

KAWASAKI HEAVY INDUSTRIES, LTD.

Semiannual Report 2005

For the six months ended September 30, 2005

	<i>Millions of yen</i>		<i>Thousands of</i>
	<i>2005</i>	<i>2004</i>	<i>U.S. dollars</i>
For the period:			<i>2005</i>
Net sales.....	¥ 593,579	¥ 537,715	\$ 5,243,168
Operating income	12,577		

Boosting Corporate Value and Establishing Trust in the Kawasaki Brand

Operating Income Rises Substantially

The Japanese economy continued to recover during the interim period under review, mainly supported by increases in private capital investment stemming from improved corporate earnings. However, the overall operating environment for Kawasaki Heavy Industries, Ltd. (KHI), was challenging as a result of cutbacks in government public works investment and higher raw material prices.

Amid this operating environment, the KHI Group continued aggressive marketing activities. As a consequence, total orders rose ¥13.6 billion, or 2.7%, from the interim period of the previous year, to ¥516.7 billion, due mainly to the receipt of major orders in the Rolling Stock, Construction Machinery & Crushing Plant segment.

Net sales for the interim period climbed 10.4%, or ¥55.9 billion year on year, to ¥593.6 billion, as revenues rose in all business segments, led especially by the Aerospace and Rolling Stock, Construction Machinery & Crushing Plant segments.

Profitability showed a marked improvement over a year earlier, with operating income increasing 81.1%, or ¥5.6 billion, to ¥12.6 billion, and net income increasing 55.5%, or ¥1.9 billion, to ¥5.2 billion. Developments boosting profits included a weakening in the value of the yen, advances in the Aerospace segment, improvement in the Gas Turbines & Machinery segment, a firm performance in the Consumer Products & Machinery segment, and other factors.

KHI's fundamental stance is to pay our shareholders stable cash dividends appropriate to our earnings performance. However, after giving due consideration to the importance of expanding retained earnings and the uncertainties in the operating environment for the full fiscal year ending March 31, 2006, we have

decided to suspend the payment of cash dividends for the interim period under review.

Strategies Aimed at Creating New Value

The KHI Group defines its corporate mission as drawing fully on its broad base of advanced technologies to create new value by offering products that almost literally work modern-day wonders on land, at sea, and in the air while remaining true to its corporate philosophy of contributing to the development of societies around the world. Through these activities, we work to enhance customer satisfaction by offering our customers superior products and services that are differentiated by their technology and brand power. Our ultimate goal is to meet the expectations, first and foremost, of our shareholders as well as our customers, employees, and the communities we serve by implementing management policies that increase KHI's corporate value.

As we implement these core strategies under our Medium-Term Business Plan, we are changing our business structure to adapt to become aligned with the operating environment and create a stronger earnings base, with the objective of attaining sustainable growth. We are focusing our resources especially on the Aerospace and Consumer Products & Machinery segments, which we have positioned as our core businesses, as well as on our Rolling Stock business and Gas Turbines & Machinery segment, which we have positioned as "developing businesses." Our aim is to grow and develop these businesses to become mainstay earnings generators. In our Aerospace segment, we are proceeding with new projects to develop the P-X next maritime patrol aircraft and the C-X next transport aircraft for the Japan Defense Agency (JDA), and the Boeing 787 aircraft with The Boeing Company. Accordingly, we are devoting capital investment to these projects on a priority basis. In the Consumer Products & Machinery segment, we are working to enhance

the value of the Kawasaki brand and substantially improve the competitiveness of our products. In the Rolling Stock business, we are strengthening our operating systems, principally overseas, to respond to strong demand, especially in China and North America. In addition, in the Gas Turbines & Machinery segment we are expanding our industrial gas turbine business operations and making capital investments for the development and production of the Rolls Royce TRENT 1000 jet engine, which has been selected for the Boeing 787 aircraft.

On the other hand, in our Shipbuilding and Plant & Infrastructure Engineering segments, where operating conditions have become tough because of increased international competition and cut-backs in government public works investment in Japan, we are carrying out structural reforms and are working to improve their earnings performance. In these two segments, we have set up two fully owned subsidiaries—namely, Kawasaki Shipbuilding Corporation and Kawasaki Plant Systems, Ltd., which are working to create a stronger earnings base with greater independence and flexibility in management.

In the steel structures business within the Plant & Infrastructure Engineering segment, we have been adopting various restructuring measures, including consolidation of factories, but the market outlook for steel bridges, one of the main products in this business, has become uncertain as a consequence of our alleged violation of Japan's Antimonopoly Act in bidding for certain projects. Accordingly, while we intend to keep our advanced technology for steel bridges, we are moving forward with measures to restructure this business to enable it to continue without depending on sales of steel bridges.

