Mitsubishi Heavy Industries

Annual Report 2001

for the year ended March 31, 2001

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Consolidated Summary

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2001 and 2000

	In millions of yen except per share amounts		In thousands of U.S. dollars except per share amounts
	2001	2000	2001
Net sales	**¥3,045,024**	¥2,875,039	**$24,576,462**
Operating income (loss)	**74,889**	(23,797)	**604,433**
Net income (loss)	**(20,351)**	(137,006)	**(164,251)**
Per 100 shares of common stock:			
Net income (loss)—primary	**(¥603)**	(¥4,062)	**($4.87)**
Net income (assuming full dilution)	**—**	—	**—**
Cash dividends	**400**	250	**3.23**
Total assets	**¥4,236,634**	¥4,636,739	**$34,193,975**
Stockholders' equity	**1,278,242**	1,245,064	**10,316,722**

Notes: 1. U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥123.90=US$1, the exchange rate prevailing at March 30, 2001.
2. The accompanying consolidated financial statements for the years ended March 31, 2001 and 2000 have been compiled in accordance with accounting principles and practices generally accepted in Japan.

A Message from the Management

A Message from the Management

During the fiscal year under review, ended March 31, 2001, the Japanese economy benefited from a sustained uptrend in private sector capital investment centered on investment related to information technology (IT). However, growth in IT-related investment showed signs of decelerating, while public-sector investment declined for a second consecutive year, and personal consumption continued to be depressed due to income drops and concerns regarding future employment security. These factors were compounded during the latter half of the year by a hiatus in export growth, which had been a primary impetus supporting economic recovery. Consequently, the overall economic situation perceivably shifted into a recessionary mode.

Amid these economic conditions, Mitsubishi Heavy Industries, Ltd. (MHI), obtained a variety of major new orders, including those for four liquefied natural gas (LNG) carriers from the Shipbuilding & Ocean Development division, gas turbine combined cycle thermal power plants from the Power Systems division, a high-speed train system in Taiwan from the Machinery & Steel Structures division, and F-2 support fighters from the Aerospace division. In addition, the Mass and Medium-Lot Manufactured Machinery division increased the scale of its operations in various air conditioners, forklifts, and other products. Thus, the value of new orders grew ¥290.5 billion from the level in the previous fiscal year, to ¥2,640.3 billion (US$21,310 million).

Although the net sales of the Machinery & Steel Structures division decreased, the drop was more than offset by the performance of other divisions. The Power Systems division's sales advanced considerably, reflecting the coincidental timing of a relatively high number of large-scale thermal power plant deliveries, and the Aerospace division recorded a similar upsurge in sales as it began delivering F-2 support fighters to the Japan Defense Agency. These large gains and a relatively moderate increase in sales by the Shipbuilding & Ocean Development division boosted the Company's total net sales ¥170.0 billion, to ¥3,045.0 billion (US$24,576 million).

Having made its provision of reserves to cover losses on unprofitable orders during the fiscal year ended March 31, 2000, and steadily progressed with programs for bolstering its operations and reducing costs, MHI was able to generate ¥74.9 billion (US$604 million) in operating income and ¥63.2 billion (US$510 million) in ordinary income. On the other hand, the Company recorded extraordinary losses consisting of equity in loss of Mitsubishi Motors Corp., valuation losses on investment securities due to a drop in stock prices, and the provision for potentially problematic credit assets. The latter two losses were due to the application of new accounting standards for financial instruments. As a result, MHI recorded ¥5.1 billion (US$41 million) in loss before income taxes and ¥20.4 billion (US$164 million) in net loss. The application of new accounting standards for retirement benefits led to the recognition of a gap between the newly calculated level of retirement benefit liabilities and the level of the reserve for retirement benefits and retirement pension assets. The Company recorded an extraordinary loss of ¥172.5 billion (US$1,393 million) to completely amortize this gap, but also recorded an extraordinary gain of ¥167.9 billion (US$1,355 million) due to the use of investment securities to establish a retirement benefit trust.

Regarding cash flows, net cash provided by operating activities totaled ¥254.1 billion (US$2,051 million), owing principally to the upturn in the Company's profitability compared with the previous fiscal year as well as a drop in inventories that accompanied the delivery of large-scale plants overseas and other products. Thus, free cash flow from operating and investing activities amounted to an inflow of ¥178.0 billion (US$1,436 million), an improvement of ¥111.8 billion from the previous fiscal year. This reflected the Company's progressive repayment of borrowings, which led to a ¥114.6 billion reduction in interest-bearing debt from the level at the end of the previous fiscal year.

The Company continued the suspension of interim dividend payments but disbursed year-end dividends at the rate of ¥400 (US$3.23) per 100 shares, an increase of ¥150 per 100 shares from the previous fiscal year.

As previously described, MHI was able to boost the level of its new orders and net sales and greatly improve its profitability during the fiscal year under review. However, the Company continues to face an extremely harsh operating environment, as reflected in the now-chronic decline in Japan's public works budget and the persistent capital investment control measures of electric power companies, which are important customers. Recognizing the seriousness of the situation, MHI is redoubling its efforts to strengthen its business structure and performance through the concerted implementation of a variety of measures in line with its medium-term management plan (the 2000 Business Plan).

During the fiscal year under review, MHI realized a number of noteworthy achievements in strategically emphasized business fields. For example, while the slackness of growth in demand for power in Japan together with other factors has kept the level of the Power Systems division's domestic orders low, the division has proactively sought orders overseas, where demand for gas turbine combined cycle thermal power plants is strong. A large number of overseas orders for power plants have been obtained. Regarding transportation systems operations, a major order for a high-speed train system in Taiwan was obtained on the strength of the Japanese consortium members' special technologies as well as MHI's strengthened systems for managing large-scale overseas projects. In aerospace operations, the Company delivered the first F-2 support fighter to the Japan Defense Agency in September 2000. The first military aircraft to be developed cooperatively by Japan and the United States, the F-2 is expected to play a key role in Japan's defense during the 21st century.

To optimize operational management systems, several changes were made with regard to power systems, mass and medium-lot manufactured machinery, and shipbuilding businesses. Global demand for gas turbine combined cycle thermal power plants is projected to rise greatly. To augment the Power Systems division's ability to supply such power plants, the production systems at related manufacturing facilities were reorganized and steps were taken to increase production capacity. In April 2000, MHI shifted to a new business department system for such mass and medium-lot manufactured machinery products as forklifts, general-use engines, air conditioners, injection-molding equipment, printing equipment, and machine tools. By integrating manufacturing and marketing operations, the new system enables more rapid and flexible responsiveness to changing market conditions. Regarding shipbuilding, measures were taken to increase the closeness of operational cooperation among the design, materials procurement, and other departments of related facilities.


Nobuyuki Masuda, Chairman　Takashi Nishioka, President

MHI has also actively sought to arrange alliances with other companies, with such goals as promoting growth in business scale and the mutual supplementation of product lines. In the aerospace business, we signed a memorandum of understanding with U.S.-based Boeing that calls for collaboration in an expanded range of fields, including the operation and utilization of the International Space Station and the cooperative development of upper-stage engines for next-generation rockets. In the steel manufacturing equipment business, the Company established a steel rolling and processing-related joint venture with Hitachi, Ltd. in October 2000; agreed with Nissan Motor Co., Ltd., to engage in collaboration in the forklift business, centered on the cooperative development of new models, the mutual provision of products, and joint materials procurement; and agreed with the Kinki Sharyo Co., Ltd., to collaborate in order solicitation and manufacturing activities related to rail product export projects.

MHI's efforts to strengthen itself through such moves as right-sizing its workforce and reducing interest-bearing debt proceeded approximately according to schedule.

As described, the Company made steady progress implementing the 2000 Business Plan in each of its business fields during the fiscal year under review.

MHI has actively proceeded with environmental protection programs. The

Company completed the receipt of ISO 14001 certification of the environmental management systems of all 13 of its domestic manufacturing facilities in December 2000, and an environmental report describing the Company's environmental protection stance and programs was prepared and distributed.

Looking to the future, a full-scale recovery in the Japanese economy in the near future appears unlikely in light of projections that the downtrend in public investment will continue, personal consumption will remain slack, and growth in private sector capital investment will decelerate. Regarding exports, the U.S. economy has supplied the principal impetus behind the worldwide economic expansion due to its lengthy period of accelerating growth; however, this growth is now showing clear indications of deceleration. This can be expected to slow growth in Asian economies and otherwise protract the harsh export environment.

Based on consideration of this environment and the current lack of major growth surges in its existing operations, MHI will strengthen its manufacturing operations in market segments with growth potential and further step up its new product development activities in promising fields.

