,955** | 199,637 | 209,040 | **1,648,187** |
| Interest-bearing debt | **486,350** | 447,028 | 437,387 | **4,581,724** |
| Per share amounts (yen and U.S. dollars): | | | | |
| Net income (loss) | **¥ (13.4)** | ¥ (4.4) | ¥ 13.3 | **$ (0.13)** |
| Cash dividends | **—** | 6.0 | 6.0 | **—** |

*Note: The U.S. dollar amounts represent arithmetical results of translating Japanese yen to dollars on the basis of ¥106.15=$1, the rate prevailing as of March 31, 2000. These translations are solely for the convenience of the readers.*

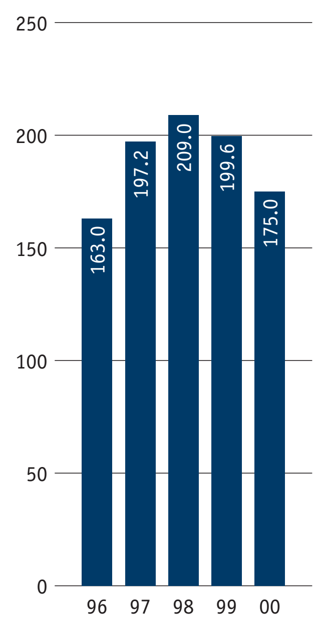
Net sales
(Billions of yen)




Net income
(Billions of yen)




Total shareholders' equity
(Billions of yen)



# To Our Shareholders

Amid harsh business conditions caused by a prolonged recession in Japan and the delayed recovery of other Asian economies, we focused on finding new opportunities for our products in Western markets, where growth was robust. Alongside this, we made further progress in radically lowering our cost base to improve earnings across our entire business.

For the fiscal year ended March 31, 2000 (fiscal 2000), sales of the Consumer Products segment were up slightly from the previous year, increasing 2.6% to ¥277.2 billion. However, sales fell in Transportation Equipment, Aerospace, Industrial Equipment and Other. As a result, total net sales declined 4.4% to ¥1,149.7 billion. Operating income slumped ¥20.4 billion, or 94.2%, to ¥1.3 billion, and the net loss for the year widened to ¥18.6 billion.

Sales fell in the face of a persistent economic downturn in Japan and slow growth throughout the rest of Asia. The strong yen compounded these problems. In terms of profits, margins declined substantially in our industrial equipment business. Another principal reason for our weaker performance were extraordinary losses including a write down of securities and prior period retirement allowances regarding designated subsidiaries.

In view of these losses, we elected not to pay a dividend for the fiscal year ended March 2000. We hope that our shareholders will understand and appreciate our position on this issue.

Owing to a sluggish pace of recovery, demand in the Japanese and other Asian markets remains depressed. The resulting intense competition is likely to cause ongoing erosion of selling prices. Combined with uncertainties over currency movements in foreign exchange markets and growing concerns about an economic slowdown in the United States, we expect general business conditions to remain harsh.

It is therefore imperative that we face and overcome these difficulties so that we can survive and continue to grow as a globally competitive company. Accordingly, we must reassess and reorganize our business as quickly as possible. To do so, we need to implement a raft of structural reforms so that we can shift to a mix of technologically advanced, high-value-added businesses–and, in the process, win the approval of capital markets.

Accordingly, we have designated the fiscal year ending March 2001 as a year of structural business reform. In the near-term, in addition to undertaking a radical review of our business structures, we plan to rapidly implement a series of measures designed to reduce our fixed cost base and thereby lower our break-even point.

Fundamentally, on a mid- to long-term basis, our primary objective is to strengthen our core businesses. In addition, we will undertake a comprehensive review of our shipbuilding operations targeting international competitiveness. In our industrial equipment business, which is afflicted by a combination of slumping demand and falling selling prices, we will selectively focus on, and direct resources toward, specific areas that are profitable as well as demonstrate future growth potential. Moreover, within this segment, we will reevaluate the production process, including the integration of facilities and other improvement measures.

We ask our shareholders for their continued support and understanding as we take on these important challenges.

July 2000

M. Tazaki

Masamoto Tazaki
President

KHI President Masamoto Tazaki speaks frankly about the critical need for change to ensure the future.

**Having taken up your new appointment as president, how do you intend to manage KHI during these difficult times?**

I have always regarded adversity as a positive advantage point when managing–difficulties need to be tackled with passion, energy and a spirit of challenge. My attitude is that, by tackling such obstacles, we can grasp an ideal opportunity to capture the lead over our competitors. In this way, I intend to take over at the helm of KHI with this same strong sense of determination.

Today's business environment is characterized by huge changes that are rapidly transforming the structure of our economy and society–indeed, you could say that we are at an historic turning point. We are in an age where the axiom "survival of the fittest" applies particularly strongly. Only those who force their own evolution to change will survive. At such a turning point, using the basic policy of enhancing customer satisfaction as embraced by our consumer products business as an example, we must revolutionize our thinking along these lines to grow as a company over the coming decades.

Traditionally, our portfolio includes an enormous number of products that are made to order, such as industrial plants, wherein cost reduction is necessarily a perennial issue. However, if we are to boost earnings and thrive during this era of mega-competition, we must move beyond conventional thinking of simply taking orders for custom-made products, and then seeking efficient ways to reduce costs.

As I mentioned above, in the consumer products business, raising customer satisfaction is a core concept. Even with those businesses that characteristically involve made-to-order products, we must work to assess customer needs, and then deliver "something different" that sets us apart from the competition at a price that creates value both for us as a company and for the customer. Through such value-added, differentiated products, I believe that we can increase customer satisfaction while generating profits. We also need to realize that raising customer satisfaction is as much about the development of technologies that will give our products a competitive edge as it is about after-sales service, or the total cost and performance over the life cycle of respective products.

Around the world, the Kawasaki brand name has a well-established image for high quality, high performance, and good service–especially in sports motorbikes. I want to transfer the benefits of that brand image to all our company's products. If we raise customer satisfaction and build up the Kawasaki brand image for all our operations, this will in turn enable us to realize the optimum means in truly creating something different.

The consumer products business also has another important asset that sets KHI apart from other firms–namely a marketing, production, sales, distribution and service network that spans the globe. In promoting globalization and efficiency across all business lines, from now, I want us to make increased use of this network, particularly in relation to our mass-produced industrial items.

**What issues will be important during the coming year of business reform?**

Above all, we need to put an end to the losses that have afflicted us for two years' running. We must stage a significant recovery in earnings. I have designated the coming year as one of business reform primarily to emphasize a fundamental shift in our management approach. Instead of pursuing volume, we need to pursue quality, namely a higher rate of earnings. Further, we need to build businesses that can produce strong profit levels without being contingent on scale.

Last year, we formulated a medium-term business plan that would take us through to the end of March 2004. Under the current business conditions, we must also switch the focus of this plan from quantity to quality on a clearly defined basis. I plan to complete the review of this process by the end of this year. However, as a first step in the practical implementation of this transition, we will be significantly reducing our fixed cost base through greater selectivity and focus. This will involve the integration of manufacturing plants and other measures to streamline our operations, principally in our plant engineering and steel structures businesses. My aim is to drastically lower our break-even point through such actions.

As a separate course of action, I also want to institute a much more rigorous internal evaluation system with regard to effectively managing the profitability of long-term and large-scale contracts. In reviewing KHI's performance over the past two years, losses incurred on major orders in the rolling stock and plant engineering divisions had a significant impact on our profitability. From now, we must be much more selective regarding respective projects in ensuring comprehensive analyses and avoidance of order-related contractual risks.

**In your view, what conditions do KHI's core businesses need to fulfill?**

I believe there are three conditions. First, the products must be highly competitive. This is fundamental for a manufacturer: unless the products enjoy a superior position in world markets in terms of their competitiveness on technical, sales and service fronts, they cannot be considered a core business. Second is the scale of operations. To develop a business on a global scale, I think it needs to have a turnover of at least $1 billion. Third, the market needs to be large and stable, or have high potential.

Judged on these criteria, KHI currently has five businesses that qualify as being core: rolling stock, aerospace, gas turbines, environmental plant and related products, and consumer products. We will invest in these five areas selectively and shift the focus of management resources accordingly.

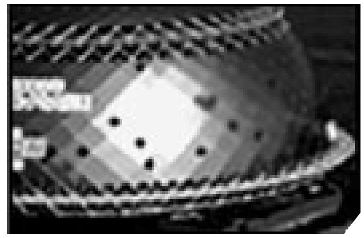
First of all, we are well positioned to expand our rolling stock business. Although revenues have not grown to the scale I just mentioned, we can leverage our position as a leading and highly regarded rolling stock manufacturer, in supplying markets in the United States and Asia, which demonstrate a substantial growth potential.

Next, aerospace fully satisfies the criteria for being a core business. We rank among the top makers of aircraft in Japan, and we have immense technical expertise in this field. In addition, there are high barriers to entry by new competitors, a stable demand in the defense industry, and considerable growth potential in the commercial aviation sector.

Gas turbines represents another field with the potential to grow into a core business. Although KHI's business for gas turbines is currently small in scale, further expansion is anticipated supported by the overall growth of the jet engine business. Increased demand is also expected for gas turbine generators, which we have developed capitalizing on original KHI technologies.

Additionally, environmental plant and related products is an area with tremendous opportunities in the future. At the moment, we are predominantly a manufacturer of municipal refuse incinerators, but in the future I want us to apply our accumulated engineering technical expertise in other businesses to this sector.

Finally, in consumer products, we rank among the four main world manufacturers of motorcycles. We are especially strong in the premium and sports motorbike classes. Having developed our business in Western markets, we see a lot of room for growth by developing our position in the expanding Asian market.



**What is KHI's financial strategy?**

In the short term, we need to return to the black and repair our balance sheet as a matter of urgency. However, I see my ultimate mission as senior management as the creation of enterprise value. Previously, I was talking about customer satisfaction. In the same vein, the most important product for me as a representative of top management is KHI stock, and the customers for that stock are KHI shareholders. So it is vital that we work to raise the satisfaction of these customers by maximizing enterprise value.

Specifically, if we are to survive and thrive over the coming decades, we must revitalize our operations by selectively investing our finite resources to the maximum effect. This involves becoming better versed in the thinking that we first introduced last year, when we started using return on invested capital as a key management indicator. It is vital that we begin to use our capital more efficiently than we have in the past.

It is also crucial that we gain the confidence of shareholders and investors in how we will generate earnings growth. For this reason, we must increase disclosure and accountability to shareholders in all aspects of our business performance, policies and strategy. This means building trust and boosting transparency.

Lastly, making a profit for our owners must be a foremost priority. I firmly believe that it is important to satisfy all our stakeholders. If we maximize enterprise value, then we can achieve objectives in this respect as well.

**Where do you want the KHI Group to be in, say, five years' time?**

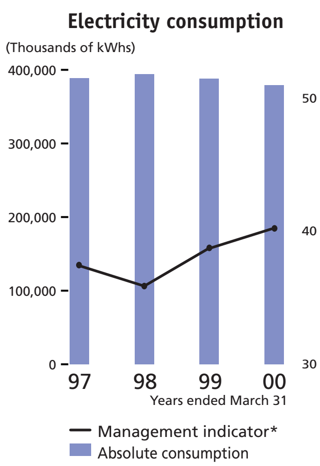
As a comprehensive heavy industries manufacturer, we benefit from the fact that cyclical variations in the earnings of our various businesses tend to complement each other. Through our varied product and customer mix, we can achieve a good balance between the private and public sectors, and between domestic and overseas markets. This makes it easier to manage the effects of fluctuations in exchange rates, public investment levels, and the state of the domestic economy. As well as financial synergy between the various parts of the business, we also derive operational synergy from a combination of the technological, manufacturing and sales expertise in each business. Finally, the high loyalty, transferability and quality of our employees afford us great versatility in combining the efforts of our various divisions.

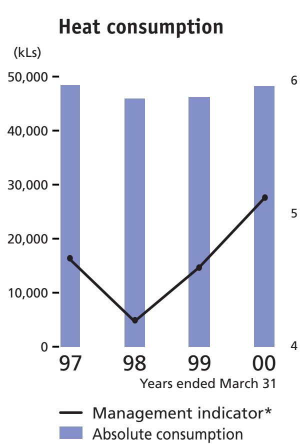
I believe that these are our fundamental strengths as a company. Through the policies I am proposing, we can take full advantage of such assets, by rebuilding our business model and developing multiple core businesses to provide stable revenue streams with growth potential. Once each business is able to operate as a financially independent entity, we will seek to further optimize the KHI Group management structure through consideration of such options as the establishment of separate companies, an internal company system, or a holding company structure. Regardless of such measures, we will endeavor to retain the aforementioned synergy-generating features.

My personal management philosophy is based on the concept of sustainable growth. By reforming our business and management structures along the lines I have discussed, and by applying our wholehearted efforts to the task, I believe we can make this company prosper again. I hope our shareholders will lend us their support.

# Concern for the Environment

Fiscal 2000 was the final year of the second three-year stage of KHI's environmental protection activities plan (EPAP). The primary focus during the year was to finalize the establishment and implementation of internal environmental management systems (EMS).




*Management indicator = absolute consumption (emission) volume/(non-consolidated sales (¥ billion) x10)

Alongside these measures, KHI established the fundamental concepts and policies as a framework for the company's environmental protection activities. To guide companywide progress on tackling environmental problems, a new Environmental Management Department was created in April 1999, while the KHI Environmental Charter was formulated in August. By establishing multiple goals in connection with its environmental protection program and pursuing the achievement of these objectives, KHI aims to make its operations more eco-friendly, while also contributing to the realization of a recycling-oriented society that is able to coexist in harmony with the environment.

## ENVIRONMENTAL MANAGEMENT SYSTEMS SET-UP

Within the scope of its global operations, KHI strives to be a positive contributor to the process of protecting the environment. The company aims not only to solve environmental problems, but also to help develop a truly eco-friendly and recycling-oriented society. By harmonizing its operations with the environment, and by developing technology and products that can help protect and preserve the environment, KHI hopes to contribute to the sustainable development of society. To realize these aims, KHI has been developing and implementing a range of practical environmental protection activities since 1994, when the company initiated the first stage of EPAP.

As previously noted, fiscal 2000 marked the final year of the second, three-year stage of EPAP, which began in April 1997. The principal objective of this stage was to construct EMS based on ISO14001 standards that would underpin KHI's environmental protection activities, and to gain ISO14001 certification for them.

The activities undertaken in fiscal 2000 tackled this challenge on a number of fronts.

First, KHI's basic EMS structure was completed during the year.

Under the current EMS, the Corporate Environment Committee promotes the environmental protection activities for the entire company. The Committee, being chaired by the board director in charge of KHI's overall environmental protection activities, plans and evaluates EPAP.

At the divisional level, the heads of each division are charged with the responsibility of implementing the division's environmental protection activities. They chair Divisional Environment Committees, which formulate divisional activities plans in line with EPAP, and oversee divisional activities. Each division is taking active measures to reduce the environmental impact of KHI's activities through reviewing its total business processes as a manufacturer–from R&D through to design, purchasing, manufacturing, distribution, use and disposal of its products.

Second, three divisions of KHI gained ISO14001 certification during fiscal 2000–namely, the Steel Structure & Industrial Equipment, the Gas Turbines, and the Consumer Products & Machinery. This brought the total number of KHI divisions that have gained ISO14001 certification to five, out of thirteen.

Third, in line with the establishment of the company's EMS, the KHI Environmental Charter was formulated in August 1999. This states the fundamental concept underlying the company's stance on the environment and outlines basic policies.

## ENVIRONMENTAL PROTECTION PERFORMANCE INDICATORS & COSTS

Energy-saving measures are a prime focus of KHI's environmental protection program. The company has drawn up several numerical energy-saving targets, using energy consumption per unit of non-consolidated sales as the corresponding management performance indicator. The performance targets set for fiscal 2000 were 1% reductions in the corresponding management indicators. However, primarily due to the 6.2% fall in non-consolidated sales during fiscal 2000 compared with the previous year, actual performance indicators of electricity, water and heat rose 4.0%, 5.2% and 11.2%, respectively. During fiscal 2000, absolute consumption of electricity, water and heat recorded decreases of 2.4% and 1.3%, and an increase of 4.3%, respectively, compared to the previous fiscal year. This led to a reduction in total energy costs in absolute terms of ¥132 million.

