

# Kobe Steel Interim Report 2003

*Six Months Ended  
September 30*

**KOBELCO**  
 **KOBE STEEL, LTD.**

## Message from the President

In the first half of fiscal 2003, Japan's exports to China, other Asian countries and the United States increased and private-sector capital investment showed signs of improvement. Although there were indications that business activity was picking up, the economy did not achieve full recovery.

Under these conditions, Kobe Steel, Ltd. continued to place its full efforts into reducing costs and increasing profitability. For the half-year period ended September 30, 2003, orders fell for municipal solid waste treatment plants due to sluggish demand. However, steel exports to Asia were high and demand was strong for construction equipment in China. As a result, consolidated net sales at Kobe Steel rose 1.7% to ¥587 billion. Operating income went up 21.8% to ¥42 billion, and net income rose 72.1% to ¥9.0 billion.

### *Iron and Steel*

Domestic steel demand was firm in the first half of the fiscal year. Although the construction industry was sluggish, export demand from the automotive and other manufacturing markets was strong and private-sector capital investment showed improvement. With steel exports mainly to Asia at a high level, Japan's crude steel production increased over the same period last year. Market conditions continued to improve for steel, as demand tightened both in Japan and overseas.

With this background, vigorous marketing and the stable operations of the No. 1 Power Plant in our wholesale electric power supply business contributed to a 5.0% increase in segment sales to ¥265.1 billion. Operating income went up 30.6% to ¥27.9 billion, owing to an increase in the shipments of steel products and improvement in sales prices.

In our wholesale electricity supply business, trial operation of the No. 2 Power Plant began in July 2003 and the start-up of commercial operations is slated for April 2004. Together with the No. 1 Power Plant, we will have a total generation capacity of 1.4 million kilowatts of electricity when both plants are in operation in April.

### *Aluminum and Copper*

Although the cool summer and higher taxes on *happoshu*, a low-malt beer, reduced demand for beverage containers, the growth in aluminum bottle cans led to a small increase in the shipments of rolled aluminum products in the half-year period. Demand for automotive sheet, plate for semiconductor and liquid crystal fabrication equipment, blanks for disk drives, and automotive extrusions was firm, leading to higher overall aluminum shipments over the same period last year.

Shipments of rolled copper products were up over the same period last year. Demand for copper strip used in electronic applications was flat in comparison to the same period last year, but demand for copper tube for air conditioners increased in Japan.

Although product sales increased, our withdrawal from overseas aluminum ingot projects led to a 4.1% decrease in segment sales to ¥122.8 billion. Operating income increased 13.0% to ¥7.2 billion owing to higher product shipments and overall cost reductions.

### *Machinery*

Domestic orders increased 21.8% to ¥63.4 billion due to higher

private-sector capital investments that supported orders for rotating machinery, tire machinery and environmental equipment. Overseas orders rose 6.5% to ¥15.9 billion owing to strong demand for rotating machinery and tire machinery to China. As a result, total orders for the Machinery segment increased 18.4% to ¥79.3 billion and the backlog of orders for the half year was ¥147.7 billion.

Machinery segment sales decreased 15.1% to ¥83.5 billion due to low orders for municipal solid waste treatment plants. Operating income went down ¥2.6 billion, resulting in an operating loss of ¥2.4 billion.

### *Construction Machinery*

The domestic construction machinery market began showing signs of recovery as replacement purchases increased. In China, demand for construction equipment was strong due to the large push in infrastructure projects. Demand in Southeast Asia was also strong, while the North American market gradually started to recover.

Owing to robust demand in China and improvement in the domestic market, segment sales increased 27.2% to ¥93.3 billion. Operating income rose 134.5% to ¥3.5 billion.

### *Real Estate*

A tax break on housing loans stimulated demand in the real estate market, leading to a slight increase in housing starts - the first increase in four years. Owing to strong marketing efforts, segment sales increased 30.8% to ¥20.6 billion. Operating income rose 34.8% to ¥2.6 billion.