Regarding strengthened operations in market segments with growth potential, the Power Systems division, for example, is working to boost the capabilities and efficiency of gas turbines and develop its new H-model gas turbines. The division also revised its plan for boosting gas turbine production capacity, raising the targeted annual capacity level from 25 units to 36, and is working to further expand its overseas business by working through such overseas units as the service bases it has established in the United States. In environmental protection equipment operations, MHI is responding to the tightening of emission-control regulations by accelerating its development of new technologies, and the Company is dynamically preparing to initiate operations related to such new business fields as polychlorinated biphenyl (PCB) processing, soil purification, and recycling-related processing. Regarding transportation systems operations, the Company is strengthening its organizational capabilities for responding to growing overseas demand for new transportation systems and railroad construction work. The Aerospace division is concertedly using its technological expertise to ensure that the H-IIA rocket's first test launch will be a success and that the rocket can be used as a means of entering the commercial satellite launching market.

With respect to new product development activities in promising fields, MHI is doing its utmost to ensure that such products as integrated coal-gasification/combined-cycle-power plants, amorphous solar cells, and electronic toll collection (ETC) systems are developed and marketed in accord with plans. In addition, the Mass and Medium-Lot Manufactured Machinery division is developing and marketing high-quality products tailored to effectively meet customer requirements, such as a battery-powered forklift for sale in export markets, a new model of web offset printing press, and a micro gas turbine.

Noting that current and prospective customers are becoming increasingly rigorous in their selection of suppliers, MHI is endeavoring to arrange the cooperation of all relevant departments—such as the marketing, design, procurement, machining, and other departments involved in manufacturing—beginning from the earliest stages of order solicitation and product development activities. In this and other ways, the entire Company intends to further boost product quality and supply products that feature the ideal specifications when considered from customers' perspectives. As a result, MHI will renew its attention to the manufacturing expertise that has always been the principal source of the Company's competitive strength, and thereby market products that generate still higher levels of customer satisfaction.

Although MHI is facing extremely severe conditions in its operating environment, we are confident that our implementation of the various strategies and programs just described will be reflected in the Company's future dynamic development. We hope for the continued understanding and support of our shareholders and associates.

N. Masuda

Nobuyuki Masuda, Chairman

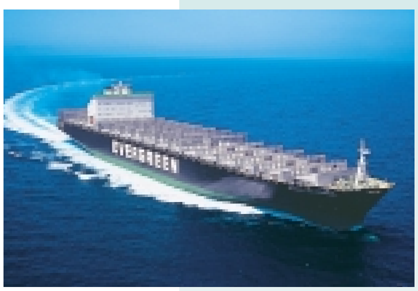
T. Nishioka

Takashi Nishioka, President

Review of Operations

Shipbuilding & Ocean Development

Liquefied Natural Gas Carrier “LNG JAMAL”



Container Ship “EVER ULYSSES”

Passenger Ferry “EUROPEAN CAUSEWAY”

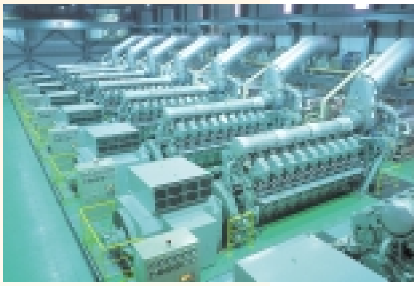
Global demand for new ships surged, reflecting a recovery in shipping market conditions, but the expansion of Korean shipbuilding capacity intensified the competition to obtain orders for large oil carriers, container carriers, and other types of vessels. Thus, MHI continued to face a harsh operating environment for shipbuilding operations during the period under review. However, dynamic marketing activities that highlighted MHI’s special capabilities for high-added-value products enabled the Company to obtain orders for six container carriers, six car ferries, four liquefied natural gas (LNG) carriers, and two liquefied petroleum gas (LPG) carriers (all figures in this section exclude vessels of less than 100 gross tons). The Company received orders for a total of 22 vessels, including escort ship, submarine, and other types of vessel orders from the Japan Defense Agency. Consequently, the aggregate value of new orders rose to ¥272.8 billion (US$2,202 million), and the Company’s outstanding orders for vessels grew to comprise 43 vessels totaling 2,110 thousand gross tons. A total of 19 newly built vessels were delivered during the period. Reflecting an increase in shipbuilding activity, net sales for the period under review rose from the level in the previous fiscal year, to ¥293.8 billion (US$2,371 million).

Power Systems

Tachibanawan Coal-Fired Thermal Power Station of Electric Power Development Co., Ltd.

Nagoya Power Station of Nakayama Nagoya Kyodo Hatsuden Co., Ltd.

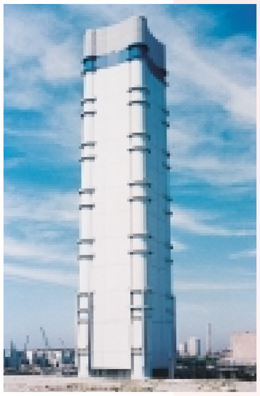
Because of such factors as slack growth in Japanese demand for electrical power and the partial deregulation of power company operations, power companies have restrained their capital investment. As a result, the value of new domestic orders for improving, rebuilding, and repairing existing power plants fell from an already low level, although an order for a nuclear power plant caused the total value of new domestic orders to rise. Against the backdrop of a worldwide expansion of demand for gas turbines, MHI energetically pursued new orders in each overseas region. Consequently, the Company obtained orders for gas turbine combined cycle thermal power plants in Mexico, the United States, Azerbaijan, and Taiwan as well as an order for a geothermal power plant in Kenya, and the value of new overseas orders exceeded the level in the previous fiscal year. Thus, the total value of new orders in the Power Systems division rose to ¥739.2 billion (US$5,966 million). Due to a coincidental confluence of large-scale thermal power plant project completions as well as surges in domestic and overseas sales of boilers and turbines, net sales totaled ¥900.4 billion (US$7,267 million), an increase from the previous fiscal year.



Diesel Power Plant of the Taiheiyo Energy Center

Machinery & Steel Structures


Ammonia Plant (Indonesia)


Steel Stack


On Board Unit for ETC

The value of new overseas machinery orders for flue gas desulfurization systems and other products declined, reflecting the receipt of orders for large-scale projects involving those products during the previous fiscal year, but an order for a high-speed train system in Taiwan boosted the overall value of new overseas orders to a level considerably higher than in the previous fiscal year. In Japan, the adoption of tighter dioxin-related restrictions on refuse incineration plants led to the receipt of numerous orders for dioxin countermeasures, and orders related to electronic toll collection (ETC) systems grew due to the full-scale adoption of such systems for highways. As increases were also seen in domestic orders for such products as compressors, pumps, and airport terminal equipment, the total value of new domestic orders rose. Consequently, the aggregate value of new machinery orders advanced to ¥286.1 billion (US$2,309 million). However, decreases in sales of environmental protection systems, new transport systems, chemical plants, and other products caused the Company's net sales to decline to ¥396.9 billion (US$3,203 million).

With regard to steel structures operations, the postponement of orders for public works projects, the continued restraint of capital investment by such important customers as those in the electric power and steelmaking industries, and the slackness of private-sector demand presented MHI with an operating environment that was harsh overall. However, orders in bridge-related operations recovered to their normal level following a temporary drop in the previous fiscal year, and major orders were obtained for cranes. As a result, the total value of new steel structures orders grew to ¥78.1 billion (US$630 million). Net sales fell to ¥144.4 billion (US$1,166 million) owing to drops in sales of such products as bridges as well as cultural, sports, and leisure-related facilities.


Tuas South Incineration Plant (Singapore)

Aerospace


Boeing 777, for which MHI is responsible for Aft Fuselage Panel, Tail Fuselage, Entry Doors

Demand for commercial sector aerospace products was firm, with note-worthy increases seen in orders for wing and other components for Global Express business jets, fuselage and tail assembly components for the Dash 8-Q400 regional turboprop aircraft, and aft fuselage and other components for Boeing's B777 aircraft. With regard to defense-related aircraft, although MHI was able to increase its orders for F-2 support fighters, decreases in orders for shipboard maritime patrol helicopter development programs and other products caused the overall level of new orders from the Japan Defense Agency to decline. As a result, the total value of new orders for aerospace products was ¥432.8 billion (US$3,493 million), down slightly from the previous fiscal year. Reflecting the deliveries of 18 F-2 support fighters ordered from the Japan Defense Agency in the fiscal years 1996 and 1997, net sales grew to ¥522.2 billion (US$4,215 million).


Bombardier Canadair Regional Jet Series 700, for which MHI is responsible for Aft Fuselage


F-2 Support Fighter

Mass and Medium-Lot Manufactured Machinery

With respect to general machinery and special vehicle operations, sales of turbochargers increased due to firm demand from customers responding to new environmental protection regulations, and sales of forklifts to the United States and Europe were strong. Moreover, a major order for the supply of earth-moving equipment to a customer in Turkey was received. However, during the previous fiscal year, concerns regarding the Y2K issue in the United States spurred a sharp surge in demand for portable gasoline engine generators that, in turn, boosted demand for small engines, but U.S. demand for small engines dropped during the year under review. As a result of this and other factors, new orders and net sales in general machinery and special vehicle operations both declined slightly from the previous fiscal year, amounting to ¥298.0 billion (US$2,405 million) and ¥304.4 billion (US$2,457 million), respectively.