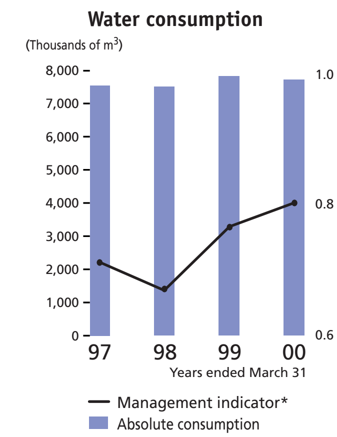
KHI is also working to conserve resources by reducing waste product volume produced by all its operations, and through a variety of companywide recycling programs. During fiscal 2000, the total amount of waste product volume was reduced by 3,204 tons, or 4.3%, to 71,922 tons. At 48,095 tons, the total volume of materials recycled was on a par with the previous year. The proportion of the waste product volume accounted for by recycling thus rose by 2.2 percentage points, to 66.9%.

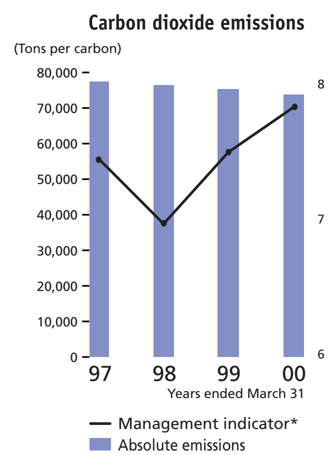
KHI is managing its use of chemicals to exercise greater control over their effects on the environment. Since 1997, the company has been voluntarily recording the amounts being handled of 178 separate chemical substances. This is in line with the Pollutant Release & Transfer Register (PRTR) system, which is scheduled to become mandatory following the enactment of Japanese legislation in April 2001. This system governs the release of specified chemical substances into the environment and any improvements made to the handling of such processes.

In compliance with the PRTR system, each KHI division keeps precise records of the amounts of these 178 chemicals that are purchased, used, discharged, or transferred. The two chemicals that have the greatest usage in volume terms within the company are xylene and toluene, which are used in paints and other coatings. In the future, KHI plans to switch to more eco-friendly paints.

The total cost of KHI's environmental protection measures during fiscal 2000 amounted to ¥7,772 million. This figure included environmental R&D costs of ¥6,100 million, calculated on an accrual base. As a proportion of non-consolidated sales, environmental costs rose 0.05 percentage point to 0.82%.

In November 1999, to improve disclosure of such actions in response to the demands of society, KHI issued its first environmental report. The company also created a special environmental section within its corporate home page.



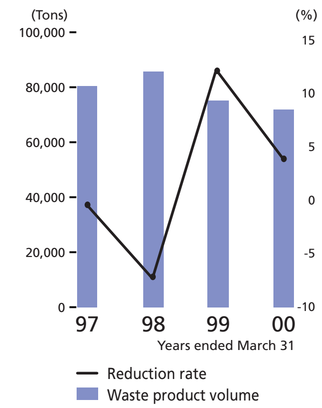




## MAKING BUSINESS MORE ECO-FRIENDLY

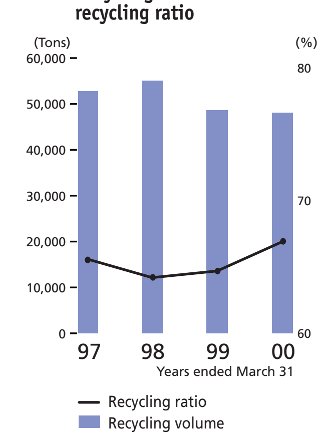
Modern society has changed immensely in economic terms, and now is much more highly focused on environmental concerns. In other words, the era of a society centered on the economics of mass production, mass consumption and mass disposal is at an end. In its place, the focus has shifted to making the most efficient use of resources over the life cycle

## Against this backdrop, KHI has formulated the third three-year stage of EPAP, which will cover the period ending in March 2003.

Waste product volume and reduction rates




Recycling volume and recycling ratio




of a product, from production through distribution, consumption and disposal. Within this context, the aim is to make society more oriented towards the recycling of all resources, thereby reducing the impact of economic activity on the environment. In Japan, legislation was passed in May 2000 based on this concept.

Against this backdrop, KHI has formulated the third three-year stage of EPAP, which will cover the period ending in March 2003. Based on the concepts and policies stated in KHI's Environmental Charter and on the company's EMS, this plan aims to establish an eco-friendly means of conducting business throughout the company. Specifically, the plan mandates KHI to make continuous progress on the following matters.

- Development of environmental protection measures on a companywide basis
- Compliance with environmental legislation and regulations
- Programs addressing global warming countermeasures
- Implementation of green purchasing
- Development of eco-friendly products
- Implementation of environmental performance evaluations
- Fuller disclosure of environmental actions via issuance of reports
- Implementation of environmental accounting

Green purchasing is one of the new initiatives in the third stage of KHI's EPAP. The company's green purchasing program will place environmental concerns alongside such traditional purchasing criteria as quality, cost and delivery lead time, with the idea being to give priority to the procurement of products and materials that reduce environmental impact as much as possible.

In assessing environmental impact, KHI will analyze and select purchased products over their entire life cycle, from raw material sourcing to final disposal. When suppliers are equivalent in terms of quality, cost and delivery, priority will be given to those that are more eco-friendly. To make such judgments, KHI will source environmental information on products from all of its suppliers.

In product development, KHI plans to introduce the use of Life Cycle Assessment (LCA) methodology to help design products that are kinder to the environment. As well as ensuring that products use and emit smaller quantities of environmental pollutants, conserve resources, save energy, and make use of sustainable resources, this process will help design products that can be used over a long period, and that are made out of recycled, reusable or recyclable materials. In addition, products will be designed for ease of disposal or ease of processing for recycling. During fiscal 2001, ahead of the introduction of LCA methodology, KHI aims to establish product environmental assessment methods.

As part of the third stage of the company's EPAP, KHI also plans to introduce environmental performance evaluations and environmental accounting. The former will be conducted via annual internal environmental audits by division. During fiscal 2001, KHI aims to introduce this practice throughout its operations. The environmental accounting system will be used to determine the precise costs and effects of environmental protection measures at divisional level. During fiscal 2001, as a means of identifying existing or potential problems, KHI will conduct a trial environmental accounting program in designated divisions using guidelines issued by Japan's Environment Agency.

Along with the environmental report for the whole of KHI, which was first issued in 1999, from 2000 onwards the company plans to begin issuing divisional reports on the environmental status of its individual businesses.

# Review of Kawasaki Global Operations

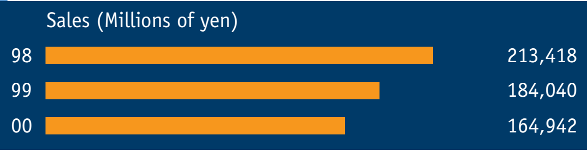
Transportation Equipment

Aerospace

Industrial Equipment

Consumer Products

# Transportation Equipment




**Main Products**

- LNG carriers
- LPG carriers
- Container ships
- VLCCs and other types of tankers
- Bulk carriers
- Highspeed vessels
- Submarines
- Maritime application equipment
- Electric cars (including Shinkansen)
- Electric and diesel locomotives
- Passenger coaches
- Integrated transit systems
- Monorail cars
- Platform screen doors

Due to increased overseas revenues, which derived mainly from contracts for U.S. customers, rolling stock sales rose. However, sales from ships declined, primarily due to the effects of the strong yen. Total segment sales for fiscal 2000 fell 10.4% to ¥164.9 billion.

Segment operating income was swayed by a number of factors. With most of the losses on large rolling stock contracts for U.S. customers having been recognized in the previous fiscal year, rolling stock largely improved in terms of profit performance. However, a slump in the prices of ships, combined with the strength of the yen, affected the profitability of ships. As a result, the segment registered an operating loss of ¥9.7 billion–though this was a 35.5% improvement on the previous year.

During fiscal 2000, KHI received orders for a total of nine vessels, including a submarine and seven container ships. However, previous orders for three VLCCs (very large crude-oil carriers) were canceled. Combined with a decline in large-scale orders for rolling stock from overseas customers, this resulted in a substantial decrease in the level of orders secured by the segment as a whole compared with the previous year.

KHI’s shipbuilding specialty is the construction of high-value-added and high-speed vessels. In particular, the company is one of the world's technologically most accomplished suppliers of LNG, LPG and other types of gas carriers. During fiscal 2000, KHI delivered a total of 12 vessels, including two VLCCs, one LNG carrier, one LPG carrier, and a submarine. However, the global shipbuilding industry still suffers from oversupply. The resulting intense competition continues to make business conditions harsh for KHI. The company is responding by focusing on its specialty areas, and by seeking alliances with other firms. In this way, this area of operations will strive to improve international competitiveness.

In terms of both operational scale and technical expertise–the latter deriving partly from the company's wealth of aerospace technology–KHI is Japan's leading rolling stock manufacturer. As such, it is supplying high-speed Shinkansen bullet trains to Japan Railways (JR) companies, and is participating in a number of development and manufacturing projects for various types of rolling stock. The company also actively supplies overseas orders. During fiscal 2000, domestic revenues included the sale of new types of Shinkansen bullet trains, such as the *Hikari Railstar* Series 700E to JR West and the *Max* Series E4 to JR East. Overseas, the division delivered subway cars for Singapore.

Owing to its efficiency as a mass transportation method and its environmental advantages, demand for railways continues to rise worldwide–particularly in big cities in the United States and Asia. By tapping its vast wealth of expertise and experience, and by using advanced technology, KHI plans to forge ahead as one of the leading global suppliers of rolling stock.

### Reggane LPG Carrier

Ordered by Sonatrach Petroleum Corporation of Algeria, this LPG (liquefied petroleum gas) carrier has an 84,000 m$^3$ capacity. The vessel's four independent gas storage tanks constructed using special steel keep the LPG at temperatures as low as -48°C. The ship also features advanced fire-prevention and fire-fighting facilities.

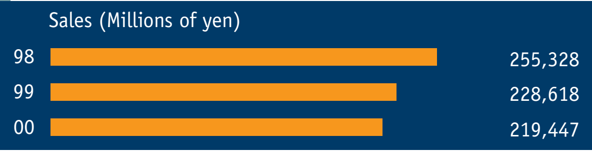

### *Max* Series E4 Shinkansen Bullet Train

Having produced *Max* series E4 Shinkansen bullet trains since their debut in December 1997, KHI delivered a E4 Shinakansen featuring the application of new, world-class technology in July 1999. Jointly developed by JR East and KHI, the nose structures of this new E4 are the first in the world to be constructed from carbon fiber-reinforced plastic (CFRP). By fully applying aerospace technology for compound materials, CFRP enables the production of a car body which is as strong or even stronger, as well as lighter and more classically streamlined compared with conventional aluminum models.

### Singapore Subway Cars

These cars have been designed to boost capacity on existing lines, and will also be used on the line to Changi Airport in Singapore scheduled to open in 2001. Fitted with wider seats, they provide increased comfort and safety. The trains incorporate improved external design features such as a renewed front view and painted outer panels.

# Aerospace




**Main Products**

T-4 intermediate jet trainers

CH-47, OH-1 and BK117 helicopters

Component parts for B777 and B767 passenger airplanes

Missiles

Electronic equipment

Space equipment

Jet engines

Gas turbines

During fiscal 2000, while sales to the Japan Defense Agency (JDA) rose, commercial aviation sales declined. Total segment sales decreased by 4.0% to ¥219.4 billion. Primarily due to the appreciation of the yen, segment operating income plunged 41.3% to ¥10.8 billion. With commercial aviation demand declining, orders received by the segment as a whole dipped below the level of the previous year.

KHI ranks among Japan's leading aircraft manufacturers, and is renowned internationally for its technological prowess. The company manufactures high-quality products, mainly aircraft and jet engines, for both the defense and commercial sectors. With regard to commercial business operations, KHI is a member of joint development and production programs for the Boeing 767 and 777 passenger airplanes. In the jet engine field, it has been involved in the V2500 international development and production project. KHI is also jointly developing and manufacturing aircraft engines with leading world suppliers such as Rolls-Royce of the U.K. for the RB211/Trent series and Pratt & Whitney of the United States for the PW4000 series.

During fiscal 2000, KHI commenced delivery of OH-1 light observation helicopter to JDA. In the commercial fields, one of the year's highlights was the establishment of a new business relationship with Embraer of Brazil for a joint development and manufacturing contract for the ERJ-170, a regional jet aircraft.

Defense programs remain a core revenue source, accompanied by a stable upward trend related to worldwide demand for commercial aircraft over the medium and long term. As one of Japan's leading aircraft manufacturers, KHI continues to be competitive internationally in terms of technology and quality. By capitalizing on such expertise, and through strengthening its network of alliances with overseas manufacturers, KHI continues to expand its business base in this segment. With its commercial aviation operations well positioned to grow, KHI's global aerospace business undoubtedly has a bright future.

### OH-1 Helicopter

As prime contractor, KHI started full-scale production of OH-1 light observation helicopter for the JDA back in 1998, with the first being delivered in January 2000. Developed and manufactured entirely in Japan, they will be used for Ground Self-Defense Force surveillance operations. As well as aerial reconnaissance, they can also be used for mid-air troop control and supervision.

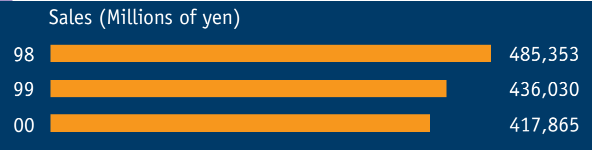
### BK117 Helicopter

Over 400 Kawasaki BK117 helicopters have been delivered around the world. Of these, 128 have gone to Japanese customers–such as the Yamaguchi Prefecture fire-prevention unit pictured here. The BK117 is being widely used by public services in a range of civilian applications, from personnel transport to fire-fighting and police operations. Advanced functionality and meticulous after-sales support have drawn high praise from many customers.

### Regional Jet Aircraft Development with Embraer

In October 1999, KHI concluded a joint development and manufacturing contract with Brazilian commercial aircraft manufacturer Embraer for the ERJ-170, a 70-seater regional jet aircraft. Concerning this project, the company will be responsible for the development, design and manufacture of major wing components wherein a high level of technical expertise is required.

# Industrial Equipment




**Main Products**

Steel making, cement, chemical and other industrial plants

Power plants

Municiple refuse incineration plants

Aero-derived gas turbine engines for naval vessels

Bridges

LNG and LPG tanks

Shield machines and tunnel boring machines

Crushing machinery

Industrial hydraulic equipment

Wheel loaders

Medium-sized gas turbine generators

In fiscal 2000, while sales of environmental plants and related products rose, sales pertaining to KHI's steel structures operations declined, owing to a fall in Japanese public-works spending. This resulted in a decrease in total segment sales, which fell 4.2% to ¥417.9 billion. Margins tumbled in both industrial plant and steel structures operations, producing a segment operating loss of ¥11.3 billion, compared with operating income of ¥0.7 billion in the previous year. Overall, orders received fell as a large increase in environment-related orders failed to offset a decline in orders for industrial plants and power plants.

KHI is regarded as a leading engineering expert involving a diverse range of industrial plant construction projects in Japan and abroad. In particular, the company's proven technical expertise in steel and cement plant engineering is noted as one of the highest in the world. Relating to its steel structures business, KHI has participated in the construction of a number of bridges and other major infrastructure projects. During the year, completed projects included a hot strip mill delivered to a Japanese steel maker and the glass dome of the Osaka Maritime Museum.

Both the industrial plant and steel structures businesses have been adversely affected by a prolonged recession in Japan and a slow recovery in Southeast Asia. Accordingly, KHI is currently undertaking measures aimed at accelerating the streamlining of its operations in these areas. In addition, by shifting resources and focusing on specialist areas and high-value-added products, the company plans to reinforce earnings, thereby establishing a strong base for future development.

