

KAWASAKI HEAVY INDUSTRIES, LTD.

2003

Semiannual Report

For the six months ended September 30, 2003

	<i>Millions of yen</i>		<i>Thousands of</i>
	<i>2003</i>	<i>2002</i>	<i>U.S. dollars</i>
For the period:			2003
Net sales.....	¥ 523,270	¥ 539,691	\$ 4,703,551
Operating income (loss)	1,616	(2,234)	14,526
Net loss	3,396	3,488	30,526
Research and development expenses.....	6,100	6,400	54,831
Depreciation and amortization	15,796	15,348	141,987
Net cash provided by operating activities	11,000	21,068	

To Our Shareholders

Transforming Our Earnings Structure and Targeting Sustainable Growth

Although signs of recovery emerged in the Japanese economy during the six-month interim period ended September 30, 2003, overall economic conditions remained weak, along with the continuation of cuts in government public works investment and lackluster personal consumption.

In this operating environment, the Kawasaki Heavy

changes in the business environment and achieve sustainable growth. Our target is to reach a before-tax return on invested capital (ROIC) of 9% or higher by the end of the fiscal year ending March 31, 2007.

To attain our objectives, we are sharpening the focus of our business portfolio through the exercise of selectivity and concentration in allocating our corporate resources. We are directing our resources especially toward core and developing businesses, namely Aerospace, Consumer Products & Machinery, Rolling Stock, and Gas Turbines & Machinery, and working to strengthen the contribution of these activities to KHI's earnings.

Also, under our policy of "Quality followed by Quantity," we are making every effort to offer products and services that are differentiated by technology and brand equity and further sharpening our business model aimed at strengthening profitability and creating a stable, high-margin earnings foundation.

For the foreseeable future, we must assume that the operating environment in Japan and overseas will remain challenging. To enhance KHI's enterprise value through the attainment of sustainable growth, we plan to move forward with realignments in our portfolio of businesses

forward with realignments in our portfolio of businesses

forward with realignments in our portfolio of businesses and steadily improve corporate value.



Other

Orders received in this segment rose ¥11.9 billion, or 22.7%, from the same period of the previous fiscal year, to ¥64.2 billion. Net sales were also up ¥7.3 billion, or 13.3%, to ¥61.9 billion, principally due to higher

overseas sales of industrial hydraulic equipment to China. Operating income amounted to ¥1.2 billion, representing an improvement of ¥1.7 billion.

Review by Geographic Segment

Sales in Japan for the interim period under review amounted to ¥366.4 billion, a slight increase of ¥2.6 billion, or 0.7%, from the same period of the previous fiscal year. Operating loss dropped ¥5.6 billion, or 91.8%, to ¥0.5 billion, supported by a recovery in the shipbuilding business.

In North America, sales were down ¥24.2 billion, or 19.2%, to ¥101.9 billion, because of reduced deliveries to customers from the rolling stock subsidiary. This geographic segment reported an operating loss of ¥0.9 billion, compared with an operating income of ¥0.4 billion for the same period of the previous fiscal year.

Sales in Europe increased ¥6.8 billion, or 18.1%, to ¥44.1 billion, because of higher revenues of the motorcycle sales subsidiary in the region. Operating income declined ¥0.4 billion, or 33.0%, to ¥0.7 billion.

In Asia, sales declined ¥1.8 billion, or 17.7%, from the interim period of the previous fiscal year, to ¥8.4 billion, and this geographic segment reported an operating loss of ¥0.3 billion compared to operating income of ¥0.2 billion in the interim period of the previous fiscal year.

In other areas, sales increased ¥0.3 billion, or 13.7%, to ¥2.5 billion, and operating performance achieved break-even—approximately the same level as for the interim period of the previous fiscal year.

Cash Flows

During the interim period under review, net cash provided by operating activities amounted to ¥11.0 billion, compared with ¥21.1 billion for the same period of the previous year. Net cash used in investing activities was ¥14.3 billion, versus ¥18.9 billion for the same period of the previous year. Acquisition of property, plant and equipment accounted for the largest portion of these cash outlays. Net cash used in financing activities amounted to ¥4.6 billion, compared with ¥38.3 billion in

the same period of the previous year, as the Company reduced the amount of debt outstanding. Free cash flow, which is the sum of net cash provided by operating activities and net cash used in investing activities, was negative ¥3.3 billion. As a result of these factors, cash and cash equivalents at the end of the interim period were ¥7.2 billion lower than at the end of March 2003, amounting to ¥52.6 billion.