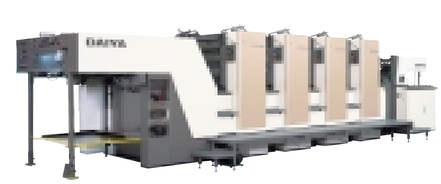
Air-conditioning and refrigeration systems operations benefited from a recovery in overall demand due to such factors as a rise in private-sector capital investment and unusually hot summer weather. MHI continued to develop and launched energy-saving new types and models of room air conditioners and packaged air-conditioning units, and orders and sales of such products grew. A major order was obtained for a large cooling and heating plant that will serve a district to the east of the Shinagawa train station in Tokyo's Minato Ward. Consequently, the total value of new orders and net sales in air-conditioning and refrigeration systems operations increased from the previous fiscal year, to ¥218.5 billion (US$1,763 million) and ¥203.0 billion (US$1,638 million), respectively.

Regarding industrial machinery operations, there was considerable variation in the degree of recovery in demand from different Japanese industries, and an intensification of competition overseas depressed order prices. Such factors caused harsh market conditions for industrial machinery to continue, and demand for such products as food-processing equipment and commercial web offset printing presses decreased, although major orders were received for offset newspaper-printing equipment. Orders for machine tools increased, reflecting strong demand from IT-related industries, and orders for such products as plastic-processing and papermaking equipment also grew. As a result, new industrial machinery operations orders increased to ¥194.7 billion (US$1,572 million). Due to the rise in sales of papermaking machinery and other products, net sales grew to ¥209.6 billion (US$1,692 million).

Mitsubishi Daiya Brand Ceiling Recessed Type Commercial Air Conditioner

Superior Sound-Attenuated Generator Set (under 70dB at 1m from DG)

Super Dry Gear Hobbing Machine "GN-D10A"



Mitsubishi Sheet-fed Offset Press "DIAMOND3000"

Topics

High-Speed Train System in Taiwan


Contract Signing Ceremony

In December 2000, a signing ceremony was held in Tokyo for a contract that provides for the first overseas use of Japan's high-speed train system (referred to as *Shinkansen* in Japanese). The system will allow trains traveling at speeds of up to 300kph to span the 345km distance between Taipei and Kaohsiung in approximately 90 minutes. The order was accepted by a Japanese consortium comprising MHI, two other manufacturers, and four general trading companies.

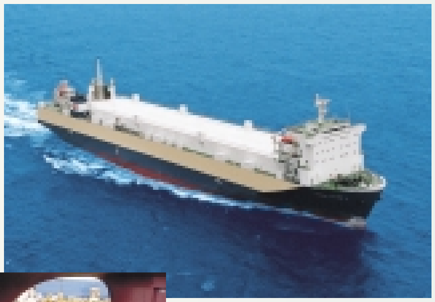
MHI plays the role of manufacturing coordinator within the consortium and is responsible for the supply of the signaling, communications, catenary, and disaster-prevention portions of the system. Construction of the high-speed train system is progressing steadily, and the system is scheduled to begin operating in October 2005.

Experimental Model of Next-Generation SST

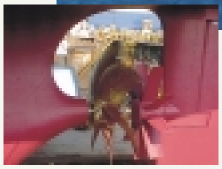
In February 2001, an experimental model of a next-generation supersonic transport (SST) aircraft was created as part of a next-generation SST technology development project of the National Aerospace Laboratory of Japan's Ministry of Education, Culture, Sports, Science and Technology (MEXT). As the prime contractor for the model, MHI began related development and manufacturing work in fiscal 1997. The flight testing to be performed with the model involves rocket-launching the model to an altitude of approximately 20,000 meters. At that point, the model will separate from the rocket and glide, enabling the measurement of various data, such as that of the pressure exerted on the aircraft's body. This type of wind-tunnel testing performed while actually flying an aircraft model has attracted considerable attention from around the world. The testing is scheduled to take place some time around March 2002 in Australia.


Non-powered Experimental Airplane

Car and General Cargo Carrier “TRANS FUTURE 3”



Car and General Cargo Carrier “TRANS FUTURE 3”



Mitsubishi Stator Fin

In March 2001, MHI delivered the car and general cargo carrier “TRANS FUTURE 3”, designed with emphasis on helping preserve the global environment. The vessel is one of the world’s first to incorporate the Company’s technologies for stator fins that convert propeller-induced water flows into propulsive force. This, the extremely low-drag hull configuration, and other factors have increased the fuel efficiency of the vessel by approximately 11% compared to conventional ships, while the vessel’s nitrogen oxide emissions are 12% lower. As “TRANS FUTURE 3” can carry approximately 1,500 large sized cars or 7,500m^3 of packaged lumber at 21 knots, it is considered to be a high-performance ship as well as an environment-friendly eco-ship.

Technology for Completely Detoxifying PCBs

PCB Hydrothermal Destruction System

MHI has developed polychlorinated biphenyl (PCB) hydrothermal destruction treatment units able to completely detoxify PCBs, which are feared to have a harmful effect on the environment and ecosystems. It is estimated that there are 150,000 tons of PCBs in storage in Japan. The newly developed MHI units use the hydrothermal destruction method, which is more environment-friendly than other methods like chemical degradation, to break PCBs down into such ordinary substances found in the natural environment as water, carbon dioxide, and salt. In addition, while the other treatment facilities are not able to neutralize PCB containers, the MHI units perform a preliminary container treatment process prior to the hydrothermal destruction, so that the PCBs that permeated into container materials are also neutralized.

Topics

Financial Section

Five-Year Summary

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31 of respective years

	In millions of yen except per share amounts					In thousands of U.S. dollars except per share amounts
	2001	2000	1999	1998	1997	2001
Net sales	**¥3,045,024**	¥2,875,039	¥2,907,762	¥3,096,110	¥3,142,472	**$24,576,462**
Operating income (loss)	**74,889**	(23,797)	65,308	144,259	198,084	**604,433**
Interest income and expenses—net	**(7,708)**	(7,607)	(3,386)	(2,608)	3,615	**(62,212)**
Income (loss) before income taxes	**(5,121)**	(217,672)	49,018	133,535	216,938	**(41,332)**
Net income (loss)	**(20,351)**	(137,006)	18,089	60,605	123,609	**(164,251)**
Per 100 shares of common stock:						
Net income (loss)—primary	**(¥603)**	(¥4,062)	¥536	¥1,797	¥3,665	**($4.87)**
Net income —assuming full dilution	**—**	—	515	1,782	3,650	**—**
Cash dividends	**400**	250	1,000	1,000	1,000	**3.23**
Total assets	**¥4,236,634**	¥4,636,739	¥4,746,597	¥4,731,822	¥4,361,701	**$34,193,975**
Stockholders' equity	**1,278,242**	1,245,064	1,337,378	1,368,866	1,347,390	**10,316,722**
Current assets	**2,891,271**	3,474,015	3,638,867	3,549,382	3,191,901	**23,335,521**
Current liabilities	**1,965,808**	2,319,456	2,399,150	2,436,755	2,340,766	**15,866,083**
Bank loans and long-term debt	**1,090,696**	1,205,301	1,249,231	1,177,473	755,568	**8,803,033**

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2. The accompanying consolidated financial statements for the years ended March 31, 2001 and 2000 have been compiled in accordance with accounting principles and practices generally accepted in Japan.