In contrast, environmental plants and related products offer positive, long-term, growth prospects. KHI ranks in the top echelon of Japanese makers of municipal refuse incineration plants, both in terms of a solid customer base and technical expertise. Fiscal 2000 saw the delivery of a major municipal refuse incineration plant, the Kobe Clean Center. The company also undertook renovation of a number of existing facilities to eliminate dioxin emissions. KHI continues to develop and improve technologically advanced products that are expected to generate new business.

KHI is one of Japan's leading manufacturers of industrial hydraulic equipment and gas turbine generators, and is also developing its construction machinery business. Cooperating with the Consumer Products & Machinery Group, these businesses are enhancing their worldwide sales network to boost sales of such mass-produced industrial equipment.

## Kobe East Municipal Refuse Incineration Plant

Each of the three incinerators at this plant, known as the Kobe Clean Center, is capable of processing 300 tons of refuse per day. Fully fitted with anti-dioxin installations, it also features a highly efficient power generation system that converts any excess heat produced.

## Hot Strip Mill

KHI designed, developed, constructed and installed this hot strip mill for Nakayama Steel Works on a full turnkey basis, including all pilot-scale testing and civil engineering work. Fitted with a blast furnace and all the machines necessary to roll, cut and finish various thicknesses of steel, the mill boasts a compact design that saves space and energy.

## Osaka Maritime Museum Dome

The glass dome of the Osaka Maritime Museum, opened in July 2000, is a steel-framed hemisphere 35 meters high with a diameter of 70 meters. Constructed entirely at KHI's Harima Works, it was assembled from approximately 4,800 individual sheets of glass and then transported by sea to Osaka city.

# Consumer Products

Sales (Millions of yen)

| | |
|---|---|
| 98 | 259,107 |
| 99 | 270,021 |
| 00 | 277,176 |

**Main Products**

Motorcycles

All-Terrain Vehicles (ATVs)

Jet Ski® personal watercraft

General-purpose gasoline engines

Brush cutters

Transmissions

Industrial robots

Sales of motorcycles in the United States and Europe remained robust, and motorcycle demand in Asia also recovered. Sales of ATVs (All-Terrain Vehicles) and *MULE* utility vehicles also rose in the United States. As a result, despite the effects of the strong yen, segment sales rose slightly compared with the previous year, advancing 2.6% to ¥277.2 billion. However, the strength of the yen had a significant impact on profits. Despite higher earnings at KHI's U.S. subsidiaries, segment operating income fell 39.0% to ¥9.5 billion.

The Kawasaki brand name is widely associated with medium and large super sports bikes, and other top-of-the-range motorcycles. Other popular consumer products are ATVs and Jet Ski® watercraft, which KHI was the first firm in the world to commercialize successfully. These products are made at 16 manufacturing bases, and distributed globally through a total of over 6,000 dealerships around the world. During fiscal 2000, to extract greater synergy in manufacturing and sales from this network, industrial robots were transferred to this segment from the Industrial Equipment segment.

Demand in the major markets of Europe and North America is projected to demonstrate healthy growth. Demand should also continue to recover in Asian markets as their economies regain previous levels of growth. KHI is developing new Kawasaki brand products designed to cater to market trends and user needs. At the same time, KHI is focusing on building up its development, manufacturing and sales expertise to foster the growth of its global business.

Motor sports and marine sports remain the prime focus. Through the development of professional racing factory bikes, KHI uses the resulting stream of technical advances to make constant improvements to its commercial product range. While building the brand image, racing also helps to develop an avid fan base.

## Ninja ZX-12R Super Sports Bike

Incorporating KHI's state-of-the-art technology, the ZX-12R sits at the pinnacle of the Kawasaki super sports bike range. Featuring the world's first aluminum monocoque frame on a mass-production bike, it is powered by a water-cooled, 4-stroke, 4-cylinder, DOHC, 1,199cm³ engine. With a sleek, streamlined form, it displays a balance of power, handling and high-speed stability that make it one of the finest motorcycles available.

## Japan Superbike Championship

In the 2000 Japan Superbike Championship race series, Hitoyasu Izutsu competed for Kawasaki on a ZX-7RR. This bike has a water-cooled, 4-stroke, 4-cylinder, DOHC, 748cm³ engine.

## *MULE* 2510 Diesel

This model is the top of the range of the *MULE* utility vehicle series. Fitted with a water-cooled, 4-stroke, 3-cylinder, 953cm³ diesel engine, it was developed and is being manufactured under an alliance with a Japanese diesel engine maker.


## Z-Series Industrial Robots

This series of robots is designed to transport objects weighing between 130 and 300 kg. Featuring a compact design that enables them to take up little room, they also boast long reach and wide maneuverability.

With the economy hit by sluggish consumer spending and a downturn in capital investment, Japan's GDP contracted during the fiscal year ended March 31, 2000 (fiscal 2000).

# Financial Review

## OVERVIEW

During the fiscal year ended March 31, 2000 (fiscal 2000), KHI's net sales declined for a second consecutive year in the face of a persistent economic downturn in Japan and sluggish growth throughout the rest of Asia. These problems were further compounded by continued appreciation of the yen. With the exception of Consumer Products, which was taken out of the Transportation Equipment segment and reclassified as a segment on its own, all of KHI's business segments posted decreases in sales revenues. Total consolidated net sales fell 4.4% to ¥1,149.7 billion ($10,831 million).

## OVERSEAS SALES

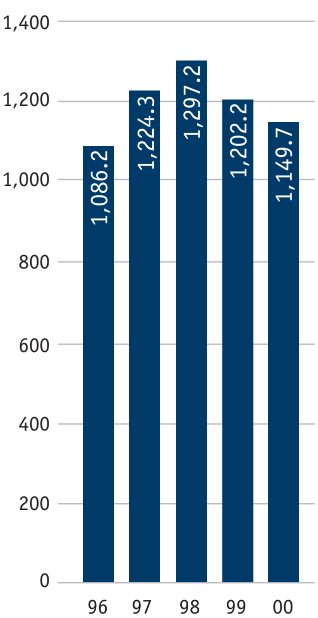
Total overseas sales fell ¥9.6 billion ($91 million), or 2.0%, to ¥461.5 billion ($4,348 million). This accounted for 40.1% of total sales, compared with a percentage of 39.2% in fiscal 1999. The breakdown of this sales figure between the four overseas regions was: North America ¥221.3 billion ($2,085 million), down 4.3%; Europe ¥94.0 billion ($885 million), up 7.2%; Asia ¥75.1 billion ($707 million), up 5.9%; and Other Areas ¥71.2 billion ($671 million), down 12.6%.

## NET INCOME

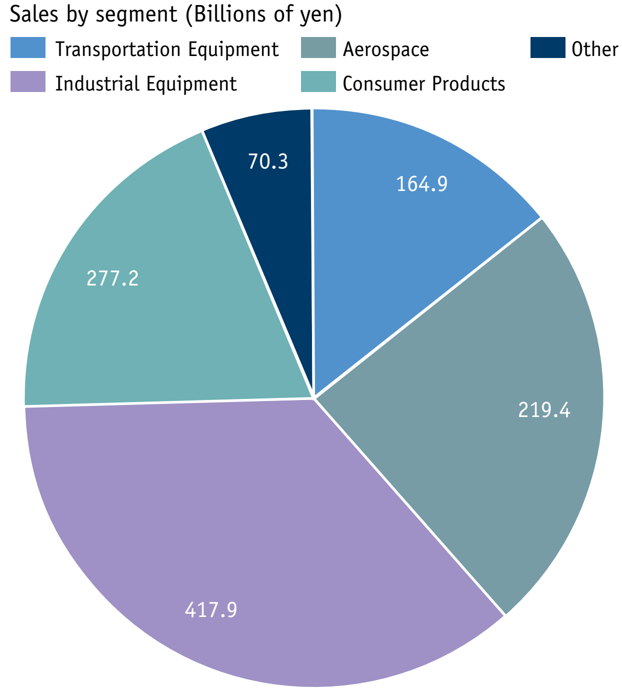
The ratio of the cost of sales to net sales rose 0.9 percentage point, from 86.9% to 87.8%. The ratio of selling, general and administrative (SGA) expenses to net sales rose 0.8 percentage point, from 11.3% to 12.1%. As a result, operating income plunged 94.2% to ¥1.3 billion ($12 million). The ratio of operating income to net sales fell 1.7 percentage points, from 1.8% to 0.1%.

Net other income (expenses) was an expense of ¥24.0 billion ($226 million), compared with an expense of ¥22.2 billion for fiscal 1999. This amount includes a ¥3.9 billion ($37 million) write-down of marketable securities, investments in securities and others, and a ¥2.7 billion ($26 million) prior-period retirement allowance, recorded as extraordinary losses. Loss before income taxes and minority interests totaled ¥22.7 billion ($214 million), compared with a loss of ¥0.5 billion for fiscal 1999. KHI adopted tax effect accounting beginning fiscal 1999, by which an amount of ¥9.5 billion ($89 million) was recorded as deferred income taxes for fiscal 2000.The net loss for the year increased from ¥6.1 billion to ¥18.6 billion ($176 million). The net loss per share amounted to ¥13.4 ($0.13), compared with a loss of ¥4.4 per share in fiscal 1999.

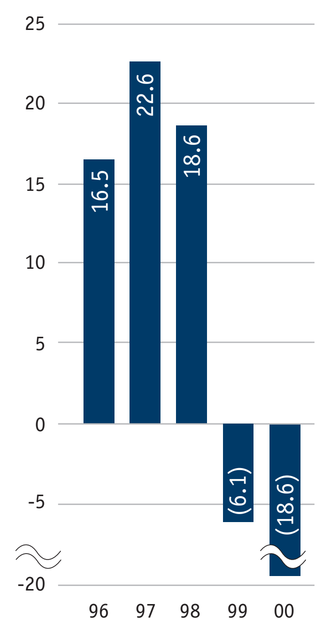
Net sales
(Billions of yen)




Sales by segment (Billions of yen)




Net income
(Billions of yen)



In view of the situation, management elected not to pay any cash dividends for fiscal 2000.

## RESULTS BY GEOGRAPHIC AREA

Sales in Japan declined 5.5% to ¥929.1 billion ($8,753 million), while operating income fell from a ¥27.3 billion profit in fiscal 1999 to a loss of ¥4.5 billion ($42 million), because the parent company was affected by continued appreciation of the yen, a persistent economic downturn in Japan and sluggish growth throughout the rest of Asia.

In North America, boosted by the recovery of a rolling stock subsidiary, sales rose 3.1% to ¥160.4 billion ($1,511 million). Following substantial losses on rolling stock contracts posted in fiscal 1999, operating income of ¥3.7 billion ($35 million) was recorded.

Due primarily to the substantial appreciation of the yen against the euro, sales in Europe fell 14.5%, to ¥39.6 billion ($373 million). At ¥0.8 billion ($8 million), operating income was down 36.3% compared with the previous year.

Sales in Asia increased sharply to ¥16.3 billion ($154 million), a 26.7% rise due mainly to higher sales of motorcycles. However, due to the continued affect of the currency crisis, the operating loss increased from ¥0.9 billion to ¥1.6 billion ($15 million).

At ¥4.3 billion ($40 million), sales in Other Areas were 5.6% below fiscal 1999. However, operating income was substantially higher, increasing 85.1% to ¥87 million ($819 thousand).

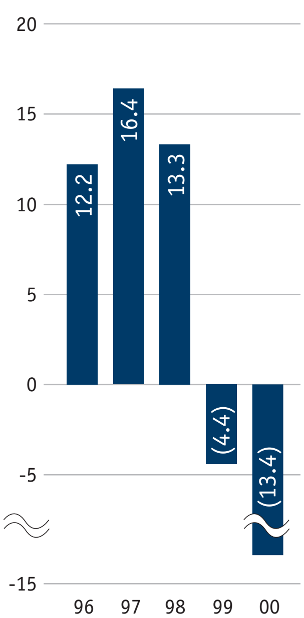
## R&D AND CAPITAL EXPENDITURES

Total consolidated R&D expenses during fiscal 2000 rose ¥1.3 billion to ¥19.9 billion ($188 million). This was equivalent to 1.7% of net sales. Capital expenditures on a cash flow basis during fiscal 2000 totaled ¥37.5 billion ($353 million), a decrease of 7.2% from fiscal 1999.

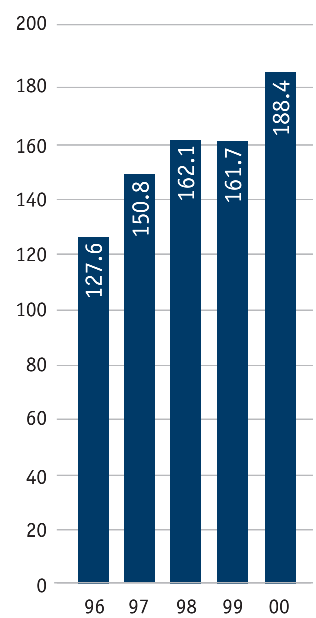
## CASH FLOWS

A decrease in inventories, combined with an increase in advances received, more than offset the cash outflow resulting from the consolidated loss before income taxes and minority

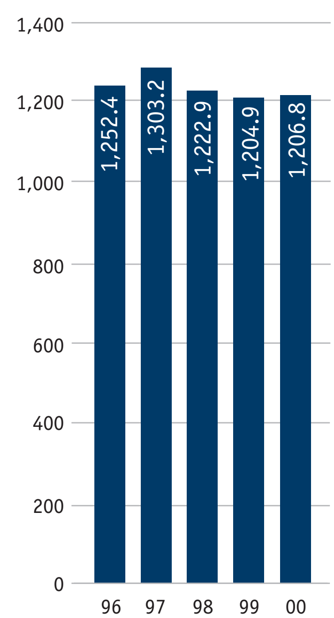
Net income per share
(Yen)



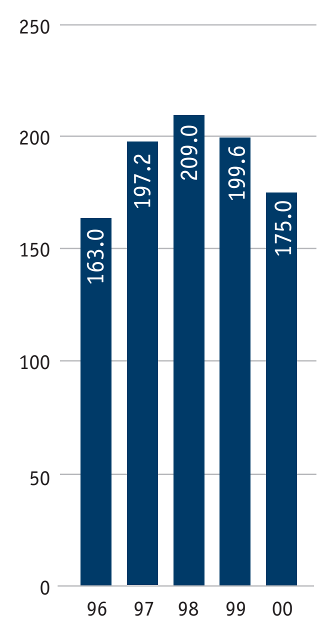

Working capital
(Billions of yen)




Total assets
(Billions of yen)




Total shareholders' equity
(Billions of yen)

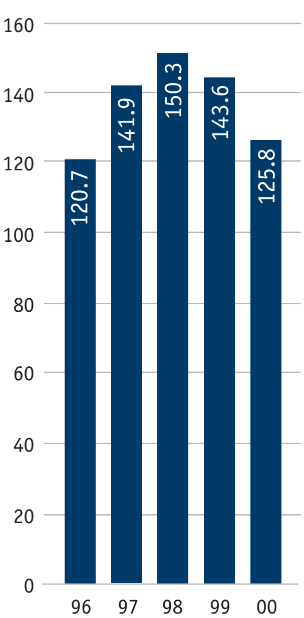


# Financial Review

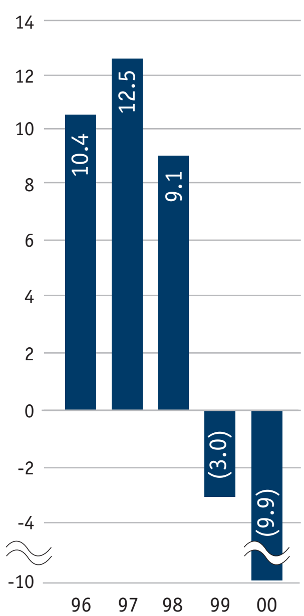
interests of ¥22.7 billion ($214 million). As a result of decreases in cash paid for interest and cash paid for income taxes, net cash provided by operating activities rose 39.8% to ¥31.2 billion ($294 million). Due mainly to an increase in addition to long-term loans receivable, net cash used for investing activities increased 7.4% to ¥46.6 billion ($439 million). Proceeds from long-term debt, mainly issue of corporate bond, increased 61.0%, or ¥33.5 billion ($315 million) to ¥88.4 billion ($832 million), while repayment of long-term debt was ¥39.7 million ($374 million). Cash dividends paid decreased, and decrease in short-term borrowings was also reduced. As a result of the foregoing, net cash provided by financing activities was ¥39.7 billion ($374 million), an increase of ¥37.4 billion ($352 million).