### *Other Businesses*

The transfer of equity shares in a semiconductor testing subsidiary led to an 18.8% decline in segment sales to ¥20.7 billion. Operating income increased 20.9% to ¥2.7 billion owing to the improved performance of a subsidiary engaged in materials testing and the manufacture of target material for liquid crystal displays.

### *Outlook*

Japan's economy is not expected to achieve a full recovery in the second half of the fiscal year. While private-sector capital investment is showing signs of improvement, the severe employment situation and low incomes are putting downward pressure on personal spending.

Under these conditions, we are carrying out our Fiscal 2003-2005 Consolidated Medium-Term Business Plan to improve the profitability, performance and business foundation of the Company.

Our financial targets are to achieve a pretax ordinary income of ¥80 billion, increase return on assets to 6%, and reduce debt by ¥250 billion to ¥640 billion. Over the next three years, we intend to create and expand sales of distinctive, value-added products; further advance our alliances; respond to the global market; reduce costs and undertake investments to improve competitiveness; and improve corporate governance.

Moving forward to meet these goals, we ask for your continued understanding and support.

December 2003

Koshi Mizukoshi  
President and Chief Executive Officer



## Consolidated Interim Balance Sheets

At September 30, 2003 and 2002 (unaudited)

Assets	Thousands of U.S. dollars			Liabilities, Minority Interests and Stockholders' Equity	Thousands of U.S. dollars		
	Millions of yen		(Note 1)		Millions of yen		(Note 1)
	2003	2002	2003	2003	2002	2003	
<i>Current assets:</i>				<i>Current liabilities:</i>			
Cash and time deposits	¥ 89,026	¥ 100,830	\$ 800,234	Short-term borrowings	¥ 161,163	¥ 292,583	\$ 1,448,656
Marketable securities	—	7	—	Current portion of long-term debt	186,550	87,931	1,676,854
Notes and accounts receivable:				Notes and accounts payable			
Trade	187,272	193,079	1,683,344	Trade	231,645	201,202	2,082,202
Unconsolidated subsidiaries and affiliates	79,795	70,323	717,258	Construction	11,586	18,624	104,144
Other	17,981	15,452	161,627	Unconsolidated subsidiaries and affiliates	58,411	53,146	525,043
Allowance for doubtful accounts	(1,526)	(1,144)	(13,717)	Other	17,051	11,375	153,267
	283,522	277,710	2,548,512		318,693	284,347	2,864,656
Inventories	231,725	227,756	2,082,921	Advances from customers	27,007	28,956	242,760
Deferred income taxes	22,947	17,439	206,265	Customers' and employees' deposits	21,158	20,655	190,184
Other	20,128	20,231	180,926	Provision for restructuring costs	6,880	8,295	61,843
Total current assets	647,348	643,973	5,818,858	Income and enterprise taxes payable	4,094	3,906	36,800
				Deferred income taxes	938	102	8,431
				Other	44,621	46,806	401,088
				Total current liabilities	771,104	773,581	6,931,272
<i>Investments and other assets:</i>				<i>Long-term liabilities:</i>			
Investments in securities	71,872	51,534	646,041	Long-term debt	595,769	668,466	5,355,227
Investments in and advances to unconsolidated subsidiaries and affiliates	40,036	44,446	359,874	Employees' severance and retirement benefits	54,952	54,595	493,951
Long-term loans receivable	6,467	7,747	58,130	Deferred income taxes	8,462	10,507	76,063
Other	83,819	80,829	753,429	Other	105,117	105,367	944,872
Allowance for doubtful accounts	(9,339)	(9,875)	(83,946)		764,300	838,935	6,870,113
	192,855	174,681	1,733,528				
<i>Plant and equipment:</i>				<i>Contingent liabilities (Note 2)</i>			
Land	226,125	224,180	2,032,584				
Buildings and structures	596,049	613,471	5,357,744	<i>Minority interests</i>	29,434	29,705	264,575
Machinery and equipment	1,720,384	1,760,223	15,464,126				
Construction in progress	45,499	30,349	408,980				
	2,588,057	2,628,223	23,263,434				
Less accumulated depreciation	(1,627,753)	(1,618,574)	(14,631,488)	<i>Stockholders' equity:</i>			
	960,304	1,009,649	8,631,946	Common stock			
				Authorized-6,000,000 shares			
				Issued-2,974,549,861 shares in 2003			
				and 2,867,549,861 in 2002	218,163	215,167	1,961,016
				Capital surplus	67,975	137,643	611,011
				Retained earnings (Accumulated deficit)	20,821	(58,087)	187,155
				Land revaluation	3,254	2,313	29,250
				Net unrealized holding gains (losses) on securities	12,067	(1,042)	108,467
				Foreign currency translation adjustments	(7,746)	(9,948)	(69,627)
				Treasury stock, at cost	(1,017)	(752)	(9,142)
				Total stockholders' equity	313,517	285,294	2,818,130
					¥ 1,878,355	¥ 1,927,515	\$ 16,884,090
<i>Intangible assets</i>	16,942	21,211	152,288				
<i>Deferred income taxes</i>	60,906	78,001	547,470				
	¥ 1,878,355	¥ 1,927,515	\$ 16,884,090				