Segment Information

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2001 and 2000

INDUSTRY SEGMENT	Net Sales: In millions of yen 2001	Net Sales: In millions of yen 2000	Net Sales: In thousands of U.S. dollars 2001	Operating Income (Loss): In millions of yen 2001	Operating Income (Loss): In millions of yen 2000	Operating Income (Loss): In thousands of U.S. dollars 2001
Shipbuilding & Ocean Development	¥ 293,797	¥ 275,036	$ 2,371,245	(¥4,101)	(¥201)	($33,102)
Power Systems	900,388	739,884	7,267,053	29,026	(37,156)	234,273
Machinery & Steel Structures	541,286	673,228	4,368,733	8,415	(5,079)	67,923
Aerospace	522,211	402,173	4,214,778	32,871	29,542	265,301
Mass and Medium-Lot Manufactured Machinery	717,067	705,950	5,787,468	435	(18,841)	3,510
Others	121,547	118,327	981,005	8,243	7,938	66,528
Subtotal	3,096,296	2,914,598	24,990,282	74,889	(23,797)	604,433
Eliminations	(51,272)	(39,559)	(413,820)	—	—	—
Total	¥3,045,024	¥2,875,039	$24,576,462	¥74,889	(¥23,797)	$604,433

INDUSTRY SEGMENT	Total Assets: In millions of yen 2001	Total Assets: In millions of yen 2000	Total Assets: In thousands of U.S. dollars 2001	Depreciation: In millions of yen 2001	Depreciation: In millions of yen 2000	Depreciation: In thousands of U.S. dollars 2001
Shipbuilding & Ocean Development	¥ 280,144	¥ 306,112	$2,261,050	¥ 7,372	¥ 7,829	$ 59,499
Power Systems	1,022,611	1,194,055	8,253,516	23,649	24,980	190,871
Machinery & Steel Structures	545,634	704,783	4,403,825	10,072	11,221	81,289
Aerospace	677,766	747,643	5,470,265	15,765	16,683	127,237
Mass and Medium-Lot Manufactured Machinery	761,595	813,541	6,146,853	24,209	25,978	195,396
Others	300,242	286,210	2,423,259	18,285	18,668	147,582
Subtotal	3,587,992	4,052,344	28,958,768	99,352	105,359	801,874
Corporate Assets and Eliminations	648,642	584,395	5,235,207	—	—	—
Total	¥4,236,634	¥4,636,739	$34,193,975	¥99,352	¥105,359	$801,874

INDUSTRY SEGMENT	Capital Expenditures: In millions of yen 2001	Capital Expenditures: In millions of yen 2000	Capital Expenditures: In thousands of U.S. dollars 2001
Shipbuilding & Ocean Development	¥ 5,313	¥ 4,922	$ 42,883
Power Systems	16,237	18,618	131,051
Machinery & Steel Structures	7,834	8,537	63,226
Aerospace	12,022	22,264	97,030
Mass and Medium-Lot Manufactured Machinery	26,572	21,214	214,466
Others	28,483	24,674	229,884
Subtotal	96,461	100,229	778,540
Eliminations	—	—	—
Total	¥ 96,461	¥ 100,229	$ 778,540

Overseas Sales			
Overseas sales	¥1,173,064	¥1,178,505	$9,467,832
Ratio to Total Net Sales	38.5%	41.0%	

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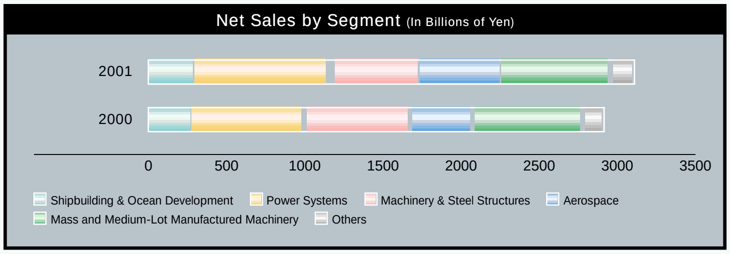
2. The accompanying consolidated financial statements for the years ended March 31, 2001 and 2000 have been compiled in accordance with accounting principles and practices generally accepted in Japan.

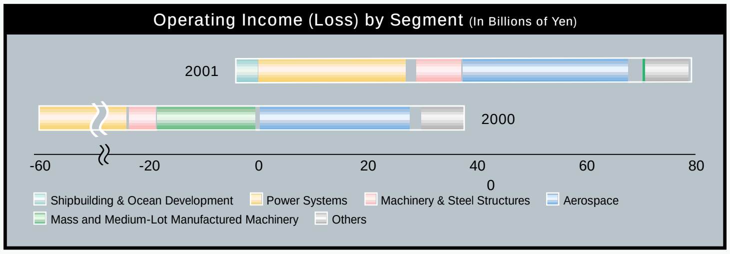
GEOGRAPHIC DISTRIBUTION	Net Sales			Operating Income (Loss)		
	In millions of yen		In thousands of U.S. dollars	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001	2001	2000	2001
Japan	¥2,908,382	¥2,733,433	$23,473,621	¥71,529	(¥33,349)	$577,311
North America	147,949	140,020	1,194,100	(585)	5,006	(4,720)
Asia	35,749	36,090	288,531	2,785	3,260	22,480
Western Europe	58,893	56,959	475,329	1,477	1,772	11,920
Others	7,806	17,072	63,001	(317)	(486)	(2,558)
Subtotal	3,158,779	2,983,574	25,494,582	74,889	(23,797)	604,433
Eliminations	(113,755)	(108,535)	(918,120)	—	—	—
Total	¥3,045,024	¥2,875,039	$24,576,462	¥74,889	(¥23,797)	$604,433

GEOGRAPHIC DISTRIBUTION	Total Assets		
	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Japan	¥3,378,563	¥3,852,935	$27,268,466
North America	126,563	116,963	1,021,494
Asia	26,343	23,577	212,613
Western Europe	47,785	47,474	385,676
Others	8,737	11,395	70,519
Subtotal	3,587,991	4,052,344	28,958,768
Corporate Assets and Eliminations	648,643	584,395	5,235,207
Total	¥4,236,634	¥4,636,739	$34,193,975

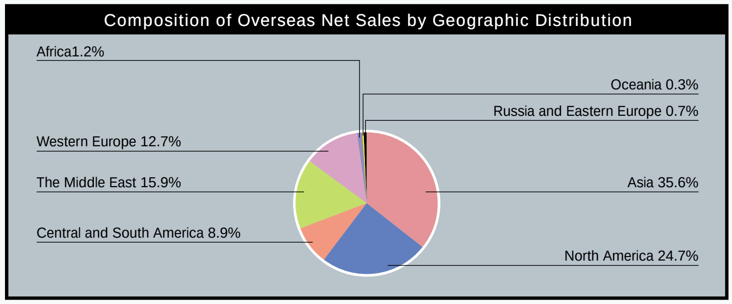
Net Sales by Segment (In Billions of Yen)



Operating Income (Loss) by Segment (In Billions of Yen)



Composition of Overseas Net Sales by Geographic Distribution



Consolidated Balance Sheets

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
March 31, 2001 and 2000

	In millions of yen		In thousands of U.S. dollars (Note 2)
ASSETS	2001	2000	2001
Current assets:			
Cash and deposits	¥ 203,055	¥ 196,726	$ 1,638,859
Trade receivables (Note 4):			
Notes	56,259	59,546	454,070
Accounts	1,019,906	965,160	8,231,684
Allowance for doubtful receivables	(6,549)	(7,791)	(52,853)
Marketable securities	75,965	262,978	613,116
Inventories (Note 3)	1,290,684	1,758,014	10,417,144
Advances to suppliers	51,068	60,695	412,169
Deferred income taxes (Note 5)	87,527	80,014	706,433
Prepaid expenses and other current assets (Note 4)	113,356	98,673	914,899
Total current assets	2,891,271	3,474,015	23,335,521
Property, plant and equipment (Note 4):			
Land	138,612	137,424	1,118,739
Buildings and structures	633,817	626,580	5,115,556
Machinery and equipment	1,321,158	1,307,953	10,663,097
Construction in progress	17,368	16,058	140,175
	2,110,955	2,088,015	17,037,567
Less accumulated depreciation	1,355,183	1,311,107	10,937,713
Net property, plant and equipment	755,772	776,908	6,099,854
Investments and advances:			
Investments in unconsolidated subsidiaries and affiliates accounted for under the equity method of accounting	111,688	155,139	901,432
Long-term loans and advances	103,788	77,838	837,676
Sundry investments in securities	337,288	46,302	2,722,258
Deferred income taxes (Note 5)	32,680	81,618	263,761
Allowance for doubtful advances	(62,477)	(49,017)	(504,251)
Net investments and advances	522,967	311,880	4,220,876
Other assets	66,624	73,936	537,724
Total assets	¥4,236,634	¥4,636,739	$34,193,975

See accompanying notes to consolidated financial statements.