This resulted in a net increase in cash and cash equivalents of ¥23.0 billion ($217 million). Combined with an increase in cash and cash equivalents of ¥4.3 billion ($41 million) arising from newly consolidated subsidiaries, cash and cash equivalents at the fiscal 2000 year-end amounted to ¥82.2 billion ($774 million).

Total shareholders' equity per share
(Yen)




Return on equity
(%)




**FINANCIAL CONDITION**

A rise of 55.1%, or ¥30.5 billion ($287 million), in cash on hand and in banks, including time deposits with maturities of over three months in an amount of ¥3.6 billion ($34 million), was partially offset by a 9.0% fall in inventories. Current assets decreased to ¥879.4 billion ($8,285 million). Total investments and long-term loans fell 7.3% to ¥47.3 billion ($445 million). Due to an amount of ¥9.3 billion ($88 million) being recognized as deferred tax assets, intangible and other assets rose 70.8% to ¥17.0 billion ($160 million). Total assets were largely unchanged, rising 0.2% to ¥1,206.8 billion ($11,369 million).

Current liabilities decreased 4.4% to ¥691.0 billion ($6,510 million). This was due largely to decreases in trade payables, short-term borrowings and current portion of long-term debt, and accrued expenses.

Total long-term liabilities increased 21.0% to ¥334.4 billion ($3,150 million), due primarily to a 26.5% increase in long-term debt, less current portion, which was mainly used for re-financing. As a result, total liabilities increased slightly, rising 2.7% to ¥1,025.4 billion ($9,660 million). However, working capital increased substantially, rising 16.5% to ¥188.4 billion ($1,775 million).

Due to the consolidated net loss of ¥18.6 billion ($176 million), which was the principal factor causing a 26.4% fall in retained earnings to ¥68.8 billion ($649 million), and following the payment of cash dividends worth ¥4.2 billion ($39 million), shareholders' equity dropped 12.4% to ¥175.0 billion ($1,648 million). The shareholders' equity ratio fell 2.1 percentage points, from 16.6% to 14.5%.

# Six-Year Summary

Kawasaki Heavy Industries, Ltd. and consolidated subsidiaries
Years ended March 31

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | **2000** | 1999 | 1998 | 1997 | 1996 | 1995 |
| **Operating results:** | | | | | | |
| Net sales | **¥1,149,698** | ¥1,202,189 | ¥1,297,212 | ¥1,224,259 | ¥1,086,244 | ¥1,070,444 |
| Cost of sales | **1,008,860** | 1,045,143 | 1,114,693 | 1,041,697 | 928,126 | 912,432 |
| Gross profit | **140,838** | 157,046 | 182,519 | 182,562 | 158,118 | 158,012 |
| Selling, general and administrative expenses | **139,587** | 135,380 | 131,440 | 120,351 | 111,362 | 110,413 |
| Operating income | **1,251** | 21,666 | 51,079 | 62,211 | 46,756 | 47,599 |
| Net income (loss) | **(18,632)** | (6,132) | 18,556 | 22,572 | 16,462 | 10,216 |
| Capital expenditure | **37,513** | 40,428 | 42,928 | 35,130 | 39,319 | 33,729 |
| Depreciation and amortization | **35,081** | 34,607 | 32,416 | 31,245 | 30,823 | 30,899 |
| R & D expenses | **19,900** | 18,600 | 17,800 | 17,400 | 17,300 | 17,000 |
| **Financial position at year-end:** | | | | | | |
| Working capital | **¥ 188,403** | ¥ 161,712 | ¥ 162,084 | ¥ 150,759 | ¥ 127,644 | ¥ 106,458 |
| Net property, plant and equipment | **245,278** | 244,866 | 242,435 | 233,196 | 231,615 | 227,173 |
| Total assets | **1,206,806** | 1,204,857 | 1,222,906 | 1,303,168 | 1,252,371 | 1,191,664 |
| Long-term debt, less current portion | **264,048** | 208,763 | 198,135 | 197,130 | 204,801 | 184,535 |
| Total shareholders' equity | **174,955** | 199,637 | 209,040 | 197,161 | 162,984 | 152,991 |
| **Per share amounts (yen):** | | | | | | |
| Net income (loss) | **¥ (13.4)** | ¥ (4.4) | ¥ 13.3 | ¥ 16.4 | ¥ 12.2 | ¥ 7.6 |
| Cash dividends | **—** | 6.0 | 6.0 | 7.0 | 5.5 | 5.0 |
| Shareholders' equity | **125.8** | 143.6 | 150.3 | 141.9 | 120.7 | 113.3 |
| **Other data:** | | | | | | |
| Number of shares issued (millions) | **1,391** | 1,391 | 1,391 | 1,389 | 1,350 | 1,350 |
| Number of employees | **29,772** | 26,486 | 26,102 | 24,211 | 24,401 | 24,266 |
| **Non-consolidated data:** | | | | | | |
| Orders received | **865,834** | 950,312 | 1,007,695 | 958,477 | 1,028,903 | 939,899 |

# Consolidated Balance Sheets

Kawasaki Heavy Industries, Ltd. and consolidated subsidiaries
As of March 31, 2000 and 1999

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| Assets | 2000 | 1999 | 2000 |
| **Current assets:** | | | |
| Cash on hand and in banks | ¥ 85,782 | ¥ 55,306 | $ 808,121 |
| Marketable securities (Notes 3 and 5) | 46,021 | 47,785 | 433,547 |
| Receivables | | | |
| Trade | 397,616 | 403,423 | 3,745,794 |
| Other | 16,304 | 13,173 | 153,594 |
| Allowance for doubtful receivables | (3,375) | (3,041) | (31,795) |
| | 410,545 | 413,555 | 3,867,593 |
| Inventories (Notes 4 and 5) | 316,529 | 347,765 | 2,981,902 |
| Deferred tax assets (Note 9) | 4,216 | 5,507 | 39,717 |
| Other current assets | 16,345 | 14,481 | 153,981 |
| Total current assets | 879,438 | 884,399 | 8,284,861 |
| **Investments and long-term loans:** | | | |
| Investments in securities (Notes 3 and 10) | 32,136 | 38,967 | 302,742 |
| Long-term loans | 8,716 | 1,784 | 82,110 |
| Other (Note 5) | 13,734 | 13,264 | 129,383 |
| Allowance for doubtful receivables | (7,327) | (3,009) | (69,025) |
| Total investments and long-term loans | 47,259 | 51,006 | 445,210 |
| **Property, plant and equipment** (Note 5)**:** | | | |
| Land | 50,822 | 50,070 | 478,775 |
| Buildings | 244,103 | 238,406 | 2,299,604 |
| Machinery and equipment | 443,876 | 429,758 | 4,181,592 |
| Construction in progress | 5,829 | 5,115 | 54,913 |
| | 744,630 | 723,349 | 7,014,884 |
| Accumulated depreciation | (499,352) | (478,483) | (4,704,211) |
| Net property, plant and equipment | 245,278 | 244,866 | 2,310,673 |
| **Intangible and other assets** | | | |
| Deferred tax assets (Note 9) | 9,315 | 2,956 | 87,753 |
| Intangible and other assets | 7,676 | 6,989 | 72,313 |
| | 16,991 | 9,945 | 160,066 |
| **Foreign currency translation adjustments** | 17,840 | 14,641 | 168,064 |
| Total assets | ¥ 1,206,806 | ¥ 1,204,857 | $11,368,874 |

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

| Liabilities and shareholders' equity | Millions of yen 2000 | Millions of yen 1999 | Thousands of U.S. dollars (Note 1) 2000 |
|---|---|---|---|
| **Current liabilities:** | | | |
| Short-term borrowings and current portion of long-term debt (Note 5) | **¥ 222,302** | ¥ 238,265 | **$ 2,094,225** |
| Trade payables | **310,557** | 321,830 | **2,925,643** |
| Advances from customers | **86,012** | 81,409 | **810,287** |
| Accrued income taxes (Note 9) | **2,441** | 3,424 | **22,996** |
| Accrued expenses | **19,549** | 21,375 | **184,164** |
| Provision for product warranty | **1,648** | 1,386 | **15,525** |
| Deferred tax liabilities (Note 9) | **515** | 5,162 | **4,852** |
| Other current liabilities | **48,011** | 49,836 | **452,294** |
| Total current liabilities | **691,035** | 722,687 | **6,509,986** |
| **Long-term liabilities:** | | | |
| Long-term debt, less current portion (Note 5) | **264,048** | 208,763 | **2,487,499** |
| Retirement and severance benefits | **58,332** | 54,024 | **549,524** |
| Deferred tax liabilities (Note 9) | **2,705** | 2,573 | **25,483** |
| Other | **9,313** | 10,894 | **87,734** |
| Total long-term liabilities | **334,398** | 276,254 | **3,150,240** |
| **Contingent liabilities** (Note 11) | | | |
| **Minority interests** | **6,418** | 6,279 | **60,461** |
| **Shareholders' equity** (Note 6)**:** | | | |
| Common stock of ¥50 par value : | | | |
| Authorized - 3,360,000,000 shares | | | |
| Issued - 1,390,595,964 shares | **81,427** | 81,427 | **767,094** |
| Capital surplus | **24,682** | 24,682 | **232,520** |
| Retained earnings | **68,846** | 93,528 | **648,573** |
| Total shareholders' equity | **174,955** | 199,637 | **1,648,187** |
| Total liabilities and shareholders' equity | **¥ 1,206,806** | ¥ 1,204,857 | **$11,368,874** |

# Consolidated Statements of Operations

Kawasaki Heavy Industries, Ltd. and consolidated subsidiaries
For the three years ended March 31, 2000, 1999 and 1998

| | Millions of yen | | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|---|
| | **2000** | 1999 | 1998 | **2000** |
| **Net sales** | **¥ 1,149,698** | ¥ 1,202,189 | ¥ 1,297,212 | **$10,830,881** |
| **Cost of sales** | **1,008,860** | 1,045,143 | 1,114,693 | **9,504,098** |
| Gross profit | **140,838** | 157,046 | 182,519 | **1,326,783** |
| **Selling, general and administrative expenses** | **139,587** | 135,380 | 131,440 | **1,314,998** |
| Operating income | **1,251** | 21,666 | 51,079 | **11,785** |
| Other income (expenses): | | | | |
| Interest and dividend income | **4,274** | 5,495 | 5,122 | **40,264** |
| Equity in income (loss) of unconsolidated subsidiaries and affiliates | **(654)** | 683 | 1,236 | **(6,161)** |
| Interest expense | **(11,782)** | (12,646) | (11,907) | **(110,994)** |
| Other, net (Note 8) | **(15,819)** | (15,723) | (3,815) | **(149,025)** |
| Income (loss) before income taxes and minority interests | **(22,730)** | (525) | 41,715 | **(214,131)** |
| **Income taxes** (Note 9) | | | | |
| Current | **(5,899)** | (9,358) | (22,618) | **(55,572)** |
| Deferred | **9,466** | 2,943 | — | **89,176** |
| **Minority interests in net (income) loss of consolidated subsidiaries** | **531** | **808** | **(541)** | **5,002** |
| **Net income (loss)** | **¥ (18,632)** | **¥ (6,132)** | **¥ 18,556** | **$ (175,525)** |

| | Yen | | | U.S. dollars (Note 1) |
|---|---|---|---|---|
| **Per share amounts** (Note 2 (v)): | | | | |
| Net income (loss) | **¥(13.4)** | ¥ (4.4) | ¥ 13.3 | **$(0.13)** |
| Net income - diluted | **—** | — | 12.0 | **—** |
| Cash dividends | **—** | 6.0 | 6.0 | **—** |

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

# Consolidated Statements of Shareholders' Equity

Kawasaki Heavy Industries, Ltd. and consolidated subsidiaries
For the three years ended March 31, 2000, 1999 and 1998

| | Thousands | Millions of yen | | |
|---|---|---|---|---|
| | Number of shares of common stock | Common stock | Capital surplus | Retained earnings |
| Balance at March 31, 1997 | 1,389,123 | ¥ 81,088 | ¥ 24,345 | ¥ 91,728 |
| Net income for the year | — | — | — | 18,556 |
| Adjustment for changes of interests in consolidated subsidiaries | — | — | — | 23 |
| Increase in retained earnings arising from newly consolidated subsidiaries | — | — | — | 2,727 |
| Decrease in retained earnings arising from affiliates newly accounted for by the equity method | — | — | — | (83) |
| Cash dividends | — | — | — | (9,728) |
| Bonuses to directors and statutory auditors | — | — | — | (292) |
| Conversion of convertible bonds | 1,473 | 339 | 337 | — |
| Balance at March 31, 1998 | 1,390,596 | 81,427 | 24,682 | 102,931 |
| Net loss for the year | — | — | — | (6,132) |
| Cumulative effect of adopting tax effect accounting | — | — | — | 5,652 |
| Increase in retained earnings arising from affiliates newly accounted for by the equity method | — | — | — | 65 |
| Merger of unconsolidated subsidiaries with consolidated subsidiary | — | — | — | 24 |
| Adjustment for changes of interests in affiliates accounted for by the equity method | — | — | — | (406) |
| Cash dividends | — | — | — | (8,344) |
| Bonuses to directors and statutory auditors | — | — | — | (262) |
| Balance at March 31, 1999 | 1,390,596 | 81,427 | 24,682 | 93,528 |
| Net loss for the year | — | — | — | (18,632) |
| Increase in retained earnings arising from newly consolidated subsidiaries | — | — | — | 2,677 |
| Increase in retained earnings arising from affiliates newly accounted for by the equity method | — | — | — | 34 |
| Decrease due to companies ceasing to be an affiliate accounted for by the equity method | — | — | — | (3,996) |
| Decrease due to merger of unconsolidated subsidiaries with consolidated subsidiary | — | — | — | (357) |
| Adjustment for changes of interests in affiliates accounted for by the equity method | — | — | — | (64) |
| Cash dividends | — | — | — | (4,172) |
| Bonuses to directors and statutory auditors | — | — | — | (172) |
| **Balance at March 31, 2000** | **1,390,596** | **¥ 81,427** | **¥ 24,682** | **¥ 68,846** |

| | Thousands of U.S. dollars (Note 1) | | |
|---|---|---|---|
| Balance at March 31, 1999 | $ 767,094 | $ 232,520 | $ 881,093 |
| Net loss for the year | — | — | (175,525) |
| Increase in retained earnings arising from newly consolidated subsidiaries | — | — | 25,219 |
| Increase in retained earnings arising from affiliates newly accounted for by the equity method | — | — | 320 |
| Decrease due to companies ceasing to be an affiliate accounted for by the equity method | — | — | (37,645) |
| Decrease due to merger of unconsolidated subsidiaries with consolidated subsidiary | — | — | (3,363) |
| Adjustment for changes of interests in affiliates accounted for by the equity method | — | — | (603) |
| Cash dividends | — | — | (39,303) |
| Bonuses to directors and statutory auditors | — | — | (1,620) |
| **Balance at March 31, 2000** | **$ 767,094** | **$ 232,520** | **$ 648,573** |

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

# Consolidated Statements of Cash Flows

Kawasaki Heavy Industries, Ltd. and consolidated subsidiaries
For the years ended March 31, 2000 and 1999