Condensed Consolidated Balance Sheets

Kawasaki Heavy Industries, Ltd. and Consolidated Subsidiaries
As of September 30 and March 31, 2003 and September 30, 2002

	Millions of yen			Thousands of U.S. dollars
	September 30, 2003 (unaudited)	March 31, 2003	September 30, 2002 (unaudited)	September 30, 2003 (unaudited)
Assets:				
Current assets:				
Cash on hand and in banks	¥ 54,111	¥ 61,185	¥ 55,463	\$ 486,391
Receivables, less allowance	313,103	393,067	321,214	2,814,409
Inventories.....	392,741	342,387	415,451	3,530,257
Other current assets	46,907	31,323	50,510	421,636
Total current assets	806,862	827,962	842,638	7,252,693
Investments and long-term loans, less allowance	72,783	65,744	74,068	654,228
Net property, plant and equipment.....	261,884	234,352	240,552	2,354,013
Intangible and other assets	18,762	21,103	15,424	168,647
Total assets.....	¥1,160,291	¥1,149,161	¥1,172,682	\$10,429,581
Liabilities and shareholders' equity:				
Current liabilities:				
Short-term borrowings and current portion				
of long-term debt	¥ 229,708	¥ 201,248	¥ 221,919	\$ 2,064,791
Payables.....	241,502	294,769	272,351	2,170,804
Advances from customers.....	140,441	100,829	155,872	1,262,391
Other current liabilities	79,680	93,345	66,667	716,225
Total current liabilities	691,331	690,191	716,809	6,214,211
Long-term liabilities:				
Long-term debt, less current portion.....	205,178	226,936	226,922	1,844,297
Others.....	79,155	51,858	64,177	711,505
Total long-term liabilities.....	284,333	278,794	291,099	2,555,802
Minority interests	3,747	5,591	5,323	33,681
Shareholders' equity:				
Common stock	81,427	81,427	81,427	731,928
Capital surplus	31,388	24,683	24,683	282,139
Retained earnings	70,742	77,069	60,559	635,883
Net unrealized gains on securities	9,326	3,671	4,836	83,829
Foreign currency translation adjustments.....	(11,918)	(12,225)	(12,029)	(107,128)
Treasury stock	(85)	(40)	(25)	(764)
Total shareholders' equity	180,880	174,585	159,451	1,625,887
Total liabilities and shareholders' equity.....	¥1,160,291	¥1,149,161	¥1,172,682	\$10,429,581

	<i>Millions of yen</i>		<i>Thousands of</i>
	<i>2003</i>	<i>2002</i>	<i>U.S. dollars</i>
Net sales.....	¥523,270	¥539,691	2003

Consolidated Statements of Cash Flows

Kawasaki Heavy Industries, Ltd. and Consolidated Subsidiaries
For the six months ended September 30, 2003 and 2002 (unaudited)

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Cash flows from operating activities:			
Loss before income taxes and minority interests	¥ (948)	¥ (8,509)	\$ (8,521)
Depreciation and amortization	15,796	15,348	141,987
Provision for retirement and severance benefits	2,256	4,484	20,279
Accrued bonuses	(2,801)	709	(25,178)
Provision for (reversal of) allowance for doubtful accounts	277	(1,403)	2,490
Loss on sales of investments in subsidiaries	(118)	—	(1,061)
Gain (loss) on sale of securities	(413)	38	(3,712)
Gain (loss) on sale of fixed assets	(311)	648	(2,796)
Gain on contribution of securities to employees' retirement benefit trust	—	(1,312)	—
Provision for restructuring charges	(1,047)	—	(9,411)
Interest and dividend income	(1,106)	(2,221)	(9,942)
Interest expense	3,941	5,157	35,425
Changes in assets and liabilities:			
Decrease (increase) in:			
Trade receivables	80,614	74,404	724,620
Inventories	(40,904)	(49,120)	(367,676)
Other current assets	(8,240)	(5,661)	(74,067)
Increase (decrease) in:			
Trade payables	(51,844)	(48,634)	(466,013)
Advances received	39,964	44,454	359,227
Other current liabilities	(12,631)	(3,289)	(113,537)
Other, net	(810)	1,071	(7,283)
Subtotal	21,675	26,164	194,831
Cash received for interest and dividends	1,726	2,266	15,514
Cash paid for interest	(3,986)	(4,761)	(35,829)
Cash paid for income taxes	(8,415)	(2,601)	(75,640)
Net cash provided by operating activities	11,000	21,068	98,876