LIABILITIES, MINORITY INTERESTS AND STOCKHOLDERS' EQUITY	In millions of yen		In thousands of U.S. dollars (Note 2)
	2001	2000	2001
Current liabilities:			
Trade payables:			
Notes	¥ 143,851	¥ 130,997	$ 1,161,030
Accounts	599,431	559,560	4,838,020
Bank loans (Note 4)	340,047	410,137	2,744,526
Current portion of long-term debt (Note 4)	70,802	101,045	571,447
Advance payments received on contracts	552,023	880,836	4,455,389
Accrued expenses	117,541	107,690	948,675
Accrued income taxes	16,343	1,827	131,902
Allowance for losses on construction contracts	52,043	61,691	420,040
Other current liabilities	73,727	65,673	595,054
Total current liabilities	1,965,808	2,319,456	15,866,083
Long-term liabilities:			
Long-term debt (Note 4)	679,847	694,119	5,487,060
Long-term payables for pension expense	—	96,582	—
Accrued severance indemnities	—	226,214	—
Reserve for retirement allowances	268,474	—	2,166,866
Other long-term liabilities	31,250	40,130	252,219
Total long-term liabilities	979,571	1,057,045	7,906,145
Total liabilities	2,945,379	3,376,501	23,772,228
Minority interests	13,013	15,174	105,025
Stockholders' equity:			
Common stock:			
Authorized—6,000,000,000 shares			
Issued (Note 6):			
2001—3,373,027,082 shares	265,455		2,142,494
2000—3,373,015,502 shares		265,452	
Capital surplus (Note 6)	203,701	203,697	1,644,072
Retained earnings (Note 7)	747,614	775,915	6,034,010
Net unrealized gains on investment securities	78,269	—	631,714
Foreign currency translation adjustments	(16,797)	—	(135,568)
Total stockholders' equity	1,278,242	1,245,064	10,316,722
Total liabilities, minority interests and stockholders' equity	¥4,236,634	¥4,636,739	$34,193,975

Consolidated Statements of Operations and Retained Earnings

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2001 and 2000

	In millions of yen		In thousands of U.S. dollars (Note 2)
	2001	2000	2001
Net sales	¥3,045,024	¥2,875,039	$24,576,462
Cost of sales	2,707,842	2,624,905	21,855,061
Gross profit	337,182	250,134	2,721,401
Selling, general and administrative expenses	262,293	273,931	2,116,968
Operating income (loss)	74,889	(23,797)	604,433
Non-operating income:			
Interest and dividend income	20,084	21,242	162,101
Equity in earnings of unconsolidated subsidiaries and affiliates	1,916	—	15,460
Foreign exchange gains	9,771	—	78,864
Other income	3,032	3,860	24,474
	34,803	25,102	280,899
Non-operating expenses:			
Interest expense	27,792	28,849	224,313
Equity in losses of unconsolidated subsidiaries and affiliates	—	17,574	—
Foreign exchange losses	—	24,556	—
Other expenses	18,669	19,847	150,680
	46,461	90,826	374,993
Ordinary income (loss)	63,231	(89,521)	510,339
Gains on contribution of investment securities to trust for retirement allowances	167,880	—	1,354,962
Gains on change in interest of affiliates (Note 8)	10,561	—	85,235
Gains on sales of investment securities	9,901	—	79,917
Gains on sales of marketable securities	—	116,007	—
Valuation gains on long-term foreign currency receivables and payables	6,419	—	51,810
Gains on sales of fixed assets (Note 9)	5,731	4,710	46,253
Amortization of transition difference arising from initial adoption of the new accounting standard for retirement benefits	172,549	—	1,392,646
Prior service cost for retirement pension plan	—	130,755	—
Equity in loss of affiliates (Note 10)	53,357	—	430,649
Losses on revaluation of investment securities (Note 11)	16,808	—	135,657
Provision for doubtful receivables	16,052	—	129,556
Restructuring charges (Note 12)	4,346	—	35,077
Losses on damage from natural disasters	5,732	899	46,263
Losses on works on construction contracts	—	91,972	—
Losses on improvements in Mass and Medium-lot manufactured machinery	—	25,242	—
Income (loss) before income taxes	(5,121)	(217,672)	(41,332)
Income taxes (Note 5)			
Current	24,101	15,612	194,516
Deferred	(9,939)	(96,815)	(80,217)
Minority interests in income after taxes	1,068	537	8,620
Net income (loss)	(20,351)	(137,006)	(164,251)
Retained earnings:			
Balance at beginning of year	775,915	868,250	6,262,433
Adjustment for deferred income taxes of prior year	—	55,604	—
Add:			
Increase in retained earnings at beginning of year by adding newly consolidated subsidiaries and companies accounted for by the equity method	482	900	3,887
Increase reflecting increases of beginning balance of retained earnings of companies accounted for by the equity method	—	2,497	—
Increase reflecting increases in capital stock of companies accounted for by the equity method	—	2,665	—
Deduct (Note 7):			
Cash dividends	8,432	16,865	68,059
Bonuses to directors and statutory auditors	—	130	—
Balance at end of year	¥ 747,614	¥ 775,915	$ 6,034,010

	In yen		In U.S. dollars (Note 2)
Per 100 shares of common stock:	2001	2000	2001
Net income (loss)—primary	(¥603)	(¥4,062)	($4.87)
Net income—assuming full dilution	—	—	—
Cash dividends	400	250	3.23

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2001 and 2000

	In millions of yen		In thousands of U.S. dollars (Note 2)
	2001	2000	2001
Cash flows from operating activities:			
Income (loss) before income taxes	(¥5,121)	(¥217,672)	($41,332)
Adjustments to reconcile income (loss) before income taxes to net cash provided by operating activities:			
Depreciation and amortization	99,352	105,868	801,874
Decrease in accrued severance indemnities	(226,214)	—	(1,825,780)
Increase in reserve for retirement allowances	268,473	—	2,166,851
Equity in losses of unconsolidated subsidiaries and affiliates	51,442	17,574	415,188
Interest and dividend income	(20,084)	(21,242)	(162,101)
Interest expense	27,792	28,849	224,313
Gains (losses) on sales and devaluation of marketable securities	—	(113,890)	—
Other non-operating income and expenses	24,955	47,749	201,417
(Increase) decrease in receivables	(45,914)	41,816	(370,568)
(Increase) decrease in inventories and advances to suppliers	482,755	257,487	3,896,327
Decrease in investment securities due to contribution to trust for retirement allowances	31,671	—	255,615
(Increase) decrease in other assets	(43,520)	3,736	(351,251)
Increase (decrease) in payables	47,375	20,514	382,362
Increase (decrease) in advance payments received on contracts	(330,475)	(123,996)	(2,667,269)
Increase (decrease) in long-term payables for pension expense	(96,582)	96,582	(779,515)
Increase (decrease) in other liabilities	5,351	47,267	43,186
Others	11,936	19,237	96,332
Subtotal	283,192	209,879	2,285,649
Interest and dividend received	20,311	22,634	163,933
Interest paid	(28,110)	(29,503)	(226,878)
Payments for income taxes	(4,063)	(35,421)	(32,795)
Payments for prior service cost for retirement pension plan	—	(23,125)	—
Payments for other non-operating income and expenses	(17,197)	(10,684)	(138,796)
Net cash provided by operating activities	254,133	133,780	2,051,113
Cash flows from investing activities:			
Net (increase) decrease in time deposits	3,580	(3,396)	28,892
Purchases of marketable securities and investments	—	(117,899)	—
Proceeds from sales and redemption of marketable securities and investments	1,604	142,290	12,948
Purchases of property, plant, equipment and intangible assets	(100,339)	(100,335)	(809,840)
Proceeds from sale of property, plant, equipment and intangible assets	7,474	7,964	60,322
Proceeds from sale and redemption of investment securities	18,554	—	149,748
Proceeds from sale of subsidiaries’ stock resulting in change in consolidation	258	—	2,080
Disbursement of long-term loans	(9,304)	(5,794)	(75,090)
Collection of long-term loans	6,591	13,616	53,196
Others	(4,579)	(4,006)	(36,954)
Net cash used in investing activities	(76,161)	(67,560)	(614,698)
Cash flows from financing activities:			
Net increase (decrease) in bank loans	(74,295)	(22,768)	(599,638)
Proceeds from long-term debt	48,225	67,306	389,225
Repayment of long-term debt	(100,947)	(79,779)	(814,747)
Proceeds from issuance of bonds	5,392	—	43,523
Dividends paid to stockholders	(8,423)	(16,339)	(67,983)
Dividends paid to minority stockholders of subsidiaries	(1,094)	(568)	(8,827)
Others	(106)	(63)	(856)
Net cash used in financing activities	(131,248)	(52,211)	(1,059,303)
Effect of exchange rate changes on cash and cash equivalents	(2,873)	3,730	(23,187)
Net increase (decrease) in cash and cash equivalents	43,851	17,739	353,925
Cash and cash equivalents at beginning of year	199,525	181,786	1,610,372
Cash and cash equivalents at end of year	¥ 243,376	¥199,525	$ 1,964,297

1. Summary of Significant Accounting Policies

a) Basis of presenting consolidated financial statements

The accompanying consolidated financial statements of Mitsubishi Heavy Industries, Ltd. ("MHI"), together with its consolidated subsidiaries ("Subsidiaries") have been prepared in accordance with accounting principles and practices generally accepted in Japan and from the consolidated financial statements filed with the Financial Services Agency ("FSA") in Japan. Certain items presented in the consolidated financial statements filed with the FSA have been reclassified for the convenience of readers outside Japan.

b) Principles of consolidation

The accompanying consolidated financial statements for the years ended March 31, 2001 and 2000 include the accounts of MHI and Subsidiaries. All significant intercompany transactions and accounts have been eliminated.

