MITSUBISHI HEAVY INDUSTRIES, LTD. ANNUAL REPORT 2006

MITSUBISHI
HEAVY INDUSTRIES, LTD.

ANNUAL REPORT 2006

For the Year Ended March 31, 2006

CONTENTS

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements regarding MHI's plans, outlook, strategies and results for the future that are based on management's estimates, assumptions and projections at the time of publication. Certain risks and uncertainties could cause MHI's actual results to differ materially from any projections presented in this report. These risks and uncertainties include, but are not limited to, the domestic and international economic circumstances surrounding MHI's businesses, competitive activity, related laws and regulations, product development programs and changes in exchange rates.

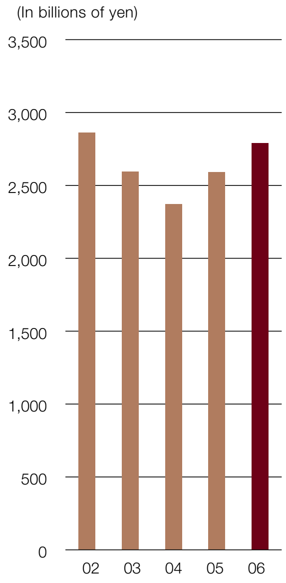
FINANCIAL HIGHLIGHTS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

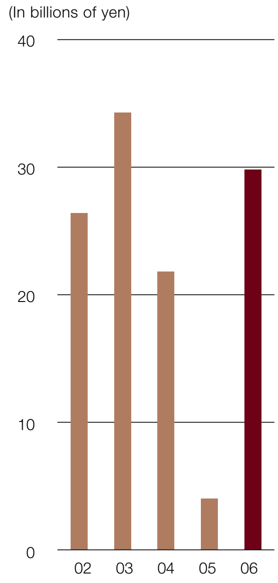
	In millions of yen except per share amounts		In thousands of U.S. dollars except per share amounts	Percent change
	2006	2005	2006	
Orders received	¥2,942,054	¥2,722,867	$25,045,152	8.0%
Net sales	2,792,109	2,590,733	23,768,696	7.8
Operating income	70,913	14,773	603,666	380.0
Net income	29,817	4,050	253,824	636.2
Research and development costs	100,798	124,023	858,076	(18.7)
Capital expenditures	140,570	112,296	1,196,644	25.2
Depreciation and amortization	100,810	99,183	858,177	1.6
Per share of common stock:				
Net income—basic	¥ 8.85	¥ 1.20	$ 0.075	637.5%
Cash dividends	4.00	4.00	0.034	0.0
Total assets	¥4,047,122	¥3,831,144	$34,452,392	5.6%
Stockholders' equity	1,376,289	1,309,977	11,716,091	5.1
Short-term borrowings and long-term debt	1,198,665	1,172,896	10,204,008	2.2

Note: U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥117.47=U.S.$1, the exchange rate prevailing at March 31, 2006.

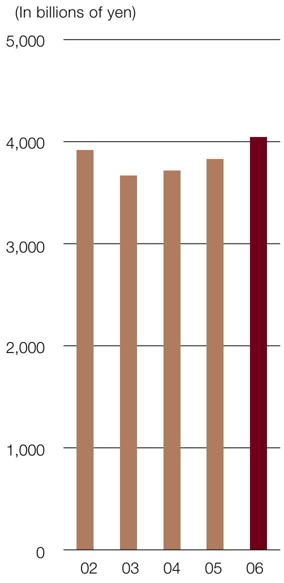
Net Sales



Net Income



Total Assets



A MESSAGE FROM THE MANAGEMENT

Operating Environment and Performance

During the fiscal year ended March 31, 2006, the Japanese economy on the whole recovered. Factors supporting this recovery included firm consumer spending against the backdrop of improvement in employment and wages, and rising capital investment thanks to continued strength in corporate earnings. Export growth also remained high, particularly to the U.S., where consumer spending was robust, and Asia, where economic growth remains strong.

In this operating environment, Mitsubishi Heavy Industries, Ltd. and its consolidated subsidiaries ("MHI Group") put greater emphasis on profitability and stepped up efforts to win orders in fields where it has previously been strong. As a result, MHI Group posted a year-on-year increase in the value of orders received on a consolidated basis of more than 8.0%, to ¥2,942.1 billion (US$25,045 million). While orders in the Shipbuilding & Ocean Development segment declined, the Power Systems segment posted higher orders due to contracts for a number of large-scale thermal power plants. The Mass and Medium-Lot Manufactured Machinery segment, where sales of forklifts overseas were strong, also recorded order growth, as did the Machinery & Steel Structures segment on a major new contract for a large-scale urban transportation system, one of its specialist fields. Orders also increased in the Aerospace segment.

Reflecting rising orders since the 2003 fiscal year, consolidated net sales also grew steadily in the year under review to ¥2,792.1 billion (US$23,769 million), 7.8% higher than the previous year. Although sales fell in Shipbuilding & Ocean Development due to a lower number of ship deliveries, sales were markedly higher in Power Systems, centering on thermal power plants overseas, and in Machinery & Steel Structures, based mainly on sales of chemical plants. The Mass and Medium-Lot Manufactured Machinery and Aerospace segments also posted year-on-year sales growth.

In terms of earnings, the MHI Group posted operating income of ¥70.9 billion (US$604 million), up ¥56.1 billion (US$466 million) from a year earlier, and ordinary income of ¥50.4 billion (US$429 million), an increase of ¥37.8 billion (US$312 million).