See accompanying notes.

## Consolidated Interim Statements of Income

Six months ended September 30, 2003 and 2002 (unaudited)

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2002	2003
<i>Net sales</i>	¥ 587,047	¥ 577,371	\$ 5,276,827
<i>Cost of sales</i>	483,058	481,677	4,342,094
Gross profit	103,989	95,694	934,733
<i>Selling, general and administrative expenses</i>	61,961	61,178	556,953
Operating income	42,028	34,516	377,780
<i>Other income (expenses):</i>			
Interest and dividend income	1,185	1,104	10,652
Interest expense	(13,333)	(15,127)	(119,847)
Seconded employees' salaries net of reimbursement	(9,938)	(9,144)	(89,331)
Gain on sale of securities	5,520	6,440	49,618
Loss on sale or disposal of plant and equipment	(2,636)	(2,823)	(23,694)
Loss on disposal of inventories	—	(2,660)	—
Business transfer gain	—	2,351	—
Foreign exchange loss	(1,820)	(2,122)	(16,360)
Reversal of allowance for special repairs	—	5,913	—
Special employees' retirement benefits	—	(980)	—
Effect of applying new accounting standard for retirement benefits	(6,368)	(6,383)	(57,241)
Provision for restructuring costs	—	(987)	—
Amortization of prior service credits of pension plans	3,488	3,488	31,353
Equity in income of unconsolidated subsidiaries and affiliates	3,479	2,138	31,272
Other, net	(4,428)	(4,488)	(39,802)
	(24,851)	(23,280)	(223,380)
<i>Income before income taxes</i>	17,177	11,236	154,400
<i>Income taxes:</i>			
Current	2,953	2,700	26,544
Deferred	4,159	3,444	37,384
	7,112	6,144	63,928
<i>Minority interests in losses (income) of subsidiaries</i>	(1,068)	137	(9,600)
<i>Net income</i>	¥ 8,997	¥ 5,229	\$ 80,872
	Yen		U.S. dollars (Note 1)
<i>Net income per 1,000 shares</i>	¥ 3,036	¥ 1,831	\$ 27,29

See accompanying notes.

## Consolidated Interim Statements of Cash Flows

Six months ended September 30, 2003 and 2002 (unaudited)