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| **Cash flows from operating activities:** | | | |
| Loss before income taxes and minority interests | **¥ (22,730)** | ¥ (525) | **$ (214,131)** |
| Adjustments to reconcile loss before income taxes and minority interests to net cash provided by operating activities: | | | |
| Depreciation and amortization | **35,081** | 34,607 | **330,485** |
| Provision for retirement and severance benefits | **3,479** | 1,842 | **32,774** |
| Accrued bonuses | **(3,419)** | 186 | **(32,209)** |
| Loss on disposal of property, plant and equipment | **1,317** | 1,382 | **12,407** |
| Provision for (reversal of) estimated loss on uncompleted contract | **(4,111)** | 5,784 | **(38,728)** |
| Write-downs of securities and others | **3,031** | — | **28,554** |
| Provision for allowance for doubtful accounts | **4,765** | 876 | **44,889** |
| Interest and dividend income | **(4,274)** | (5,495) | **(40,264)** |
| Interest expense | **11,782** | 12,646 | **110,994** |
| Changes in assets and liabilities: | | | |
| Decrease (increase) in | | | |
| Trade receivables | **3,583** | 6,985 | **33,754** |
| Inventories | **21,447** | 3,471 | **202,044** |
| Other current assets | **(5,615)** | 1,258 | **(52,897)** |
| Increase (decrease) in | | | |
| Trade payables | **(2,911)** | (5,346) | **(27,423)** |
| Advances received | **5,972** | (16,294) | **56,260** |
| Other current liabilities | **38** | 2,552 | **359** |
| Other, net | **(432)** | 1,417 | **(4,070)** |
| Sub total | **47,003** | 45,346 | **442,798** |
| Cash received for interest and dividends | **4,122** | 6,562 | **38,832** |
| Cash paid for interest | **(11,270)** | (12,380) | **(106,171)** |
| Cash paid for income taxes | **(8,623)** | (17,181) | **(81,234)** |
| Net cash provided by operating activities | **31,232** | 22,347 | **294,225** |
| **Cash flows from investing activities:** | | | |
| Acquisition of property, plant and equipment | **(37,513)** | (40,428) | **(353,396)** |
| Additions to long-term loans receivable | **(5,866)** | (406) | **(55,261)** |
| Other | **(3,200)** | (2,546) | **(30,146)** |
| Net cash used for investing activities | **(46,579)** | (43,380) | **(438,803)** |
| **Cash flows from financing activities:** | | | |
| Proceeds from long-term debt | **88,368** | 54,894 | **832,482** |
| Repayment of long-term debt | **(39,719)** | (37,681) | **(374,178)** |
| Cash dividends paid | **(4,203)** | (8,310) | **(39,595)** |
| Cash dividends paid to minority interests | **(64)** | (62) | **(603)** |
| Decrease in short-term borrowings | **(4,643)** | (6,514) | **(43,740)** |
| Net cash provided by financing activities | **39,739** | 2,327 | **374,366** |
| Effect of exchange rate changes | **(1,408)** | (946) | **(13,264)** |
| Net increase (decrease) in cash and cash equivalents | **22,984** | (19,652) | **216,524** |
| Cash and cash equivalents at beginning of year | **54,837** | 74,489 | **516,599** |
| Increase in cash and cash equivalents arising from newly consolidated subsidiaries | **4,339** | — | **40,876** |
| Cash and cash equivalents at end of year | **¥ 82,160** | ¥ 54,837 | **$ 773,999** |
| **Supplemental information on cash flows:** | | | |
| Cash and cash equivalents | | | |
| Cash on hand and in banks in the balance sheet | **¥ 85,782** | ¥ 55,306 | **$ 808,121** |
| Time deposits with maturities over three months | **(3,622)** | (469) | **(34,122)** |
| Total | **¥ 82,160** | ¥ 54,837 | **$ 773,999** |

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

# Notes to the Consolidated Financial Statements

## 1. Basis of presenting consolidated financial statements

Kawasaki Heavy Industries, Ltd. (the "Company") and its consolidated domestic subsidiaries maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code and the Securities and Exchange Law and in conformity with accounting principles and practices generally accepted in Japan, which are different from the accounting and disclosure requirements of International Accounting Standards. The accounts of overseas consolidated subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile.

The accompanying consolidated financial statements are a translation of the audited consolidated financial statements of the Company which were prepared in accordance with accounting principles and practices generally accepted in Japan from the accounts and records maintained by the Company and its consolidated subsidiaries and were filed with the Minister of Finance ("MOF") as required by the Securities and Exchange Law.

In preparing the accompanying consolidated financial statements, certain reclassifications have been made in the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. The consolidated cash flow statement for 1999 has been prepared for the purpose of inclusion in the consolidated financial statements, although such statement was not customarily prepared in Japan and not required to be filed with MOF prior to 2000.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of the reader, using the prevailing exchange rate at March 31, 2000, which was ¥106.15 to U.S. $1.00. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

## 2. Significant accounting policies

*(a) Consolidation*

The Company prepared the consolidated financial statements for the year ended March 31, 2000 in accordance with the revised Accounting Principles for Consolidated Financial Statements (the "Revised Accounting Principles") effective from the year ended March 31, 2000.

The accompanying consolidated financial statements include the accounts of the Company and significant companies, over which the Company has power of control through majority voting right or existence of certain conditions evidencing control by the Company. Investments in non-consolidated subsidiaries and affiliates, over which the Company has the ability to exercise significant influence over operating and financial policies of the investees, are accounted for on the equity method. The effect of adopting the Revised Accounting Principles is immaterial.

The consolidated financial statements include the accounts of the Company and 112 (65 in 1999 and 62 in 1998) subsidiaries.

For the years ended March 31, 2000, 1999 and 1998, respectively, 4, 58 and 59 subsidiaries are excluded from the consolidation. The amounts of total assets, net sales, net income and retained earnings of these excluded subsidiaries, in the aggregate, would not have had a material effect on the consolidated financial statements.

*(b) Application of the equity method of accounting*

For the year ended March 31, 2000, 20 (12 in 1999 and 1998) affiliates are accounted for by the equity method.

For the years ended March 31, 2000, 1999 and 1998, investments in 4, 58 and 59 unconsolidated subsidiaries and 14, 22 and 23 affiliates, respectively, are stated at cost without applying the equity method of accounting. If the equity method had been applied for these investments, the amounts of net income and retained earnings of these excluded subsidiaries and affiliates would not have had a material effect on the consolidated financial statements.

*(c) Consolidated subsidiaries' fiscal year-ends*

Fiscal year-ends of 29 (20 in 1999 and 17 in 1998) consolidated subsidiaries end on December 31. The Company consolidates such subsidiaries' financial statements as of each subsidiary's latest year-end. Unusual significant transactions for the period between each subsidiary's year-end and the Company's year-end are adjusted on consolidation.

*(d) Elimination of inter-company transactions and accounts*

All significant inter-company transactions and accounts and unrealized inter-company profits are eliminated on consolidation, and the portion thereof attributable to minority interests is credited to minority interests.

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

When the excess of equity in net assets over the cost of an investment is considered significant, it is amortized to income by the straight-line method over five years. Otherwise, it is credited directly to retained earnings in the year of acquisition or the year newly included in consolidation.

*(e) Translation of foreign currency statements*

The financial statements of the overseas consolidated subsidiaries are translated into yen as stated below, in accordance with a regulation issued by the Financial Accounting Deliberation Council.

(1) Assets and liabilities are translated at the fiscal year-end exchange rates.
(2) Share capital accounts and retained earnings are translated at historical rates.
(3) Revenue and expense accounts are translated at average rates prevailing during the fiscal year.

Differences arising from the application of the process stated above are shown as foreign currency translation adjustments in the accompanying consolidated balance sheet.

*(f) Appropriations of retained earnings*

Appropriations of retained earnings are recorded in the fiscal year when the proposed appropriations are approved.

*(g) Revenue recognition*

Sales are principally recognized at the time of completion of the contracts. However, the percentage-of-completion method is applied to long-term contracts exceeding ¥5,000 million.

*(h) Consolidated statements of cash flows*

In accordance with the "Standards for Preparation of Consolidated Cash Flow Statement, etc." (the "New Standards"), effective from the year ended March 31, 2000, the Company is required to prepare consolidated cash flow statements. The 1999 consolidated cash flow statement, which was prepared for readers outside Japan although such statement was not required, has been restated to conform to the 2000 presentation.

*(i) Cash and cash equivalents*

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

*(j) Allowance for doubtful receivables*

Possible losses from notes and accounts receivable, loans and other receivables are provided for based on relevant income tax laws and the Companies' estimates of losses on collection.

*(k) Inventories*

Inventories are stated at cost, as determined principally by the specific identification cost method, the first-in, first-out method or the moving-average method.

*(l) Marketable securities*

Marketable securities are stated principally at cost, as determined by the moving-average method. When significant impairment of value has been deemed permanent, cost has been appropriately reduced.

*(m) Investments in securities*

Investments in securities are stated at cost, as determined by the moving-average method, except for those accounted for by the equity method as explained in Note 2 (b). When significant impairment of value has been deemed permanent, cost has been appropriately reduced.

*(n) Property, plant and equipment*

Property, plant and equipment are stated at cost. Depreciation is computed principally by the declining-balance method over estimated useful lives.

*(o) Intangible assets*

Amortization of intangible assets is computed by the straight-line method.

*(p) Provision for product warranty*

Expected future product warranty costs are provided for ships and consumer products.

*(q) Bond issue expenses*

Bond issue expenses are charged to income as incurred.

*(r) Foreign currency translation*

Foreign currency accounts of the Company and its domestic subsidiaries are translated into yen as stated below, in accordance with a regulation issued by the Financial Accounting Deliberation Council.

(1) Foreign currencies and short-term monetary accounts are translated at the rates of exchange prevailing at the balance sheet date. The resulting translation gain or loss is included in the determination of net income for the year.
(2) Long-term monetary accounts and non-monetary accounts are translated at historical exchange rates prevailing at the time of transactions.
(3) Monetary accounts which are hedged by forward exchange contracts are translated into yen at the contracted rates of exchange.

If long-term monetary items were translated at exchange rates in effect at March 31, 2000, net translation losses of ¥131 million ($1,234 thousand) would have been recorded.

*(s) Income taxes*

Income taxes were principally provided for based on taxable income for the period, determined in accordance with applicable tax laws, for the year ended March 31, 1998. Effective April 1, 1998, the Company adopted the new accounting standard, which recognizes tax effects of temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting.

Under the new accounting standard, the asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The amount of deferred income taxes attributable to the net tax effects of the temporary differences at April 1, 1998 is reflected as an adjustment to the retained earnings brought forward from the previous year. Prior year's financial statements have not been restated. The cumulative effect of adopting the new accounting standard is ¥5,652 million and the effect for the year ended March 31, 1999 was to decrease net loss by ¥2,741 million.

*(t) Retirement and severance benefits*

Employees who terminate their services with the Company and its domestic consolidated subsidiaries are generally entitled to lump-sum payments, the amounts of which are determined by reference to their current basic rates of pay and length of service. The Company and its domestic consolidated subsidiaries provide for 40 percent of the amount which would be required to be paid if all eligible employees voluntarily terminated their services at the balance sheet date. For the year ended March 31, 2000, certain domestic consolidated subsidiaries changed the percentage from 40 percent to 100 percent. As a result of this change, the loss before income taxes and minority interests was increased by ¥2,745 million ($25,860 thousand).

Employees of the Company's overseas consolidated subsidiaries are generally covered by various pension plans, accounted for in accordance with generally accepted accounting principles in the country of incorporation. In addition, the Company and some of its domestic consolidated subsidiaries provide for retirement and severance benefits for directors and statutory auditors principally at 50 percent of the amount required if they retired at the balance sheet date.

*(u) Finance leases*

For the Company and its domestic consolidated subsidiaries, finance leases which do not transfer ownership and do not have bargain purchase provisions are accounted for in the same manner as operating leases in accordance with generally accepted accounting principles in Japan.

*(v) Per share amounts of net income (loss) and cash dividends*

The computations of per share amounts of net income (loss) shown in the consolidated statements of operations are based upon the weighted average number of issued shares outstanding during each period. Diluted income per share, is computed based on the assumption that all dilutive convertible bonds were converted at the beginning of the year.

Per share amounts of cash dividends for each period represent dividends declared as applicable to the respective year.

*(w) Reclassifications*

Certain prior year amounts have been reclassified to conform to 2000 presentation. These changes had no impact on previously reported results of operations or shareholders' equity.

## 3. Market value information for securities

Market values, book values and unrealized gains of quoted securities as of March 31, 2000 is as follows:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Market values: | | |
| Marketable securities | ¥ 77,611 | $ 731,145 |
| Investments in securities: | | |
| Subsidiaries and affiliates | 4,770 | 44,936 |
| Other | 136 | 1,281 |
| | 82,517 | 777,362 |
| Book values: | | |
| Marketable securities | ¥ 45,867 | $ 432,096 |
| Investments in securities: | | |
| Subsidiaries and affiliates | 8,134 | 76,627 |
| Other | 104 | 980 |
| | 54,105 | 509,703 |
| Unrealized gains | ¥ 28,412 | $ 267,659 |

## 4. Inventories

Inventories as of March 31, 2000 and 1999 are comprised as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Finished products | **¥ 44,006** | ¥ 37,950 | **$ 414,564** |
| Work in process | **235,050** | 268,027 | **2,214,319** |
| Raw materials and supplies | **37,473** | 41,788 | **353,019** |
| Total | **¥ 316,529** | ¥ 347,765 | **$ 2,981,902** |

## 5. Short-term borrowings and long-term debt

Short-term borrowings and long-term debt as of March 31, 2000 and 1999 are comprised as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Short-term borrowings: | | | |
| Short-term debt, principally bank loans and commercial paper | **¥ 187,211** | ¥ 198,093 | **$ 1,763,646** |
| Current portion of long-term debt | **35,091** | 40,172 | **330,579** |
| Total short-term debt | **¥ 222,302** | ¥ 238,265 | **$ 2,094,225** |
| Long-term debt: | | | |
| Loans from banks and other financial institutions, partly secured by mortgage or other collateral, due from 2000 to 2034, bearing interest ranging from 0.57 percent to 7.9 percent and from 0.694 percent to 7.5 percent as of March 31, 2000 and 1999, respectively | **¥ 108,242** | ¥ 82,601 | **$ 1,019,708** |
| 2.10~6.15 percent notes due 1999 | **—** | 25,000 | **—** |
| 2.50 percent notes due 2000 | **10,000** | 10,000 | **94,206** |
| 2.55 percent notes due 2001 | **10,000** | 10,000 | **94,206** |
| 1.00 percent notes due 2002 | **10,000** | — | **94,206** |
| 1.05~2.00 percent notes due 2003 | **20,000** | 10,000 | **188,413** |
| 1.94 percent notes due 2004 | **20,000** | 20,000 | **188,413** |
| 1.67 percent notes due 2005 | **10,000** | — | **94,206** |
| 1.87 percent notes due 2006 | **10,000** | — | **94,206** |
| 2.51~2.775 percent notes due 2008 | **20,000** | 20,000 | **188,413** |
| 2.33 percent notes due 2009 | **10,000** | — | **94,206** |
| 0.80 percent convertible bonds due 2001 | **8,573** | 8,573 | **80,763** |
| 0.65~0.90 percent convertible bonds due 2003 | **19,079** | 19,079 | **179,736** |
| 0.75 percent convertible bonds due 2005 | **9,609** | 9,609 | **90,523** |
| 1.10 percent convertible bonds due 2006 | **17,118** | 17,118 | **161,262** |
| 0.90 percent convertible bonds due 2008 | **8,926** | 8,977 | **84,089** |
| 1.00 percent convertible bonds due 2011 | **7,592** | 7,978 | **71,522** |
| | **299,139** | 248,935 | **2,818,078** |
| Less portion due within one year | **(35,091)** | (40,172) | **(330,579)** |
| Total long-term debt | **¥ 264,048** | ¥ 208,763 | **$ 2,487,499** |

The convertible bonds due 2001 through 2011 as of March 31, 2000 were convertible into 136,908,609 shares of common stock at the option of the holders at prices of ¥459 ($4.32) or ¥598 ($5.63) per share. The conversion prices are subject to adjustments under specified conditions.