Investments in unconsolidated subsidiaries and affiliates have been, with certain minor exceptions, stated at cost plus equity in undistributed earnings. Consolidated net income (loss) includes MHI's equity in the current net income (loss) of such companies, after the elimination of unrealized intercompany profits.

c) Securities

Investments in subsidiaries and affiliates are stated at cost based on the moving average method. Other securities with market value are stated at market value based on market prices and other fair value at the balance sheet date. The difference between the acquisition cost and the carrying value of other securities is accounted for as a component of equity. The cost of other securities sold is computed based on the moving average method. Other securities without market value are stated at cost determined by the moving average method.

Effective the year ended March 31, 2001, MHI and Subsidiaries have adopted a new accounting standard for financial instruments ("Opinion Concerning the Establishment of Accounting Standards for Financial Instruments" issued by the Business Accounting Deliberation Council ("BADC") on January 22, 1999) and have changed its method of valuation of securities.

In accordance with this new accounting standard, accounting for securities with market prices listed on securities exchanges, which were stated at the lower of cost or market in previous years, has been changed to a method based on market value. Under the new method, the difference between the acquisition cost and the carrying value is recognized as a component of equity. The effect of this change was to increase ordinary income and to decrease loss before income taxes by ¥8,206 million (US$66,232 thousand) from the amount which would have been recorded under the method applied in the prior year.

As to the presentation of the balance sheet, MHI and Subsidiaries reassessed its intentions in holding all securities at the beginning of the fiscal year and have classified debt securities and others due within one year as marketable securities in current assets and other securities as investment securities in fixed assets. As a result of this reclassification, at April 1, 2000, marketable securities in current assets decreased by ¥220,940 million (US$1,783,216 thousand) and investment securities in fixed assets increased by ¥220,710 million (US$1,781,360 thousand) and other current assets increased by ¥230 million (US$1,856 thousand).

In addition, as a result of the adoption of the market value method applied to other securities, a valuation difference of ¥130,462 million (US$1,052,964 thousand) was recognized and ¥78,269 million (US$631,714 thousand), net of the tax effect, was accounted for as the net unrealized gain on investment securities in stockholders' equity.

d) Inventories

Work in process is stated at cost determined by the specific identification method.

Finished products, raw materials and supplies are principally stated at cost determined by the moving average method.

Starting with the year ended March 31, 2000, MHI and Subsidiaries have decided to apply the lower of cost or market method, based on moving averages, to the valuation of certain finished products, instead of the previously used cost method.

e) Property, plant and equipment and depreciation

Property, plant and equipment, including significant renewals and additions, are carried at cost. When an asset is retired or otherwise disposed of, the cost and related depreciation are relieved from the respective accounts and the net difference, less any amounts realized on disposal, is reflected in earnings.

Depreciation, with minor exceptions, has been computed by the straight-line method for buildings except for related equipment, and by the declining-balance method for other assets based on the useful lives of assets, which are substantially the same as those provided for in the Corporation Income Tax Law.

f) Leases

Noncancelable lease transactions of MHI and its domestic Subsidiaries are accounted for as operating leases (whether such leases are classified as operating leases or finance leases), except those lease agreements which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases. However, lease transactions of foreign Subsidiaries are generally accounted for as either finance leases or operating leases, according to their classification.

g) Allowance for doubtful receivables

The allowance for doubtful receivables is provided at an amount sufficient to cover possible losses on the collection of receivables. The amount of the allowance is determined based on (1) an estimated amount for probable doubtful accounts based on a review of the collectibility of individual receivables, and (2) an amount based on MHI's and Subsidiaries' historical experience of write-offs of receivables other than those covered in Item (1) above.

Effective the year ended March 31, 2001, as a result of the adoption of a new accounting standard for financial instruments, MHI and Subsidiaries have changed its method of estimating the allowance for doubtful receivables. In accordance with this new accounting standard, MHI and Subsidiaries recognized ¥16,052 million (US$129,556 thousand) as an extraordinary expense on its provision for doubtful accounts which was established as a new classification of receivables. The effect of this change was to increase loss before income taxes by ¥16,052 from the amount which would have been recorded under the method applied in the prior year.

h) Allowance for losses on construction contracts

An allowance for losses on construction contracts has been provided based on an estimate of the total losses which can be anticipated for the next fiscal year and beyond in respect of construction projects on which eventual losses are deemed inevitable and amounts thereof can reasonably be estimated.

If the costs of partially completed construction contracts (of the construction contracts covered by the allowance for losses on construction contracts at March 31, 2001) exceed their respective contract revenues, the excess of such costs has been recognized as loss on revaluation of partially completed construction contracts and, accordingly, has not been included in the allowance for losses on construction contracts.

Since a large number of plant export contracts signed during 1995 and 1996 have entailed additional or corrective work in the course of project implementation and considerable losses are expected, the accounting treatment has been changed to create allowance for losses on construction contracts and resort to work in process evaluation losses in the year ended March 31, 2000.

i) Reserve for retirement allowance

A reserve for retirement allowance has been provided to prepare for employees' retirement based on estimates of the retirement benefit obligation and the pension fund assets including the retirement benefit fund.

MHI and Subsidiaries had, in general, provided for the amount equivalent to 40% of the liabilities which would be required if all employees voluntarily terminated their service at the balance sheet date, as accrued severance indemnities to the year ended March 31, 2000. Prior service liabilities (the amount by which the value of liability reserve exceeded the fair value of plan assets) had previously been amortized principally by the declining-balance method at a fixed annual rate of 20%. In the year ended March 31, 2000, MHI and Subsidiaries changed the method of accounting for pension cost principally to the accrual method.

Effective the year ended March 31, 2001, MHI and Subsidiaries adopted a new accounting standard for retirement benefits ("Opinion Concerning the Establishment of Accounting Standard for Retirement Benefits" issued by the BADC on June 16, 1998). The effect of this change was to increase the cost of retirement benefits by ¥156,226 million (US$1,260,907 thousand), to increase ordinary income by ¥7,526 million (US$60,746 thousand) and to increase loss before income taxes by ¥165,022 million (US$1,331,900 thousand) from the amounts which would have been recorded under the method applied in the prior year.

In addition, the whole amount of transition difference of ¥172,549 million (US$1,392,646 thousand) arising from the initial adoption of the new accounting standard was charged to income as an extraordinary expense for the fiscal year.

As to the presentation of the balance sheet, accrued severance indemnities and long-term prepaid expenses for prior service cost relating to the pension plan have been included in the reserve for retirement allowance.

MHI has established a retirement benefit trust of ¥199,551 million (US$1,610,577 thousand) by contributing investment securities totaling ¥31,671 million (US$255,615 thousand) at net book value. In this connection, MHI recognized a gain on contribution of investment securities to trust for retirement allowance of ¥167,880 million (US$1,354,962 thousand) for the year ended March 31, 2001.

j) Revenue recognition

Sales of products are principally recognized in the accounts upon acceptance by the customers. Revenue on specific long-term contracts which meet certain conditions is recognized on the basis of the percentage-of-completion method.

The percentage-of-completion method had previously been applied to long-term contracts of over ¥50,000 million (US$403,551 thousand) each, with a contract period of three years or longer. Starting with the year ended March 31, 2000, MHI has changed the criterion under which the percentage-of-completion method would be adopted, and new criterion is applicable to the contracts of over ¥15,000 million (US$121,065 thousand) each, with a contract period of two years or longer.

k) Tax-effect accounting

During the year ended March 31, 2000, the regulations of consolidated financial statements were changed to recognize the tax effect by the following method.

Deferred income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized based on temporary differences between financial statement and tax basis of assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled.

l) Cash and cash equivalents

During the year ended March 31, 2000, the regulations of consolidated financial statements were changed to prepare the consolidated statements of cash flows.

For the purpose of the consolidated statements of cash flows, cash, demand deposits and highly liquid investments with insignificant risk of changes in value, which have maturities of three months or less when purchased, are treated as cash and cash equivalents.

m) Foreign currency translation

Effective the year ended March 31, 2001, MHI and Subsidiaries adopted a revised accounting standard for foreign currency transactions (“Opinion Concerning the Establishment of Accounting Standards for Foreign Currency Transactions” issued by the BADC on October 22, 1999). As a result, long-term monetary receivables and payables in foreign currencies, which had formerly been translated into yen at the historical rates of exchange in effect at the dates of the respective transactions, have been translated into yen at the rate of exchange in effect at the balance sheet date. The translation gain resulted from this change was accounted for as an extraordinary income.

The effect of this change was to increase income before income taxes by ¥6,419 million (US$51,810 thousand) from the amount which would have been recorded by the method applied in the previous year.

n) Net income (loss) per share

The computation of primary net income (loss) per share is based on the avarage number of shares outstanding.

Fully diluted earnings per share are determined on the assumption that the convertible debentures were converted on the dates of each issue, appropriately adjusted for subsequent redemption.