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2002	2003
<i>Cash flows from operating activities</i>			
Income before income taxes	17,177	11,236	154,400
Depreciation	39,229	43,577	352,620
Interest and dividend income	(1,185)	(1,104)	(10,652)
Interest expense	13,333	15,127	119,847
Gain on sale of securities	(5,520)	(6,440)	(49,618)
Equity in income of unconsolidated subsidiaries and affiliates	(3,479)	(2,138)	(31,272)
Special employees' retirement benefits	—	980	—
Reversal of allowance for special repairs	—	(5,913)	—
Business transfer gain	—	(2,351)	—
Effect of applying new accounting standard for retirement benefits	6,368	6,383	57,241
Amortization of prior service credits of pension plans	(3,488)	(3,488)	(31,353)
Loss on sale or disposal of plant and equipment	2,636	2,823	23,694
Decrease in trade receivables from customers	19,090	26,352	171,596
Increase in inventories	(12,075)	(6,097)	(108,539)
Decrease in trade payables to customers	(12,750)	(8,217)	(114,607)
Other	(10,244)	3,621	(92,081)
Subtotal	<u>49,092</u>	<u>74,351</u>	<u>441,276</u>
Cash received for interest and dividends	2,152	2,068	19,344
Cash paid for interest	(13,190)	(14,342)	(118,562)
Cash paid for special employees' retirement benefits	—	(1,645)	—
Cash paid for income taxes	(4,317)	(3,048)	(38,804)
Net cash provided by operating activities	<u>33,737</u>	<u>57,384</u>	<u>303,254</u>
<i>Cash flows from investing activities</i>			
Purchase of plant, equipment and other assets	(23,172)	(28,785)	(208,288)
Proceeds from sale of plant, equipment and other assets	6,689	22,911	60,126
Purchase of investments in securities	(5,014)	(2,701)	(45,070)
Proceeds from sale of investments in securities	9,010	7,633	80,989
Decrease (increase) in short-term loans receivable	(503)	918	(4,521)
Long-term loans receivable	(569)	(309)	(5,115)
Proceeds from collection of long-term loans	806	532	7,245
Net proceeds from sale of a former consolidated subsidiary	2,227	—	20,018
Proceeds from transfer of business	—	21,055	—
Other	707	254	6,355
Net cash provided by (used in) investing activities	<u>(9,819)</u>	<u>21,508</u>	<u>(88,261)</u>
<i>Cash flows from financing activities</i>			
Decrease in short-term borrowings	(272)	(31,454)	(2,445)
Proceeds from issuance of long-term debt	15,939	49,702	143,272
Repayment of long-term debt	(79,217)	(70,206)	(712,063)
Proceeds from issuance of bonds	53,808	—	483,667
Repayment of bonds	(3,886)	(36,404)	(34,930)
Other	(5,423)	(4,855)	(48,746)
Net cash used in financing activities	<u>(19,051)</u>	<u>(93,217)</u>	<u>(171,245)</u>
<i>Effect of exchange rate changes on cash and cash equivalents</i>			
	<u>994</u>	<u>(1,047)</u>	<u>8,935</u>
<i>Increase (decrease) in cash and cash equivalents</i>	<u>5,861</u>	<u>(15,372)</u>	<u>52,683</u>
<i>Cash and cash equivalents at the beginning of the six months</i>	81,809	115,292	735,362
<i>Cash and cash equivalents of newly consolidated subsidiaries</i>	<u>696</u>	<u>107</u>	<u>6,256</u>
<i>Cash and cash equivalents at the end of the six months</i>	<u>88,366</u>	<u>100,027</u>	<u>794,301</u>

See accompanying notes.

## Consolidated Interim Statement of Stockholders' Equity

Six months ended September 30, 2003 (unaudited)

	Millions of yen							
	Shares of common stock	Common stock	Capital surplus	Retained earnings (Accumulated deficit)	Land revaluation	Net unrealized holding gains (losses) on securities	Foreign currency translation adjustments	Treasury stock
Balance at April 1, 2003	2,974,549,861	¥ 218,163	¥ 140,639	¥ (61,710)	¥ 2,422	¥ (939)	¥ (4,580)	¥ (857)
Net income	—	—	—	8,997	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	(3,166)	—
Unrealized holding gains on securities	—	—	—	—	—	13,006	—	—
Adjustment to additional paid-in capital	—	—	(72,728)	72,728	—	—	—	—
Gain on sale of treasury stock	—	—	64	—	—	—	—	—
Effect of merger of subsidiaries now accounted for by the equity method	—	—	—	(411)	—	—	—	—
Bonuses to directors	—	—	—	(21)	—	—	—	—
Increase due to merger of subsidiaries	—	—	—	7	—	—	—	—
Increase due to changes in consolidated subsidiaries	—	—	—	2	—	—	—	—
Increase due to changes in investees accounted for by the equity method	—	—	—	1,360	—	—	—	—
Adjustment to revaluation of land	—	—	—	(131)	832	—	—	—
Treasury stock	—	—	—	—	—	—	—	(160)
Balance at September 30, 2003	2,974,549,861	¥ 218,163	¥ 67,975	¥ 20,821	¥ 3,254	¥ 12,067	¥ (7,746)	¥ (1,017)