For all our activities, we have set a management policy of "Quality Followed by Quantity." Wee market





REVIEW BY GEOGRAPHIC SEGMENT

	<i>Millions of yen</i>		<i>Thousands of U.S. dollars</i>	
	<i>September 30, 2005</i>	<i>March 31, 2005</i>	<i>September 30, 2004</i>	<i>September 30, 2005</i>
	<i>(unaudited)</i>		<i>(unaudited)</i>	<i>(unaudited)</i>

Assets:

Current assets:

Cash on hand and in banks.....	¥ 32,685	¥ 44,629	¥ 36,520	\$ 288,711
Receivables, less allowance	375,420	413,619	313,005	3,316,138
Inventories.....	375,367	332,333	358,127	3,315,670
Other current assets.....	53,533	46,424	47,824	472,865
Total current assets.....	837,005	837,005	755,476	7,393,384
Investments and long-term loans, less allowance	84,250	79,569	82,777	744,192
Net property, plant and equipment.....	239,731	243,166	246,763	2,117,578
Intangible and other assets.....	32,915	34,733	29,013	290,743
Total assets.....	¥1,193,901	¥1,194,473	¥1,114,029	\$10,545,897

Liabilities and shareholders' equity:

Current liabilities:

Thousands of

	<i>Millions of yen</i>		<i>Thousands of U.S. dollars</i>
	<u>2005</u>	<u>2004</u>	<u>2005</u>
Cash flows from operating activities:			
Income before income taxes and minority interests.....	¥ 8,193	¥ 6,943	\$ 72,370
Adjustments to reconcile net income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	14,384	15,130	127,056
Decrease (increase) in assets.....	(6,771)	50,229	(59,809)
Increase (decrease) in liabilities	2,150	(38,645)	18,991
Other	(6,740)	(13,841)	(59,535)
Net cash provided by operating activities.....	11,216	19,816	99,073
Cash flows from investing activities:			
Acquisition of tangible and intangible assets	(15,305)	(14,437)	(135,191)
Acquisition of investments in securities	(425)	(1,006)	(3,754)
Other	8,038	4,133	71,000
Net cash used for investing activities.....	(7,692)	(11,310)	(67,945)
Cash flows from financing activities:			
Decrease in short-term borrowings.....	(4,055)	(18,503)	(35,818)
Proceeds from long-term debt.....	15,503	49,563	136,940
Repayment of long-term debt.....	(23,189)	(42,920)	(204,832)
Other	(3,717)	(2,958)	(32,833)
Net cash used for financing activities	(15,458)	(14,818)	(136,543)
Effect of exchange rate changes	173	105	1,528
Net decrease in cash and cash equivalents	(11,761)	(6,207)	(103,887)
Cash and cash equivalents at beginning of the period.....	44,385	42,375	392,059
Decrease in cash and cash equivalents by change of consolidation period of subsidiaries.....	—	(39)	—
Decrease in cash and cash equivalents arising from exclusion of consolidated subsidiaries.....	(111)	—	(980)
Cash and cash equivalents at end of the period.....	¥32,513	¥36,129	\$287,192

Effective April 1, 2005, Kawasaki Heavy Industries, Ltd., and its consolidated subsidiaries adopted the new accounting standards for impairment of fixed assets ("Opinion on Establishment of Accounting Standards for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the guidance on accounting standards for impairment of fixed assets (the "Financial Accounting Standard Guidance No. 6" issued by the Accounting Standards o5ng

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(a) Information by industry segment

	<i>Millions of yen</i>				
	2005				
	<i>External sales</i>	<i>Intersegment sales</i>	<i>Total sales</i>	<i>Operating expenses</i>	<i>Operating income (loss)</i>
Shipbuilding	¥ 53,736	¥ 589	¥ 54,325	¥ 53,561	¥ 764
Rolling Stock, Construction Machinery & Crushing Plant	84,331	465	84,796	82,529	2,267
Aerospace.....	91,293	951	92,244	86,643	5,601
Gas Turbines & Machinery.....	69,093	7,150	76,243	74,898	1,345
Plant & Infrastructure Engineering.....	68,609	6,121	74,730	80,395	(5,665)
Consumer Products & Machinery.....	166,339	2,295	168,634	163,490	5,144
Other.....	60,178	21,846	82,024	79,021	3,003
Total.....	593,579	39,417	632,996	620,537	12,459
Eliminations.....	—	(39,417)	(39,417)	(39,535)	118
Consolidated total	¥593,579	¥ —	¥593,579	¥581,002	¥12,577

	<i>Millions of yen</i>				
	2004				
	<i>External sales</i>	<i>Intersegment sales</i>	<i>Total sales</i>	<i>Operating expenses</i>	<i>Operating income (loss)</i>
Shipbuilding	¥ 44,471	¥ 507	¥ 44,978	¥ 42,092	¥2,886
Rolling Stock, Construction Machinery & Crushing Plant	67,600	715	68,315	65,117	3,198
Aerospace.....	73,460	831	74,291	73,222	1,069
Gas Turbines & Machinery.....	68,170	8,803	76,973	77,345	(372)
Plant & Infrastructure Engineering.....	67,463	5,655	73,118	80,259	(7,141)
Consumer Products & Machinery.....	156,490	2,531	159,021	154,219	4,802
Other.....	60,061	19,730	79,791	77,232	2,559
Total.....	537,715	38,772	576,487	569,486	7,001
Eliminations.....	—	(38,772)	(38,772)	(38,716)	(56)
Consolidated total	¥537,715	¥ —	¥537,715	¥530,770	¥6,945