2. U.S. Dollar Amounts

U.S. dollar amounts are included solely for convenience. These translations should not be construed as representations that the Japanese yen actually represent, or have been or could be converted into, U.S. dollars.

As the amounts shown in U.S. dollars are for convenience only, the rate of ¥123.90=US$1 prevailing at March 30, 2001 has been used for the purpose of the presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

3. Inventories

Inventories at March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Finished products	¥ 53,598	¥ 123,867	$ 432,595
Work in process	1,116,946	1,578,674	9,014,896
Raw materials	120,140	55,473	969,653
	¥1,290,684	¥1,758,014	$10,417,144

4. Bank Loans and Long-Term Debt

Bank loans represented principally by notes payable to banks and bank loans at March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Secured	¥ 18,362	¥ 17,694	$ 148,196
Unsecured	321,685	392,443	2,596,330
	¥340,047	¥410,137	$2,744,526

Long-term debt at March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Loans, principally from banks and insurance companies, due 2001 to 2022 with interest ranging from 0.4% to 8.0%:			
Secured	¥ 27,118	¥ 17,332	$ 218,873
Unsecured	338,051	386,135	2,728,419
Debenture bonds due 2002 to 2008 with interest ranging from 1.48% to 6.5%	310,000	310,000	2,502,018
2.1% convertible bonds due 2001	753	759	6,077
Unsecured bonds due 2005 to 2007 with interest ranging from 8.29% to 8.39% by a consolidated subsidiary	5,738	—	46,308
Export loans received from main contractors, due 2001 to 2010 with interest ranging from 1.9% to 7.7%	68,989	80,938	556,812
	750,649	795,164	6,058,507
Less current portion due within one year	70,802	101,045	571,447
	¥679,847	¥694,119	$5,487,060

A summary of assets pledged as collateral for bank loans and long-term debt at March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Property, plant and equipment	¥17,561	¥18,153	$141,732
Trade receivables:			
Notes	7,969	9,242	64,316
Accounts	9,449	7,055	76,268
Short-term loans included in prepaid expenses and other current assets	8,462	8,930	68,294
	¥43,441	¥43,380	$350,610

The aggregate annual maturities of long-term debt at March 31, 2001 were as follows:

	In millions of yen	In thousands of U.S. dollars
2002	¥ 70,802	$ 571,447
2003	219,734	1,773,480
2004	152,360	1,229,704
2005	84,121	678,945
2006	56,117	452,918
2007 and thereafter	167,515	1,352,013
	¥750,649	$6,058,507

5. Income Taxes

MHI and Subsidiaries are subject to corporation income tax, corporation inhabitants' tax and corporation enterprise tax, based on income, which in the aggregate resulted in the statutory effective tax rate of approximately 41.9% for both of the year ended March 31, 2001 and the year ended March 31, 2000.

Significant components of deferred tax assets and liabilities at March 31, 2001, which arose as a result of the recognition of the tax effect mentioned in 1 k), were as follows:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Deferred tax assets:			
Reserve for retirement allowances	¥133,800	¥ —	$1,079,906
Accrued severance indemnities	—	24,510	—
Prior service cost for retirement pension plan	—	40,541	—
Losses on works on construction contracts	22,854	36,226	184,455
Accrued expenses for construction contracts	20,896	19,935	168,651
Allowance for doubtful receivables	14,281	13,125	115,263
Others	59,081	30,044	476,841
Total gross deferred tax assets	250,912	164,381	2,025,116
Deferred tax liabilities:			
Gains on contribution of investment securities to trust for retirement allowances	(71,118)	—	(573,995)
Net unrealized gains on investment securities	(55,755)	—	(450,003)
Reserve for reduction in costs of fixed assets	—	(2,710)	—
Others	(3,832)	(39)	(30,924)
Total gross deferred tax liabilities	(130,705)	(2,749)	(1,054,922)
Net deferred tax assets	¥120,207	¥161,632	$ 970,194

Significant components of statutory effective income tax rate and income tax rate as a percentage of loss before income taxes at March 31, 2001 and 2000 were as follows:

	2001	2000
Japanese statutory effective income tax rate	41.9%	41.9%
Adjustment:		
Equity in earnings of unconsolidated subsidiaries and affiliates	(2.5)	—
Equity in losses of unconsolidated subsidiaries and affiliates	—	(3.0)
Equity in loss of MMC (Note 10)	(314.1)	—
Items excluded from expenses	(6.3)	(1.0)
Per capita levy for corporation inhabitants' tax	(0.9)	(0.9)
Items excluded from gross income	7.5	1.2
Others	(2.1)	(0.9)
Income tax rate as a percentage of loss before income taxes	(276.5%)	37.3%

6. Common Stock and Capital Surplus

The increase in the common stock account is due to the conversion of convertible debentures. The increase in the capital surplus account is due to the conversion of convertible debentures.

7. Appropriations of Retained Earnings

Cash dividends and transfers to the legal reserve are recorded in the financial year in which the appropriations of retained earnings are approved by meeting of the Board of Directors and/or Stockholders.

8. Gains on Change in Interest of Affiliates

Gains on change in interest of affiliates were generated by an increase in the capital stock of Mitsubishi Motors Corporation ("MMC") which allotted the new shares to DaimlerChrysler AG. Increases in equity resulting from increases in the capital stock of affiliates for which the equity method is applicable, had previously been treated as an increase in retained earnings, but effective the year ended March 31, 2001, they have been treated in the same manner as gains or losses arising from sales of shares.

9. Gains on Sales of Fixed Assets

Gains on sales of fixed assets in the year ended March 31, 2001 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
Land	¥5,782	$46,664
Others	(51)	(411)
	¥5,731	$46,253

10. Equity in Loss of Affiliates

Equity in loss of affiliates relates to investment in MMC for which the equity method is applied. During the fiscal year, MMC incurred losses as a result of charging as an extraordinary expense the whole amount of transition difference arising from the initial adoption of the new accounting standard for retirement benefits and additionally recognizing the costs of business restructuring and vehicle recalling. In view of the fact that the loss in investment in MMC arose mainly from the correction of past profits and losses due to a change in accounting standard and from an extraordinary expense such as business restructuring, and because of its magnitude, the equity in loss was treated as an extraordinary expense.

11. Losses on Revaluation of Investment Securities

Losses on revaluation of investment securities in the year ended March 31, 2001 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
Devaluation of securities	¥15,059	$121,540
Devaluation of golf club membership	1,749	14,117
	¥16,808	$135,657

12. Restructuring Charges

Restructuring charges in the year ended March 31, 2001 consisted of the follwing:

	In millions of yen	In thousands of U.S. dollars
Special retirement payments	¥2,601	$20,991
Loss on disposal of fixed assets	625	5,045
Expenses for changes in layout	301	2,432
Others	819	6,609
	¥4,346	$35,077

13. Leases

a) As lessee

i) The equivalent of acquisition cost (including interest portion), accumulated depreciation and balance at the balance sheet date consisted of the following:

	In millions of yen	In thousands of U.S. dollars
Equivalent of acquisition cost:		
Machinery and equipment	¥16,098	$129,925
Others	4,646	37,504
	¥20,744	$167,429
Equivalent of accumulated depreciation:		
Machinery and equipment	¥ 8,418	$ 67,943
Others	2,902	23,422
	¥11,320	$ 91,365
Equivalent of balance at the balance sheet date:		
Machinery and equipment	¥ 7,680	$ 61,982
Others	1,744	14,082
	¥ 9,424	$ 76,064

ii) The equivalent of undue lease payments (including interest portion) at March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Within one year	¥3,893	¥ 4,530	$31,420
Thereafter	5,531	7,529	44,644
	¥9,424	¥12,059	$76,064

iii) Lease payments (the equivalent of depreciation expenses)

Lease payments relating to finance lease transactions accounted for as operating leases in the accompanying consolidated financial statements for the years ended March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Lease payments	¥4,471	¥4,924	$36,088

iv) Method of computing the equivalent of depreciation expenses

The equivalent of depreciation expenses was computed by the straight-line method based on the lease periods as useful lives.

b) As lessor

i) Acquisition cost, accumulated depreciation and balance at the balance sheet date consisted of the following:

	In millions of yen	In thousands of U.S. dollars
Acquisition cost:		
Machinery and equipment	¥70,555	$569,450
Others	3,993	32,227
	¥74,548	$601,677
Accumulated depreciation:		
Machinery and equipment	¥30,294	$244,499
Others	1,627	13,133
	¥31,921	$257,632
Balance at the balance sheet date:		
Machinery and equipment	¥40,261	$324,951
Others	2,366	19,094
	¥42,627	$344,045

ii) Undue lease income at March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Within one year	¥13,274	¥11,358	$107,134
Thereafter	34,676	36,552	279,873
	¥47,950	¥47,910	$387,007

iii) Lease income and depreciation expenses

Lease income and depreciation expenses relating to finance lease transactions accounted for as operating leases in the accompanying consolidated financial statements for the years ended March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Lease income	¥14,405	¥15,246	$116,267
Depreciation expenses	12,090	12,680	97,578