As of March 31, 2000 and 1999, the following assets were pledged as collateral for short-term borrowing and long-term debt:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Marketable securities | **¥ 177** | ¥ 180 | **$ 1,667** |
| Inventories | **6,144** | 5,091 | **57,880** |
| Property, plant and equipment (at net book value) | **—** | 11,517 | **—** |
| Land | **6,247** | — | **58,851** |
| Buildings | **6,635** | — | **62,506** |
| Machinery and equipment | **491** | — | **4,626** |
| Other | **233** | 63 | **2,195** |
| Total | **¥ 19,927** | ¥ 16,851 | **$ 187,725** |

As of March 31, 2000, debt secured by the above pledged assets was as follows:

| | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| Trade payables | ¥ 97 | $ 914 |
| Short-term and long-term debt | 18,940 | 178,427 |
| Total | ¥ 19,037 | $179,341 |

The aggregate annual maturities of long-term debt as of March 31, 2000, are as follows:

| Year ending March 31, | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| 2001 | ¥ 35,091 | $ 330,579 |
| 2002 | 33,386 | 314,517 |
| 2003 | 32,471 | 305,898 |
| 2004 | 44,688 | 420,989 |
| 2005 and thereafter | 153,503 | 1,446,095 |
| Total | ¥299,139 | $ 2,818,078 |

## 6. Shareholders' equity

*(a) Capital surplus*

The Commercial Code of Japan provides that the entire issue price of new shares must be credited to common stock, provided that, by resolution of the Board of Directors, up to one-half of such issue price may be credited to capital surplus so long as the common stock is equal to at least the aggregate par value of the shares issued.

*(b) Dividends*

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

*(c) Restrictions on dividends*

Under the terms of indentures for certain notes and convertible bonds due through 2006, cumulative cash dividend payments by the Company are not to exceed an amount equivalent to accumulated net income of the Company earned during the years such securities are outstanding plus ¥10,000 million (for certain indentures ¥10,100 million).

## 7.Research and development expenses

For the year ended of March 31, 2000, Research and development expenses was ¥19,905 million ($187,518 thousand).

## 8. Other income (expenses) : other, net

Other income (expenses) : other, net in the consolidated statements of operations is comprised as follows:

| | Millions of yen | | | Thousands of U.S. dollars |
|---|---|---|---|---|
| | **2000** | 1999 | 1998 | **2000** |
| Loss on disposal of property, plant and equipment | **¥ (1,317)** | ¥ (1,382) | ¥ (993) | **$ (12,407)** |
| Gain (loss) on sales of marketable securities and investments in securities | **266** | (1,077) | 799 | **2,506** |
| Foreign exchange loss, net | **(7,774)** | (11,411) | (1,654) | **(73,236)** |
| Gain on cancellation of the shipbuilding contracts | **2,053** | — | — | **19,341** |
| Write down of marketable securities, investments in securities and others | **(3,917)** | — | — | **(36,901)** |
| Prior-period retirement allowance | **(2,744)** | — | — | **(25,850)** |
| Other, net | **(2,386)** | (1,853) | (1,967) | **(22,478)** |
| Total | **¥ (15,819)** | ¥(15,723) | ¥ (3,815) | **$ (149,025)** |

## 9. Income taxes

Income taxes in Japan applicable to the Company and its domestic consolidated subsidiaries consist of corporation tax (national tax) and enterprise tax and inhabitants taxes (local taxes) which, in the aggregate, result in normal statutory tax rates of approximately 41.9 percent for the year ended March 31, 2000 and 47.5 percent for the prior year.

Significant components of deferred tax assets and liabilities as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Deferred tax assets | | | |
| Excess bonuses accrued | **¥ 2,085** | ¥ 1,471 | **$ 19,642** |
| Retirement benefits | **5,872** | 2,684 | **55,318** |
| Estimated loss on uncompleted contracts | **1,653** | 3,692 | **15,572** |
| Allowance for doubtful receivables | **2,868** | 732 | **27,018** |
| Fixed assets - intercompany profits | **1,046** | 1,127 | **9,854** |
| Depreciation | **999** | 250 | **9,411** |
| Net operating loss carryforwards | **4,844** | 3,262 | **45,634** |
| Other | **6,499** | 8,798 | **61,225** |
| Gross deferred tax assets | **25,866** | 22,016 | **243,674** |
| Less - Valuation allowance | **(7,702)** | (7,193) | **(72,558)** |
| Total deferred tax assets | **18,164** | 14,823 | **171,116** |
| Deferred tax liabilities | | | |
| Deferral of gain on sale of fixed assets | **1,997** | 2,028 | **18,813** |
| Unrealized gain on uncompleted contracts | **1,430** | 7,565 | **13,472** |
| Other | **4,426** | 4,502 | **41,696** |
| Total deferred tax liabilities | **7,853** | 14,095 | **73,981** |
| Net deferred tax assets | **¥ 10,311** | ¥ 728 | **$ 97,135** |

## 10. Investments in unconsolidated subsidiaries and affiliates

Investments in unconsolidated subsidiaries and affiliates as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Investments in securities | **¥ 23,102** | ¥ 24,570 | **$ 217,635** |

## 11. Contingent liabilities

Contingent liabilities as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| As drawer of trade notes discounted | ¥ **355** | ¥ 721 | $ **3,344** |
| As endorser of trade notes | **36** | 60 | **339** |
| As guarantor of indebtedness of employees, unconsolidated subsidiaries and affiliates, and others | **40,642** | 46,647 | **382,873** |

## 12. Finance leases

Finance lease information, as required to be disclosed in Japan, for the respective years is as follows:

*(a) As lessee*

The original cost of leased assets under non-capitalized finance leases and accumulated depreciation, assuming it is calculated on the straight-line method over lease terms, as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Property, plant and equipment | ¥ **13,793** | ¥ 13,582 | $ **129,939** |
| Accumulated depreciation | **(6,816)** | (6,309) | **(64,211)** |
| | ¥ **6,977** | ¥ 7,273 | $ **65,728** |
| Intangible assets | ¥ **379** | ¥ 438 | $ **3,571** |
| Accumulated amortization | **(261)** | (240) | **(2,459)** |
| | ¥ **118** | ¥ 198 | $ **1,112** |

The present values of future minimum lease payments under non-capitalized finance leases as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Current portion | ¥ **2,556** | ¥ 2,654 | $ **24,079** |
| Non-current portion | **4,715** | 5,006 | **44,418** |
| Total | ¥ **7,271** | ¥ 7,660 | $ **68,497** |

Lease payments and "as if capitalized" depreciation and amortization and interest expense for non-capitalized finance leases are as follows:

| | Millions of yen | | | Thousands of U.S. dollars |
|---|---|---|---|---|
| | **2000** | 1999 | 1998 | **2000** |
| Lease payments | ¥ **3,076** | ¥ 3,094 | ¥ 3,419 | $ **28,978** |
| Depreciation and amortization | **2,862** | 3,058 | N/A | **26,962** |
| Interest | **230** | 277 | N/A | **2,167** |

*(b) As lessor*

The original cost of leased assets under finance leases and accumulated depreciation, as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Property, plant and equipment | ¥ **1,295** | ¥ 2,069 | $ **12,200** |
| Accumulated depreciation | **(714)** | (1,025) | **(6,726)** |
| | ¥ **581** | ¥ 1,044 | $ **5,474** |

The present values of future minimum lease payments to be received under finance leases as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Current portion | ¥ **173** | ¥ 288 | $ **1,630** |
| Non-current portion | **489** | 811 | **4,607** |
| Total | ¥ **662** | ¥ 1,099 | $ **6,237** |

Lease payments received, depreciation and amortization and interest on finance leases are as follows:

| | Millions of yen | | | Thousands of U.S. dollars |
|---|---|---|---|---|
| | **2000** | 1999 | 1998 | **2000** |
| Lease payments received | ¥ **218** | ¥ 325 | ¥ 334 | $ **2,054** |
| Depreciation and amortization | **147** | 276 | N/A | **1,385** |
| Interest | **38** | 50 | N/A | **358** |

## 13. Operating leases

The present values of future minimum lease payments under operating leases as of March 31, 2000 and 1999 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2000** | 1999 | **2000** |
| Current portion | ¥ **50** | ¥ 302 | $ **471** |
| Non-current portion | **178** | 517 | **1,677** |
| Total | ¥ **228** | ¥ 819 | $ **2,148** |

## 14. Derivative transactions

Since the Company and its consolidated subsidiaries operate internationally and have a substantial volume of export and import transactions, it enters into foreign currency exchange and option transactions in order to manage risk of fluctuations in exchange rates in relation to foreign currency denominated assets and liabilities.

The Company and its consolidated subsidiaries also enter into interest swap and option transactions to hedge against future fluctuations in interest rates on borrowings, primarily to fix, cap or collar interest rates on variable rate debt.

The Company and its consolidated subsidiaries's purpose for purchasing derivatives is to hedge against risks of fluctuations in currency exchange rates and interest rates rather to than be exposed to such risks through dealing or speculation. In order to minimize credit risk, the Company and its consolidated subsidiaries use only highly-rated international financial institutions as counterparty to derivative transactions.

The Company and its consolidated subsidiaries have established policies that restrict the use of derivative instruments, including limits as to the purpose, nature, type and amount, and that require reporting and review in order to control the use of derivatives and manage risk.

Outstanding positions and unrealized gains and losses at March 31, 2000 are as follows:

| | | | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|---|---|
| | | | 2000 | | 2000 |
| | | | Contract Amount | Unrealized Gain (loss) | Unrealized Gain (loss) |
| Currency related contracts: | | | | | |
| Foreign exchange contracts | | | | | |
| Sell | U.S. dollars | | ¥ 291 | ¥ 8 | $ 76 |
| | Other currencies | | 240 | 3 | 28 |
| Purchase | German Marks | | 640 | (66) | (622) |
| | U.S. dollars | | 570 | 9 | 85 |
| | Pounds | | 515 | 13 | 122 |
| | Euro | | 423 | (10) | (94) |
| | Other currencies | | 1,003 | (101) | (951) |
| Option contracts | | | | | |
| Sell options | | | | | |
| Call | U.S. dollars | | 6,635 | 59 | 556 |
| Purchase options | | | | | |
| Put | U.S. dollars | | 6,300 | (39) | (368) |
| Total | | | | ¥ (124) | $ (1,168) |
| Interest rate related contracts: | | | | | |
| Option contracts | | | | | |
| Collar | purchase | | ¥ 3,000 | ¥ (8) | $ (75) |
| Swap contracts | | | | | |
| Receive fixed for variable rates | | | — | — | — |
| Receive variable for fixed rates | | | 92,000 | (977) | (9,204) |
| Total | | | | ¥ (985) | $ (9,279) |

## 15. Segment information

Industry segments of the Company and its consolidated subsidiaries in prior years were classified into Transportation Equipment, Aerospace, Industrial Equipment and Other. Consumer products such as motorcycles, which were included in the Transportation Equipment segment, are separated from the Transportation Equipment segment and classified as the Consumer Products segment for the year ended March 31, 2000. Previously reported data have been restated accordingly. The Transportation Equipment segment manufactures and sells ships and rolling stock. Operations within the Aerospace segment include the production and sale of airplanes, helicopters and airplane engines. Products manufactured and sold by the Industrial Equipment segment include boilers, prime movers, gas turbines, hydraulic, crushing, and construction machines, chemical and steel making plants, steel bridges and hospital respiration equipment. The Consumer Products segment manufactures and sells motorcycles and Jet Ski® personal watercraft. Operations in the Other segment involve trade, mediation of overseas sales and orders and other activities.

*(a) Information by industry segment*

| | Millions of yen | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2000** | | | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets | Depreciation and amortization | Capital expenditures |
| Transportation equipment | **¥ 164,942** | **¥ 1,857** | **¥ 166,799** | **¥ 176,534** | **¥ (9,735)** | **¥ 159,783** | **¥ 3,681** | **¥ 2,793** |
| Aerospace | **219,447** | **5,981** | **225,428** | **214,633** | **10,795** | **201,494** | **4,536** | **6,437** |
| Industrial equipment | **417,865** | **34,597** | **452,462** | **463,738** | **(11,276)** | **441,886** | **9,928** | **8,677** |
| Consumer products | **277,176** | **1,986** | **279,162** | **269,621** | **9,541** | **208,780** | **11,095** | **16,485** |
| Other | **70,268** | **43,499** | **113,767** | **112,108** | **1,659** | **171,703** | **5,862** | **5,308** |
| Total | **1,149,698** | **87,920** | **1,237,618** | **1,236,634** | **984** | **1,183,646** | **35,102** | **39,700** |
| Eliminations and corporate | **—** | **(87,920)** | **(87,920)** | **(88,187)** | **267** | **23,160** | **(21)** | **(16)** |
| Consolidated total | **¥ 1,149,698** | **¥ —** | **¥ 1,149,698** | **¥ 1,148,447** | **¥ 1,251** | **¥ 1,206,806** | **¥ 35,081** | **¥ 39,684** |

| | Millions of yen | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1999 | | | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets | Depreciation and amortization | Capital expenditures |
| Transportation equipment | ¥ 184,040 | ¥ 2,326 | ¥ 186,366 | ¥ 201,462 | ¥(15,096) | ¥ 181,424 | ¥ 3,696 | ¥ 3,814 |
| Aerospace | 228,618 | 6,152 | 234,770 | 216,392 | 18,378 | 227,397 | 4,602 | 4,596 |
| Industrial equipment | 436,030 | 53,178 | 489,208 | 488,522 | 686 | 434,453 | 11,312 | 8,239 |
| Consumer products | 270,021 | 4,747 | 274,768 | 259,132 | 15,636 | 188,316 | 9,888 | 17,449 |
| Other | 83,480 | 44,138 | 127,618 | 125,461 | 2,157 | 192,349 | 5,134 | 8,046 |
| Total | 1,202,189 | 110,541 | 1,312,730 | 1,290,969 | 21,761 | 1,223,939 | 34,632 | 42,144 |
| Eliminations and corporate | — | (110,541) | (110,541) | (110,446) | (95) | (19,082) | (25) | (1) |
| Consolidated total | ¥ 1,202,189 | ¥ — | ¥ 1,202,189 | ¥ 1,180,523 | ¥ 21,666 | ¥ 1,204,857 | ¥ 34,607 | ¥ 42,143 |

| | Millions of yen | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1998 | | | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets | Depreciation and amortization | Capital expenditures |
| Transportation equipment | ¥ 213,418 | ¥ 1,640 | ¥ 215,058 | ¥ 220,966 | ¥ (5,908) | ¥ 163,551 | ¥ 3,652 | ¥ 2,885 |
| Aerospace | 255,328 | 6,173 | 261,501 | 240,962 | 20,539 | 218,618 | 4,695 | 3,823 |
| Industrial equipment | 485,353 | 53,608 | 538,961 | 521,358 | 17,603 | 444,082 | 10,592 | 9,787 |
| Consumer products | 259,107 | 3,825 | 262,932 | 246,158 | 16,774 | 198,657 | 8,695 | 10,729 |
| Other | 84,006 | 43,341 | 127,347 | 125,346 | 2,001 | 196,322 | 4,810 | 7,829 |
| Total | 1,297,212 | 108,587 | 1,405,799 | 1,354,790 | 51,009 | 1,221,230 | 32,444 | 35,053 |
| Eliminations and corporate | — | (108,587) | (108,587) | (108,657) | 70 | 1,676 | (28) | (23) |
| Consolidated total | ¥ 1,297,212 | ¥ — | ¥ 1,297,212 | ¥ 1,246,133 | ¥ 51,079 | ¥ 1,222,906 | ¥ 32,416 | ¥ 35,030 |

| | Thousands of U.S. dollars | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2000** | | | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets | Depreciation and amortization | Capital expenditures |
| Transportation equipment | **$ 1,553,858** | **$ 17,494** | **$ 1,571,352** | **$ 1,663,062** | **$(91,710)** | **$ 1,505,257** | **$ 34,677** | **$ 26,312** |
| Aerospace | **2,067,329** | **56,345** | **2,123,674** | **2,021,978** | **101,696** | **1,898,201** | **42,732** | **60,641** |
| Industrial equipment | **3,936,552** | **325,926** | **4,262,478** | **4,368,705** | **(106,227)** | **4,162,845** | **93,528** | **81,743** |
| Consumer products | **2,611,173** | **18,709** | **2,629,882** | **2,540,000** | **89,882** | **1,966,839** | **104,522** | **155,299** |
| Other | **661,969** | **409,788** | **1,071,757** | **1,056,128** | **15,629** | **1,617,550** | **55,224** | **50,005** |
| Total | **10,830,881** | **828,262** | **11,659,143** | **11,649,873** | **9,270** | **11,150,692** | **330,683** | **374,000** |
| Eliminations and corporate | **—** | **(828,262)** | **(828,262)** | **(830,777)** | **2,515** | **218,182** | **(198)** | **(151)** |
| Consolidated total | **$10,830,881** | **$ —** | **$10,830,881** | **$10,819,096** | **$ 11,785** | **$11,368,874** | **$330,485** | **$373,849** |