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Thousands of



(c) Overseas sales

	<i>Millions of yen</i>		<i>Millions of yen</i>		<i>Thousands of</i>
		<i>%</i>		<i>%</i>	<i>U.S. dollars</i>
	2003		2002		2003
	<i>Overseas sales</i>	<i>% against net sales</i>	<i>Overseas sales</i>	<i>% against net sales</i>	<i>Overseas sales</i>
North America.....	¥123,223	23.5%	¥152,803	28.3%	\$1,107,622
Europe.....	70,313	13.4	51,751	9.6	632,027
Asia.....	29,624	5.7	40,564	7.5	266,283
Other areas.....	34,291	6.6	36,310	6.7	308,234
Total	¥257,451	49.2%	¥281,428	52.1%	\$2,314,166

Net Sales, Orders and Order Backlog by Industry Segment

For the six months ended September 30, 2003 and 2002 (unaudited)

	Millions of yen		Thousands of U.S. dollars
	2003	2002	2003
Net sales:			
Shipbuilding.....	¥ 51,683	¥ 49,823	\$ 464,566
Rolling Stock, Construction Machinery & Crushing Plant.....	57,885	79,423	520,315
Aerospace.....	69,815	45,657	627,551
Gas Turbines & Machinery.....	65,799	67,694	591,452
Plant & Infrastructure Engineering.....	50,530	80,128	454,202
Consumer Products & Machinery.....	165,651	162,316	1,488,998
Other.....	61,907	54,650	556,467
Total.....	¥523,270	¥539,691	\$4,703,551

Orders received:

Shipbuilding.....	¥ 46,676	¥ 75,166	\$ 419,560
Rolling Stock, Construction Machinery & Crushing Plant.....	102,748	75,764	923,578
Aerospace.....	31,277	25,348	281,142
Gas Turbines & Machinery.....	53,364	50,106	479,676
Plant & Infrastructure Engineering.....	57,318	81,967	515,218
Consumer Products & Machinery.....	165,651	162,316	1,488,997
Other.....	64,221	52,358	577,267
Total.....	¥521,255	¥523,025	\$4,685,438

	Millions of yen			Thousands of U.S. dollars
	As of September 30, 2003	As of March 31, 2003	As of September 30, 2002	As of September 30, 2003
Order backlog:				
Shipbuilding.....	¥ 162,497	¥ 173,304	¥ 212,559	\$ 1,460,647
Rolling Stock, Construction Machinery & Crushing Plant.....	317,760	273,563	260,050	2,856,270
Aerospace.....	180,363	208,410	172,649	1,621,240
Gas Turbines & Machinery.....	136,379	160,874	168,398	1,225,879
Plant & Infrastructure Engineering.....	331,829	327,911	340,621	2,982,732
Consumer Products & Machinery.....	—	—	—	—
Other.....	25,294	31,501	36,477	227,362
Total.....	¥1,154,122	¥1,175,563	¥1,190,754	\$10,374,130

Note: The industrial hydraulic equipment business, which was formerly included in the Gas Turbines & Machinery segment, has been included in the Other segment beginning with the interim period under review. Data for the interim period of the previous fiscal year have been reclassified to reflect this change.

Kawasaki Corporate Data

(As of September 30, 2003)

Kawasaki Heavy Industries, Ltd.

Kobe Head Office:

Kobe Crystal Tower,
1-3, Higashikawasaki-cho 1-chome,
Chuo-ku, Kobe, Hyogo 650-8680, Japan

Tokyo Head Office:

World Trade Center Bldg.,
4-1, Hamamatsu-cho 2-chome,
Minato-ku, Tokyo 105-6116, Japan

Founded: 1878

Incorporated: 1896

Paid-in Capital: ¥81,427,090,720

Number of Shares Issued: 1,443,394,172 shares

Number of Shareholders: 134,672

Number of Employees: 29,651