14. Securities

a) Securities with market value classified as other securities at March 31, 2001, regardless of the consolidated balance sheet classification, consisted of the following:

	In millions of yen			In thousands of U.S. dollars		
	Acquisition cost	Carrying amount	Unrealized gain (loss)	Acquisition cost	Carrying amount	Unrealized gain (loss)
i) Carrying amounts over acquisition costs:						
Equity securities	¥132,116	¥264,838	¥132,722	$1,066,308	$2,137,508`	$1,071,200
Bonds and Debentures						
Bonds	243	376	133	1,956	3,033	1,077
Others	1,723	1,751	28	13,909	14,136	227
	¥134,082	¥266,965	¥132,883	$1,082,173	2,154,677	$1,072,504
ii) Acquistion costs over carring amounts:						
Equity securities	¥ 36,115	¥ 27,499	(¥8,616)	$ 291,487	$ 221,945	($69,542)
	¥170,197	¥294,464	¥124,267	$1,373,660	$2,376,622	$1,002,962

MHI and Subsidiaries treated securities whose market values showed a substantial decline and were not judged to recover, as impaired. The amount reflecting the impairment loss is recorded as the acquisition cost for these securities. The amount of impairment losses for the year ended March 31, 2001 amounted to ¥10,317 million (US$83,266 thousand) with respect to securities with market value classified as other securities.

b) Sales amounts of other securities and related gains and losses for the year ended March 31, 2001, excluding investment securities contributed to a retirement benefit trust mentioned in 1 i), were as follows:

In millions of yen			In thousands of U.S. dollars		
Sales amounts	Gains	Losses	Sales amounts	Gains	Losses
¥21,090	¥11,245	(¥1,175)	$170,216	$90,758	($9,481)

c) Other securities without market value at March 31, 2001 mainly consisted of the following:

	In millions of yen	In thousands of U.S. dollars
Negotiable certificate of deposits ("CD")	¥73,486	$593,106
Equity securities—unlisted	28,835	232,731
Foreign bonds—unlisted	5,000	40,355

MHI and Subsidiaries treated as impaired those securities whose real values were judged to have declined substantially due to financial difficulties of the issuers. The amount of impairment loss for the year ended March 31, 2001 amounted to ¥3,763 million (US$30,374 thousand) with respect to other securities without market value.

d) The contractual maturities of other securities at March 31, 2001 were as follows:

	In millions of yen			In thousands of U.S. dollars		
	Due within one year	Due after one year through five years	Due after five years	Due within one year	Due after one year through five years	Due after five years
CD	¥73,486	¥ —	¥ —	$593,106	$ —	$ —
Bonds and Debentures						
Bonds	—	376	—	—	3,034	—
Debentures	669	860	1,120	5,404	6,938	9,683
Others	1,688	553	—	13,623	4,469	—
	¥75,843	¥1,789	¥1,120	$612,133	$14,441	$9,683

15. Retirement Benefits

MHI and Subsidiaries have several non-contributory defined benefit pension plans and severance indemnity plans, and there are occasions where employees receive special lump-sum payments at retirement. Contributions to the plans are funded in accordance with the applicable laws and regulations. MHI has established a retirement benefit trust, as mentioned in 1 i).

Actuarial losses are amortized from the following year of the occurrence by the straight-line method within the estimated average remaining years of service of employees. Prior service cost was incurred in certain subsidiaries and amortized from the current year by the same method within 11 years.

a) Benefit obligations and related information at March 31, 2001 were as follows:

	In millions of yen	In thousands of U.S. dollars
Benefit obligations	(¥757,556)	($6,114,251)
Fair value of plan assets	417,830	3,372,316
Unfunded benefit obligations	(339,726)	(2,741,935)
Unrecognized transition difference	—	—
Unrecognized actuarial loss (gain)	71,562	577,578
Unrecognized prior service cost (benefit)	(310)	(2,509)
Net benefit liability recognized on the consolidated balance sheet	(268,474)	(2,166,866)
Prepaid pension expense	—	—
Reserve for retirement allowances	(¥268,474)	($2,166,866)

b) Benefit expenses for the year ended March 31, 2001 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
Service cost	¥ 30,092	$ 242,875
Interest cost	22,120	178,532
Expected return on plan assets	(11,829)	(95,474)
Amortization of transition difference	172,549	1,392,646
Amortization of unrecognized actuarial loss (gain)	—	—
Amortization of unrecognized service cost (benefit)	(2)	(19)
Net benefit expenses	¥212,930	$1,718,560

c) The principal assumptions used in determining the information above at March 31, 2001 were as follows:

Discount rate		3.0%
Rate of return on assets		4.0%
Years within which actuarial losses are amortized	MHI	13 years
	Subsidiaries	11~20 years

16. Contingent Liabilities

Contingent liabilities for notes discounted and loans guaranteed in the ordinary course of business amounted to ¥206,099 million (US$1,663,433 thousand) and ¥190,837 million at March 31, 2001 and 2000, respectively.

17. Supplementary Income Information

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Depreciation	¥ 99,352	¥105,359	$801,874
Research and development costs (including routine or periodic alterations to existing products)	116,243	129,768	938,198

18. Subsequent Event

On June 28, 2001 and June 29, 2000 at meetings of the stockholders of MHI, the following appropriations of retained earnings were approved:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Cash dividends	¥13,492	¥ 8,433	$108,895
Transfer to legal reserve	1,129	844	9,109
Reserve for reduction in costs of fixed assets	1,152	1,599	9,298
	¥15,773	¥10,876	$127,302

19. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2001 and 2000 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2001	2000	2001
Cash and deposits	¥ 203,055	¥196,726	$1,638,859
Time deposits with maturities over three months	(35,987)	(39,237)	(290,455)
Cash equivalents included in marketable securities	—	42,036	—
Short-term investments with maturities within three months included in marketable securities	75,019	—	605,483
Short-term investments with maturities within three months included in prepaid expenses and other current assets	1,289	—	10,410
	¥243,376	¥199,525	$1,964,297

Century Ota Showa & Co.

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The Board of Directors of
Mitsubishi Heavy Industries, Ltd.

We have audited the consolidated balance sheets of Mitsubishi Heavy Industries, Ltd. and its consolidated subsidiaries as of March 31, 2001 and 2000, and the related consolidated statements of operations and retained earnings, and cash flows for the years then ended, all expressed in yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied 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, expressed in yen, present fairly the financial position of Mitsubishi Heavy Industries, Ltd. and its consolidated subsidiaries at March 31, 2001 and 2000, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles and practices generally accepted in Japan consistently applied during the period except for the changes, with which we concur, in the method of accounting for the valuation of certain finished products as described in Note 1. d), the accounting treatment to the allowance for losses on construction contracts and the work in process valuation losses as described in Note 1. h), the method of accounting for pension cost as described in Note 1. i) and the criterion under which the percentage-of-completion method would be adopted as described in Note 1. j) in the year ended March 31, 2000, to the consolidated financial statements.

As described in Note 1. to the consolidated financial statements, Mitsubishi Heavy Industries, Ltd. and its consolidated subsidiaries adopted new accounting standards for financial instruments, retirement benefits and foreign currency transactions, effective April 1, 2000, and new accounting standards for tax-effect accounting and consolidated statement of cash flows, effective April 1, 1999, in the preparation of their consolidated financial statements .

The United States dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2001 are presented solely for convenience. Our audit also included the translation of Japanese yen amounts into United States dollar amounts and, in our opinion, such translation has been made on the basis described in Note 2. to the consolidated financial statements.

Century Ota Showa & Co.

June 28, 2001

The accompanying consolidated financial statements of Mitsubishi Heavy Industries, Ltd. and its consolidated subsidiaries have been prepared in accordance with accounting principles and practices generally accepted in Japan, which in certain respects are not equal to the application and disclosure requirements of International Accounting Standards.

Board of Directors

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EXECUTIVE VICE PRESIDENT

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Shigeharu Matsuura

Osamu Wakazono

Motoo Makita

Satoru Hatano

Hideo Hariyama

Ikuro Nagata

STATUTORY AUDITORS

Tsuneo Wakai

Hiroshi Hayashi

Kazunori Gose

Yasuo Yasaki

** Representative Director*

As of June 28, 2001

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PAID-IN CAPITAL

¥265.5 billion

(3,373,027,622 shares)

As of March 31, 2001

STOCK LISTINGS

Tokyo, Osaka, Nagoya, Fukuoka and Sapporo stock exchanges

TRANSFER AGENT

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www.mhi.co.jp

Printed in Japan

K060-ANAL01E1-A-1, (8.5) 01-8, R