*(b) Information by geographic area*

Segment information by geographic area, as required to be disclosed in Japan, for the respective years is as follows:

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | **2000** | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets |
| Japan | **¥ 929,110** | **¥ 148,766** | **¥ 1,077,876** | **¥ 1,082,344** | **¥ (4,468)** | **¥ 1,084,113** |
| North America | **160,436** | **11,288** | **171,724** | **167,977** | **3,747** | **105,322** |
| Europe | **39,554** | **4,515** | **44,069** | **43,231** | **838** | **24,496** |
| Asia | **16,321** | **4,009** | **20,330** | **21,927** | **(1,597)** | **16,675** |
| Other areas | **4,277** | **128** | **4,405** | **4,318** | **87** | **1,894** |
| Total | **1,149,698** | **168,706** | **1,318,404** | **1,319,797** | **(1,393)** | **1,232,500** |
| Eliminations and corporate | **—** | **(168,706)** | **(168,706)** | **(171,350)** | **2,644** | **(25,694)** |
| Consolidated total | **¥ 1,149,698** | **¥ —** | **¥ 1,149,698** | **¥ 1,148,447** | **¥ 1,251** | **¥ 1,206,806** |

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | 1999 | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets |
| Japan | ¥ 982,857 | ¥ 154,699 | ¥ 1,137,556 | ¥ 1,110,276 | ¥ 27,280 | ¥ 1,106,765 |
| North America | 155,635 | 11,869 | 167,504 | 172,780 | (5,276) | 112,105 |
| Europe | 46,287 | 6,252 | 52,539 | 51,224 | 1,315 | 25,736 |
| Asia | 12,881 | 2,855 | 15,736 | 16,611 | (875) | 17,036 |
| Other areas | 4,529 | — | 4,529 | 4,482 | 47 | 1,777 |
| Total | 1,202,189 | 175,675 | 1,377,864 | 1,355,373 | 22,491 | 1,263,419 |
| Eliminations and corporate | — | (175,675) | (175,675) | (174,850) | (825) | (58,562) |
| Consolidated total | ¥ 1,202,189 | ¥ — | ¥ 1,202,189 | ¥ 1,180,523 | ¥ 21,666 | ¥ 1,204,857 |

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | 1998 | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets |
| Japan | ¥ 1,105,123 | ¥ 125,662 | ¥ 1,230,785 | ¥ 1,183,543 | ¥ 47,242 | ¥ 1,096,854 |
| North America | 127,613 | 9,830 | 137,443 | 136,519 | 924 | 120,853 |
| Europe | 36,922 | 6,194 | 43,116 | 41,810 | 1,306 | 20,830 |
| Asia | 23,056 | 682 | 23,738 | 21,398 | 2,340 | 5,987 |
| Other areas | 4,498 | — | 4,498 | 4,353 | 145 | 1,669 |
| Total | 1,297,212 | 142,368 | 1,439,580 | 1,387,623 | 51,957 | 1,246,193 |
| Eliminations and corporate | — | (142,368) | (142,368) | (141,490) | (878) | (23,287) |
| Consolidated total | ¥ 1,297,212 | ¥ — | ¥ 1,297,212 | ¥ 1,246,133 | ¥ 51,079 | ¥ 1,222,906 |

| | Thousands of U.S. dollars | | | | | |
|---|---|---|---|---|---|---|
| | **2000** | | | | | |
| | External sales | Intersegment sales | Total sales | Operating expenses | Operating income | Total assets |
| Japan | **$ 8,752,803** | **$ 1,401,470** | **$10,154,273** | **$10,196,364** | **$(42,091)** | **$10,213,029** |
| North America | **1,511,408** | **106,340** | **1,617,748** | **1,582,449** | **35,299** | **992,200** |
| Europe | **372,624** | **42,534** | **415,158** | **407,263** | **7,895** | **230,768** |
| Asia | **153,754** | **37,767** | **191,521** | **206,566** | **(15,045)** | **157,089** |
| Other areas | **40,292** | **1,206** | **41,498** | **40,679** | **819** | **17,842** |
| Total | **10,830,881** | **1,589,317** | **12,420,198** | **12,433,321** | **(13,123)** | **11,610,928** |
| Eliminations and corporate | **—** | **(1,589,317)** | **(1,589,317)** | **(1,614,225)** | **24,908** | **(242,054)** |
| Consolidated total | **$10,830,881** | **$ —** | **$10,830,881** | **$10,819,096** | **$ 11,785** | **$11,368,874** |

*(c) Corporate assets*

Included in eliminations and corporate in (a) and (b) above under total assets are corporate assets of ¥33,062 million ($311,465 thousand), ¥34,540 million and ¥59,245 million at March 31, 2000, 1999 and 1998, respectively, which are mainly comprised of cash and time deposits of the Company.

*(d) Overseas sales*

Overseas sales consist of the total sales of the Company and its consolidated subsidiaries made outside of Japan. Overseas sales information, as required to be disclosed in Japan, for the respective years is as follows:

| | Millions of yen | % | Millions of yen | % | Millions of yen | % | Thousands of U.S. dollars |
|---|---|---|---|---|---|---|---|
| | **2000** | | 1999 | | 1998 | | **2000** |
| | Overseas sales | % against net sales | Overseas sales | % against net sales | Overseas sales | % against net sales | Overseas sales |
| North America | **¥ 221,272** | **19.2%** | ¥ 231,159 | 19.2% | ¥179,235 | 13.8% | **$ 2,084,522** |
| Europe | **93,984** | **8.2%** | 87,683 | 7.3% | 66,806 | 5.1% | **885,389** |
| Asia | **75,058** | **6.5%** | 70,845 | 5.9% | 99,413 | 7.7% | **707,094** |
| Other areas | **71,191** | **6.2%** | 81,453 | 6.8% | 102,599 | 7.9% | **670,664** |
| Total | **¥ 461,505** | **40.1%** | ¥ 471,140 | 39.2% | ¥448,053 | 34.5% | **$ 4,347,669** |

# Report of Independent Public Accountants

To the Shareholders and the Board of Directors of Kawasaki Heavy Industries, Ltd.:

We have audited the accompanying consolidated balance sheets of Kawasaki Heavy Industries, Ltd. (a Japanese corporation) and subsidiaries as of March 31, 2000 and 1999, and the related consolidated statements of operations and shareholders' equity for each of the three years in the period ended March 31, 2000 and cash flows for each of the two years in the period ended March 31, 2000, expressed in Japanese yen. Our audits were made in accordance with generally accepted auditing standards in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of Kawasaki Heavy Industries, Ltd. and subsidiaries as of March 31, 2000 and 1999, and the consolidated results of their operations for each of the three years in the period ended March 31, 2000 and their cash flows for each of the two years in the period ended March 31, 2000 in conformity with accounting principles generally accepted in Japan which, except for the change in the method of segmentation referred to in Note 15, were applied on a consistent basis.

Also, in our opinion, the U.S. dollar amounts in the accompanying consolidated financial statements have been translated from Japanese yen on the basis set forth in Note 1.

Asahi & Co.

Asahi & Co.
(Member Firm of Andersen Worldwide SC)

Kobe, Japan
June 29, 2000

*Statement on Accounting Principles and Auditing Standards*
*This statement is to remind users that accounting principles and auditing standards and their application in practice may vary among nations and therefore could affect, possibly materially, the reported financial position and results of operations. The accompanying financial statements are prepared based on accounting principles generally accepted in Japan, and the auditing standards and their application in practice are those generally accepted in Japan. Accordingly, the accompanying financial statements and the auditors' report presented above are for users familiar with Japanese accounting principles, auditing standards and their application in practice.*

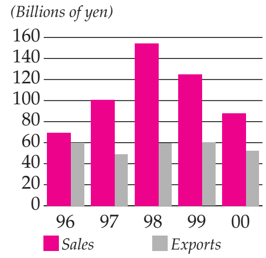
# Supplementary Information on Non-Consolidated Results

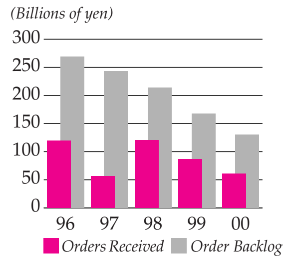
Years ended March 31

## Ships

*(Billions of yen)*

| | 96 | 97 | 98 | 99 | 00 |
|---|---|---|---|---|---|
| Sales | 69.5 | 100.6 | 154.5 | 124.9 | 88.0 |
| Exports | 60.0 | 49.0 | 59.4 | 60.2 | 52.4 |
| Orders Received | 119.3 | 56.3 | 120.9 | 86.5 | 60.6 |
| Order Backlog | 269.1 | 243.5 | 213.6 | 168.0 | 130.1 |




Major Orders

- 7 Container ships
- 1 Bulk carrier
- 1 Submarine
- Canceled: 3 VLCCs

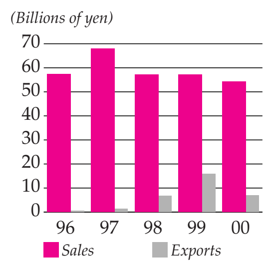
Major Components of Sales

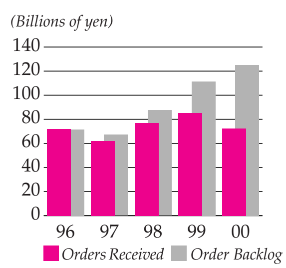
- VLCC
  (Very Large Crude-oil Carrier)
- LNG carrier
- LPG carrier
- Pure car carrier
- RO/RO Ship
- Patrol Ship
- Submarine
- Deep submergence rescue vehicle

## Rolling Stock

*(Billions of yen)*

| | 96 | 97 | 98 | 99 | 00 |
|---|---|---|---|---|---|
| Sales | 57.3 | 68.0 | 57.1 | 57.2 | 54.2 |
| Exports | 0.3 | 1.3 | 6.7 | 15.9 | 7.0 |
| Orders Received | 72.0 | 62.0 | 77.0 | 85.1 | 72.5 |
| Order Backlog | 71.6 | 67.2 | 87.5 | 111.5 | 125.2 |




Major Orders

- 388 cars for JR Group, including 131 Shinkansen cars
- 147 cars for other domestic railways
- 70 cars for Hong Kong

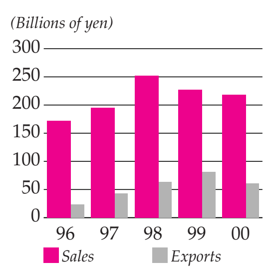
Major Components of Sales

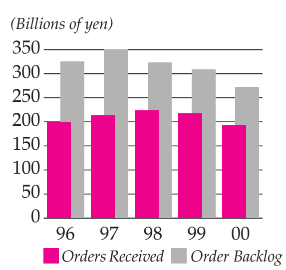
- 246 cars for JR Group, including 87 Shinkansen cars
- 235 cars for other domestic railways
- 24 subway cars for Singapore
- 8 electric locomotives for Panama

## Aerospace

*(Billions of yen)*

| | 96 | 97 | 98 | 99 | 00 |
|---|---|---|---|---|---|
| Sales | 171.8 | 194.9 | 252.3 | 226.8 | 217.9 |
| Exports | 23.4 | 43.4 | 63.2 | 81.1 | 61.0 |
| Orders Received | 198.5 | 212.8 | 223.9 | 217.4 | 192.6 |
| Order Backlog | 324.9 | 349.7 | 323.0 | 308.6 | 272.0 |




Major Orders

- T-4 intermediate jet trainers
- CH-47J large transport helicopters
- OH-1 light observation helicopters
- Helicopter engines
- Gas turbine engines for naval vessels
- Component parts for the Boeing 767 and 777
- Component parts for V2500, RB211/Trent and PW4000 turbo-fan engines

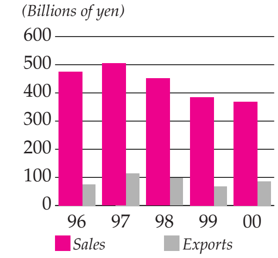
Major Components of Sales

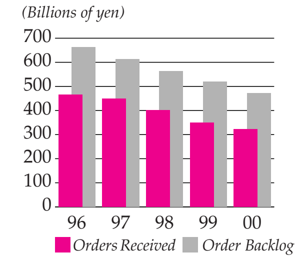
- T-4 intermediate jet trainers
- CH-47J large transport helicopters
- OH-1 light observation helicopters
- UP-3D fleet EW training support aircraft
- Helicopter engines
- Gas turbine engines for naval vessels
- Component parts for the Boeing 767 and 777
- Component parts for V2500, RB211/Trent and PW4000 turbo-fan engines

## Industrial Equipment

(Billions of yen)

| | 96 | 97 | 98 | 99 | 00 |
|---|---|---|---|---|---|
| Sales | 475.2 | 505.1 | 451.6 | 385.0 | 368.7 |
| Exports | 75.2 | 114.7 | 97.6 | 68.3 | 86.3 |
| Orders Received | 465.3 | 450.0 | 400.6 | 349.6 | 323.6 |
| Order Backlog | 663.3 | 612.7 | 562.4 | 520.6 | 471.9 |




### Major Orders

- Municipal refuse incineration plants and plant modifications for dioxin reduction
- Flue gas desulfurization plant from Taiwan
- Acrylic fiber manufacturing plant from China
- Marine gas turbines and diesel engines from domestic and overseas customers
- Natural gas compression modules from Malaysia
- Bridges
- Container cranes

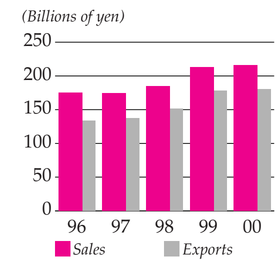
### Major Components of Sales

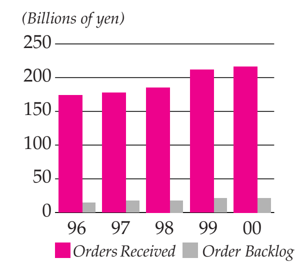
- Municipal refuse incineration plants and plant modifications for dioxin reduction
- Cogeneration power plant for a domestic steel manufacturer
- Hot strip mill for a domestic steel manufacturer
- Cattle-feed / food additive production plants to the United Sates
- Heat recovering boiler to India
- Baggage and cargo handling systems for China
- Marine gas turbines and diesel engines for domestic and overseas customers
- Shield machines and tunnel boring machines

## Consumer Products

(Billions of yen)

| | 96 | 97 | 98 | 99 | 00 |
|---|---|---|---|---|---|
| Sales | 175.2 | 174.4 | 184.7 | 213.1 | 216.0 |
| Exports | 134.1 | 137.3 | 151.7 | 178.6 | 180.8 |
| Orders Received | 173.8 | 177.4 | 185.3 | 211.7 | 216.5 |
| Order Backlog | 14.7 | 17.7 | 17.9 | 21.4 | 21.6 |



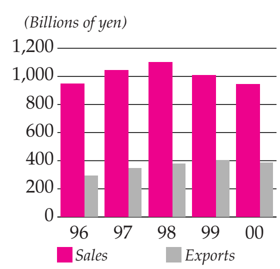



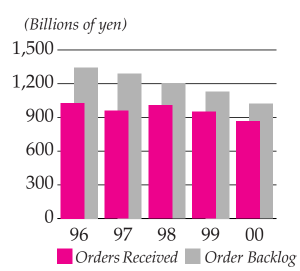

Sales of motorcycles in the United States and Europe remained robust and motorcycle demand in Asia also recovered. Sales of ATVs (All-Terrain Vehicles) and *MULE* utility vehicles also rose in the United States. As a result, despite the effects of the strong yen, sales rose slightly compared with the previous year.