	Thousands of U.S. dollars (Note 1)							
	Common stock	Capital surplus	Retained earnings (Accumulated deficit)	Land revaluation	Net unrealized holding gains (losses) on securities	Foreign currency translation adjustments	Treasury stock	
Balance at April 1, 2003	\$ 1,961,016	\$ 1,264,171	\$ (554,697)	\$ 21,771	\$ (8,441)	\$ (41,169)	\$ (7,704)	
Net income	—	—	80,872	—	—	—	—	
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	(28,458)	—	
Unrealized holding gains on securities	—	—	—	—	116,908	—	—	
Adjustment to additional paid-in capital	—	(653,735)	653,735	—	—	—	—	
Gain on sale of treasury stock	—	575	—	—	—	—	—	
Effect of merger of subsidiaries now accounted for by the equity method	—	—	(3,694)	—	—	—	—	
Bonuses to directors	—	—	(189)	—	—	—	—	
Increase due to merger of subsidiaries	—	—	63	—	—	—	—	
Increase due to changes in consolidated subsidiaries	—	—	18	—	—	—	—	
Increase due to changes in investees accounted for by the equity method	—	—	12,225	—	—	—	—	
Adjustment to revaluation of land	—	—	(1,178)	7,479	—	—	—	
Treasury stock	—	—	—	—	—	—	(1,438)	
Balance at September 30, 2003	\$ 1,961,016	\$ 611,011	\$ 187,155	\$ 29,250	\$ 108,467	\$ (69,627)	\$ (9,142)	

See accompanying notes.

## Notes to Consolidated Interim Financial Statements September 30, 2003 (Unaudited)

### 1. Presentation of Financial Statements

Kobe Steel, Ltd. (the "Company") and its consolidated domestic subsidiaries maintain their official accounting records in Japanese yen and in accordance with the provisions set forth in the Japanese Commercial Code and accounting principles and practices generally accepted in Japan ("Japanese GAAP"). The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile.

The accompanying consolidated interim financial statements should be read in conjunction with the financial statements and related notes included in the Annual Report of the Company to stockholders for the year ended March 31, 2003.

Certain accounting principles and practices generally accepted in Japan are different from International Accounting Standards and standards in other countries in certain respects as to application and disclosure requirements. Accordingly, the accompanying interim financial statements are intended for use by those who are informed about Japanese accounting principles and

practices.

The accompanying interim financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of statements of stockholders' equity) from the consolidated interim financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of the readers outside Japan, using the prevailing exchange rate at September 30, 2003, which was ¥111.25 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. Contingent Liabilities

At September 30, 2003, the Company and its consolidated subsidiaries were contingently liable for guarantees of loans of ¥9,187 million (\$82,580 thousand). This figure includes contingent guarantees and letters of awareness of ¥821 million (\$7,380 thousand).

## **Investor Information**

*Founded:* September 1905

*Incorporated:* June 1911

*Fiscal Year:* April 1-March 31

### *Transfer Agent and Office:*

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

### *Listings and Quotations:*

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

### *Depository for American Depositary Receipts:*

The Bank of New York Company, Inc.  
101 Barclay Street, New York,  
NY 10286, U.S.A.  
Tel: (212) 815-2042 (U.S. toll free: 888-269-2377)  
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