	<i>Thousands of U.S. dollars</i>				
	2005				
	<i>External sales</i>	<i>Intersegment sales</i>	<i>Total sales</i>	<i>Operating expenses</i>	<i>Operating income (loss)</i>
Shipbuilding	\$				

(b) Information by geographic area

	<i>Millions of yen</i>				
	2005				
	<i>External sales</i>	<i>Intersegment sales</i>	<i>Total sales</i>	<i>Operating expenses</i>	<i>Operating income (loss)</i>
Japan.....	¥445,137	¥ 99,957	¥545,094	¥534,427	¥10,667
North America.....	97,241	6,997	104,238	104,000	238
Europe.....	36,638	1,888	38,526	37,833	693
Asia.....	11,307	8,708	20,015	19,286	729
Other areas.....	3,256	54	3,310	3,479	(169)
Total.....	593,579	117,604	711,183	699,025	12,158
Eliminations.....	—	(117,604)	(117,604)	(118,023)	419
Consolidated total.....	¥593,579	¥ —	¥593,579	¥581,002	¥12,577

	<i>Millions of yen</i>				
	2004				
	<i>External sales</i>	<i>Intersegment sales</i>	<i>Total sales</i>	<i>Operating expenses</i>	<i>Operating income (loss)</i>
Japan.....	¥401,293	¥ 83,699	¥484,992	¥481,348	¥3,644
North America.....	81,000	7,556	88,556	89,620	(1,064)
Europe.....	40,822	2,032	42,854	41,965	889
Asia.....	11,993	7,729	19,722	18,707	1,015
Other areas.....	2,607	49	2,656	2,791	(135)
Total.....	537,715	101,065	638,780	634,431	4,349
Eliminations.....	—	(101,065)	(101,065)	(103,661)	2,596
Consolidated total.....	¥537,715	¥ —	¥537,715	¥530,770	¥6,945

	<i>Thousands of U.S. dollars</i>				
	2005				
	<i>External sales</i>	<i>Intersegment sales</i>	<i>Total sales</i>	<i>Operating expenses</i>	<i>Operating income (loss)</i>
Japan.....	\$3,931,958	\$ 882,934	\$4,814,892	\$4,720,670	\$ 94,222
North America.....	858,944	61,805	920,749	918,647	2,102
Europe.....	323,629	16,677	340,306	334,184	6,122
Asia.....	99,876	76,919	176,795	170,356	6,439
Other areas.....	28,761	478	29,239	30,730	(1,491)
Total.....	5,243,168	1,038,813	6,281,981	6,174,587	107,394
Eliminations.....	—	(1,038,813)	(1,038,813)	(1,042,514)	3,701
Consolidated total.....	\$5,243,168	\$ —	\$5,243,168	\$5,132,073	\$111,095

	<i>Millions of yen</i>		<i>Thousands of U.S. dollars</i>
	2005	<i>2004</i>	2005
Net sales:			
Shipbuilding	¥ 53,736	¥ 44,471	\$ 474,658
Rolling Stock, Construction Machinery & Crushing Plant	84,331	67,600	744,908
Aerospace	91,293	73,460	806,404
Gas Turbines & Machinery	69,093	68,170	610,308
Plant & Infrastructure Engineering	68,609	67,463	606,033
Consumer Products & Machinery	166,339	156,490	1,469,296
Other	60,178	60,061	531,561
Total	¥593,579	¥537,715	\$5,243,168

Orders received:			
Shipbuilding	¥ 38,469	¥ 73,031	\$ 339,802
Rolling Stock, Construction Machinery & Crushing Plant	77,678	37,080	686,141
Aerospace	49,371	34,236	436,101
Gas Turbines & Machinery	97,161	84,548	858,237
Plant & Infrastructure Engineering	26,285	57,443	232,179
Consumer Products & Machinery	166,339	156,490	1,469,296
Other	61,391	60,262	542,275
Total	¥516,694	¥503,090	\$4,564,031

	<i>Millions of yen</i>			<i>Thousands of U.S. dollars</i>
	<i>As of September 30, 2005</i>	<i>As of March 31, 2005</i>	<i>As of September 30, 2004</i>	<i>As of September 30, 2005</i>
Order backlog:				
Shipbuilding	¥ 252,825	¥ 263,707	¥ 226,441	\$ 2,233,239
Rolling Stock, Construction Machinery & Crushing Plant	297,326	300,837	269,932	2,626,323
Aerospace	247,671	287,441	223,039	2,187,713
Gas Turbines & Machinery	194,754	163,440	160,254	1,720,290
Plant & Infrastructure Engineering	169,345	210,160	266,059	1,495,848
Consumer Products & Machinery	—	—	—	—
Other	29,796	28,824	27,358	263,192
Total	¥1,191,717	¥1,254,409	¥1,173,053	\$10,526,605