## Total

(Billions of yen)

| | 96 | 97 | 98 | 99 | 00 |
|---|---|---|---|---|---|
| Sales | 949.0 | 1,043.0 | 1,100.2 | 1,007.0 | 944.8 |
| Exports | 293.0 | 345.7 | 378.6 | 404.1 | 387.5 |
| Orders Received | 1,028.9 | 958.5 | 1,007.7 | 950.3 | 865.8 |
| Order Backlog | 1,343.6 | 1,290.8 | 1,204.4 | 1,130.1 | 1,020.8 |



# Board of Directors

Yasuhiko Ono
**Executive Vice President**

Kenjiro Ogata
**Executive Vice President**

Yoshiro Inoue
**Executive Vice President**

Toshio Kamei
**Chairman**

Masamoto Tazaki
**President**

**Chairman**
Toshio Kamei

**President**
Masamoto Tazaki *

**Executive Vice Presidents**

Kenjiro Ogata *
Overall Administration of Market Development Department, Kansai Project Research & Development Department, International Operations Department, Domestic and Overseas Offices and Plant Engineering Group

Yasuhiko Ono *
Overall Administration of Technology Group and Ship Division

Yoshiro Inoue *
Overall Administration of Planning and Control

**Executive Managing Directors**

Hiromichi Takawa *
Senior General Manager of Plant Engineering Group

Shigeji Yamada *
Senior General Manager of Machinery & Steel Structure Group

Toshiaki Ouchida *
Senior General Manager of Aerospace Group

**Managing Directors**

Tadashi Nishimura
Senior General Manager of Gas Turbine & Machinery Group

Toru Ohmae
Senior General Manager of Consumer Products & Machinery Group

Takashi Sugoh
Deputy Senior General Manager of Aerospace Group

Hironobu Hashiguchi
Senior General Manager of Technology Group

Takehiko Saeki
Senior General Manager of Rolling Stock & Construction Machinery Group
Deputy Senior General Manager of Consumer Products & Machinery Group

Minoru Sakasai
Deputy Senior General Manager of Plant Engineering Group

**Directors**

Kazuo Mizuno
General Manager of Steel Structure & Industrial Equipment Division

Toshio Atsuta
Deputy Senior General Manager of Technology Group

Takuya Maeda
General Manager of Industrial Plant Engineering Division

Tadao Katoh
Senior Manager of General Administration Department

Shuichi Tadokoro
General Manager of Ship Division

Kosuke Sakano
Deputy Senior General Manager of Plant Engineering Group

Koumei Kawaji
General Manager of Aerospace Division

Yousuke Fujii
Deputy Senior General Manager of Consumer Products & Machinery Group

Kengo Yamashita
General Manager of Gas Turbine Division

Shiro Ikeda
Senior Manager of Personnel Department

Shinichi Morita
Senior Manager of Corporate Planning Office

Masakazu Sato
Senior Manager of Finance Department

**Corporate Auditors**

Akio Sera
Toshiaki Tatsuki
Mitsugi Maeda

(As of July 1, 2000)

** Representative Director*

# Major Consolidated Subsidiaries and Affiliates

| Name | Location | Paid-in Capital (Millions of yen, unless otherwise noted) | Equity (% ownership by KHI, unless otherwise noted) | Principal Businesses |
|---|---|---|---|---|
| **Transportation Equipment** | | | | |
| Kawasaki Rolling Stock Engineering Co., Ltd. | Japan | 140 | 100.00 | Manufacture and repair of parts and components for rolling stock; design of rolling stock |
| Kawasaki Industrial Co., Ltd. | Japan | 125 | 98.71 | Construction of arcades; manufacture and inspection of high-pressure containers; maintenance and repair of rolling stock |
| Kawasaki Rail Car, Inc. | U.S.A. | US$60,600* | 100.00 | Engineering, manufacture, sales and after-sales service of rolling stock in the United States |
| Nangtong Cosco KHI Ship Engineering Co., Ltd.† | China | US$80,000* | 50.00 | Manufacture and sale of ships |
| **Aerospace** | | | | |
| Kawasaki Helicopter System Ltd. | Japan | 200 | 100.00 | Transportation of passengers or cargo by helicopter; maintenance and repair of helicopters and flight training services; research, design and construction of heliports |
| Advanced Technology Institute of Commuter-Helicopter † | Japan | 8,025 | 19.40 | Research and development of basic technology for commuter helicopters |
| Japan Aircraft Manufacturing Co., Ltd.† | Japan | 6,048 | 25.70 | Manufacture and sale of aircraft parts |
| **Industrial Equipment** | | | | |
| Kawasaki Safety Service Industries, Ltd. | Japan | 1,708 | 72.69 | Manufacture, sale and installation of hospital respiration, fire-extinguishing and medical equipment |
| Kawasaki Thermal Engineering Co., Ltd. | Japan | 1,460 | 83.01 | Manufacture, sale and installation of general purpose boilers and air-conditioning equipment |
| Kawasaki Hydromechanics Corporation | Japan | 272 | 99.71 | Manufacture, sale and installation of hydraulic presses and various hydraulic equipment |
| Kawasaki Construction Co., Ltd. | Japan | 300 | 100.00 | Installation of steel structures |
| Kawasaki Machine Systems, Nishi-Nihon Ltd. | Japan | 104 | 100.00 | Sale and repair of industrial machinery and equipment |
| Kawasaki Machine Systems, Naka-Nihon Ltd. | Japan | 112 | 100.00 | Sale and repair of industrial machinery and equipment |
| Nichijo Manufacturing Co., Ltd. | Japan | 120 | 50.04 | Manufacture and sale of snow removal equipment |
| Kawasaki Construction Machinery Corp. of America | U.S.A. | US$8,000* | 100.00 (owned by Kawasaki Motors Corp., U.S.A.) | Manufacture and sale of construction machinery in the United States |
| Kawasaki Precision Machinery (UK) Limited | U.K. | £5,000* | 100.00 | Manufacture and sale of hydraulic products |
| Wuhan Kawasaki Marine Machinery Co., Ltd. | China | 1,100 | 55.00 | Manufacture, sale and after-sales service of Kawasaki-branded azimuth thrusters and side-thrusters, and other machinery |
| Kawasaki Setsubi Kogyo Co., Ltd.† | Japan | 1,581 | 33.62 | Design and installation of air conditioning, heating/cooling, plumbing and hygiene, lighting and power equipment and facilities |
| Japan Gas Turbine K.K.† | Japan | 1,500 | 40.00 | Sale, assembly, site engineering support, repair, testing, pilot operation, installation and arrangement of power generation equipment, plus related service-based businesses |
| Shanghai Cosco Kawasaki Heavy Industries Steel Structure Co., Ltd.† | China | US$14,900* | 40.00 | Manufacture and sale of steel structures |

| Name | Location | Paid-in Capital (Millions of yen, unless otherwise noted) | Equity (% ownership by KHI, unless otherwise noted) | Principal Businesses |
|---|---|---|---|---|
| **Consumer Products** | | | | |
| Kawasaki Motors Corporation Japan | Japan | 560 | 100.00 | Domestic wholesale of motorcycles and Jet Ski® personal watercraft |
| Kawasaki Metal Industries, Ltd. | Japan | 350 | 100.00 | Manufacture, processing and assembly of various steel products |
| Kawasaki Motors Manufacturing Corp., U.S.A. | U.S.A. | US$30,000* | 100.00 | Manufacture of motorcycles, all-terrain vehicles (ATVs), Jet Ski® personal watercraft, small gasoline engines and industrial robots |
| Kawasaki Motors Corp., U.S.A. | U.S.A. | US$65,900* | 100.00 | Distribution of motorcycles, all-terrain vehicles (ATVs), Jet Ski® personal watercraft and small gasoline engines in the United States |
| Kawasaki Motors Finance Corporation | U.S.A. | US$10,000* | 100.00 (owned by Kawasaki Motors Corp., U.S.A.) | Inventory financing for dealers of Kawasaki Motors Corp., U.S.A. |
| KM Receivables Corporation | U.S.A. | US$100 | 100.00 (owned by KMFC) | Management of accounts receivables of Kawasaki Motors Finance Corporation |
| Canadian Kawasaki Motors Inc. | Canada | C$2,000* | 100.00 | Distribution of motorcycles, all-terrain vehicles (ATVs), and Jet Ski® personal watercraft in Canada |
| Kawasaki Motors (UK) Ltd. | U.K. | £2,000* | 100.00 | Distribution of motorcycles, all-terrain vehicles (ATVs), and Jet Ski® personal watercraft in the United Kingdom |
| Kawasaki Motoren GmbH | Germany | DM12,300* | 100.00 | Distribution of motorcycles, all-terrain vehicles (ATVs), and Jet Ski® personal watercraft in Germany |
| Kawasaki Motors Pty. Ltd. | Australia | A$2,000* | 100.00 | Distribution of motorcycles, all-terrain vehicles (ATVs), and Jet Ski® personal watercraft in Australia |
| P.T. Kawasaki Motor Indonesia | Indonesia | US$10,000* | 51.00 | Manufacture and distribution of motorcycles in Indonesia |
| Kawasaki Motors (Phils.) Corporation | Philippines | P101,430* | 50.001 | Manufacture and distribution of motorcycles in the Philippines |
| Kawasaki Motors Enterprise (Thailand) Co., Ltd. | Thailand | B1,400,000* | 75.50 | Manufacture and distribution of motorcycles in Thailand |
| Kawasaki Robotics (U.S.A.), Inc. | U.S.A. | US$1,000* | 100.00 (owned by Kawasaki Motors Corp., U.S.A.) | Sales and after-sales service of industrial robots in the United States |
| Kawasaki Robotics (UK) Ltd. | U.K. | £917* | 100.00 | Sales and after-sales service of industrial robots in the U.K. and Ireland |
| Kawasaki Machine Systems Korea Ltd. | Korea | W1,500** | 100.00 | Sale and after-sales service of industrial robots, robot systems and other industrial machinery |
| Hainan Sundiro-Kawasaki Engine Co., Ltd.† | China | US$29,900* | 33.00 | Manufacture and sale of motorcycle engines |
| **Other** | | | | |
| Kawaju Shoji Co., Ltd. | Japan | 600 | 70.00 | Trading |
| Kawaju Real Estate Co., Ltd. | Japan | 320 | 100.00 | Administration of Company welfare facilities; real estate sales, leasing and construction |
| Kawasaki Kosan Co., Ltd. | Japan | 300 | 100.00 | Insurance representation; real estate leasing, administration and maintenance; leasing and provision of loans |
| Kawasaki Foods Co., Ltd. | Japan | 160 | 100.00 | Food supply to Company facilities; operation of dining facilities |

| Name | Location | Paid-in Capital (Millions of yen, unless otherwise noted) | Equity (% ownership by KHI, unless otherwise noted) | Principal Businesses |
|---|---|---|---|---|
| Kawaju Tomakomai Kanko Kaihatsu Co., Ltd. | Japan | 300 | 100.00 | Management of a golf course |
| Uji Kanko Co., Ltd. | Japan | 240 | 100.00 | Management of a golf course |
| Kawasaki do Brasil Industria e Comércio Ltda. | Brazil | R1,136* | 100.00 | Sale of KHI products in Brazil, and the rest of Central and South America; provision of order intermediation and various engineering services |
| Kawasaki Heavy Industries (U.S.A.), Inc. | U.S.A. | US$600* | 100.00 | Product sales, mediation of orders and provision of various engineering support services in North America |
| Kawasaki Heavy Industries (UK) Ltd. | U.K. | £500* | 100.00 | Sale of KHI products in various countries in Europe (principally the U.K.), the Middle East, and Africa; provision of order intermediation services |

* Monetary unit in thousands
** Monetary unit in millions
† Affiliate accounted for using equity method

(As of March 31, 2000)

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**Maryville Plant**
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**Kawasaki Construction Machinery Corp. of America**
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## OVERSEAS JOINT VENTURES

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**Robots International Limited**
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Fax: 81-471-24-7645

**Yachiyo Works**
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Fax: 81-474-82-3227

**Chiba Works**
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Fax: 81-43-263-5525

**Sodegaura Works**
50-1, Minamisode, Sodegaura
Chiba 299-0268, Japan
Phone: 81-438-62-7127
Fax: 81-438-62-7129

**Gifu Works**
1, Kawasaki-cho, Kakamigahara
Gifu 504-8710, Japan
Phone: 81-583-82-5712
Fax: 81-583-82-2981

**Nagoya Works 1**
3-11, Oaza Kusunoki, Yatomi-cho
Ama-gun, Aichi 498-0066, Japan
Phone: 81-567-68-5117
Fax: 81-567-68-5090

**Nagoya Works 2**
7-4, Kanaoka, Tobishima-mura
Ama-gun, Aichi 490-1445, Japan
Phone: 81-5675-5-0800
Fax: 81-5675-5-0803

**Kobe Works**
1-1, Higashikawasaki-cho 3-chome
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Fax: 81-78-682-5500

**Hyogo Works**
1-18, Wadayama-dori 2-chome
Hyogo-ku, Kobe 652-0884, Japan
Phone: 81-78-682-3111
Fax: 81-78-671-5784

**Nishi-Kobe Works**
234, Matsumoto, Hazetani-cho
Nishi-ku, Kobe 651-2239, Japan
Phone: 81-78-991-1133
Fax: 81-78-991-3186

**Seishin Works**
8-1, Takatsukadai 2-chome
Nishi-ku, Kobe 651-2271, Japan
Phone: 81-78-992-1911
Fax: 81-78-992-1910

**Akashi Works**
1-1, Kawasaki-cho, Akashi
Hyogo 673-8666, Japan
Phone: 81-78-921-1301
Fax: 81-78-913-1366

**Banshu Works**
2680, Oka, Inami-cho
Kako-gun, Hyogo 675-1113, Japan
Phone: 81-794-95-1211
Fax: 81-794-95-1226

**Harima Works**
8, Niijima, Harima-cho
Kako-gun, Hyogo 675-0155, Japan
Phone: 81-794-35-2131
Fax: 81-794-35-2132

**Sakaide Works**
1, Kawasaki-cho, Sakaide
Kagawa 762-8507, Japan
Phone: 81-877-46-1473
Fax: 81-877-45-0556

# Kawasaki Corporate Data

(As of March 31, 2000)

Kawasaki Heavy Industries, Ltd.

Head Office:
Kobe Crystal Tower
1-3, Higashikawasaki-cho 1-chome
Chuo-ku, Kobe 650-8680, Japan

Founded: 1878

Incorporated: 1896

Paid-in Capital:
¥81,426,590,792

Number of Shares Outstanding:
1,390,595,964 shares

Number of Shareholders:
128,242

Number of Employees:
29,772

Stock Exchange Listings:
Tokyo, Osaka, Nagoya, Kyoto,
Fukuoka, Sapporo

Newspapers in which public notices are made:
The Nihon Keizai Shimbun
The Kobe Shimbun

Transfer Agent:
The Chuo Mitsui Trust and Banking Company, Limited
7-1, Kyobashi 1-chome
Chuo-ku, Tokyo 104-0031, Japan

Handling Office
The Chuo Mitsui Trust and Banking Company, Limited
Osaka Branch Office
2-21, Kitahama 2-chome
Chuo-ku, Osaka 541-0041, Japan

Independent Auditors:
Asahi & Co.
Kobe Crystal Tower
1-3, Higashikawasaki-cho 1-chome
Chuo-ku, Kobe 650-8680, Japan

ADR Facility:
KHI has a sponsored American Depository Receipt (ADR) facility. ADRs are traded in the over-the-counter (OTC) market in the United States under cusip number 486 359 20 1 with each ADR representing four ordinary shares.

ADR Depository:
The Bank of New York
101 Barclay St., 22 West
New York, NY 10286, U.S.A.
Phone: 1-212-815-2042
U.S. Toll Free: 888-269-2377
(888-BNY-ADRS)
http://www.bankofny.com/adr

KHI Home Page at:
http://www.khi.co.jp

Kawasaki

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