These increases were chiefly attributable to higher sales, which arose due to success in winning new orders over the last few years, and a better product mix. Despite negative factors such as rising basic material costs, earnings also increased thanks to concerted efforts to enhance profitability. We made improvements in productivity as output was boosted in response to higher orders received, lowered product warranty expenses achieved through efforts to raise product quality and reliability, and reduced selling, general and administrative expenses and manufacturing costs.

After recording extraordinary income from gains on sale of fixed assets, and extraordinary expenses for business improvement and restructuring charges, the MHI Group reported income before income taxes and minority interests of ¥52.4 billion (US$446 million), an increase of ¥36.0 billion (US$293 million) compared to a year earlier, and net income of ¥29.8 billion (US$254 million), up ¥25.8 billion (US$216 million) year on year.

Although no interim dividend was paid during the year under review, management has proposed to pay a cash dividend for the year of ¥4 per share.

Takashi Nishioka, *Chairman* Kazuo Tsukuda, *President*

The MHI Group thus recorded increases in both the value of orders received and net sales compared to a year earlier, as well as stronger earnings. This performance underscores the success of the Action 05, which was designed to reduce costs across the Group and boost productivity to tackle the biggest and most pressing issue MHI faced—improving profitability.

During the year, we took a number of steps to enhance the competitiveness of our product lineup. In Power Systems, we steadily upgraded facilities to boost production capacity. We also reviewed the Power Systems operating framework with a view to raising efficiency. Specifically, we began implementing structural reforms in February 2006 to create a more unified operating structure by realigning functions that were dispersed or duplicated among the Power Systems Headquarters and its respective manufacturing sites.

In Machinery & Steel Structures, we worked to respond to an increasingly competitive market environment. One initiative was the establishment of a specialist company in the mechanical parking field in October 2005. The aim here was to enhance our ability to compete in the market by combining diverse but related functions in a single, dedicated company. Additionally, to boost operational efficiency in a business climate characterized by shrinking domestic public works spending, we began reorganizing the operating framework for the Steel Structures & Construction Headquarters and the Machinery Headquarters, including the bridge construction business.

In Aerospace, we continued to make steady progress with the development and testing of wing boxes made of composite material for the Boeing 787. The use of composite material wings in a large commercial passenger aircraft will be a world first. Construction of a factory to carry out volume production of the wing boxes also progressed steadily.

In Mass and Medium-Lot Manufactured Machinery, we established a new manufacturing site in Europe by acquiring a local factory. This step was taken to meet rising demand for industrial engines in the region. We also expanded our machine tool production facilities to boost output.

Meanwhile, in April 2006, as part of initiatives to reinforce the MHI Group operating structure, we established the Production System Innovation Planning Department. Reporting directly to the president, this organization will promote initiatives designed to enhance basic manufacturing capabilities across the entire Group. The goal is to create powerful frontline production facilities capable of competing with those of rival manufacturing companies worldwide.

Next, we would like to report on MHI's indictment for infringements of the Antimonopoly Act in the year. In June and August of last year, MHI was indicted to the Tokyo High Court in relation to steel bridge construction ordered by the Ministry of Land, Infrastructure and Transport and the former Japan Highway Public Corporation. The following September, the Fair Trade Commission of Japan (JFTC) issued MHI with a cease and desist recommendation. MHI is also currently under JFTC investigation related to multiple public-sector orders for sludge treatment facilities.

MHI would like to take this opportunity to offer its sincerest apologies to shareholders for the considerable concern it has caused in relation to these incidents.

Over the years, MHI has continually emphasized the importance of compliance and offered employees guidance and training in this area, with activities led by our Compliance Committee. However, in order to further reinforce related initiatives and prevent acts that violate the Antimonopoly Act, MHI has taken the following actions.

In July 2005, MHI established an Internal Audit Department and Corporate Social Responsibility Center to reinforce internal auditing and build a stronger compliance promotion framework. The Board of Directors also passed a resolution pledging to observe the Antimonopoly Act and to refrain from any actions that could be construed as questionable. At the same time, the Board repeated an order of strict compliance at all times with the Antimonopoly Act to all employees.

Subsequently, the following August, MHI established an Order Compliance Committee. Including three outside experts, this committee is charged with monitoring, improving and providing guidance in relation to processes for securing new orders in each division. Aiming to ensure proper conduct in all of MHI's public-sector projects, this committee also examines steps to prevent any potential violations of the Antimonopoly Act. The committee has also formulated MHI policy for order securing processes in public-sector projects and clearly defined advance checking mechanisms for all individual projects. Other steps taken include new rules for the regular rotation of personnel involved in public-sector projects and initiatives to enhance training on Antimonopoly Act.

As illustrated by the above steps, every director and employee in the MHI Group is now constantly and fully aware of the importance of fulfilling their corporate social responsibilities as they go about their work. By promoting initiatives designed to ensure compliance Groupwide, we will work to rapidly regain society's trust in MHI.

Issues to Be Addressed BY MHI GROUP

In the year ahead, export growth is expected to remain high, supported by strong growth in the U.S. and China for the foreseeable future. However, factors putting pressure on corporate profits, such as rising prices for crude oil and other raw materials and increased personnel costs, could lead to a slowdown in capital investment. This together with an expected ongoing decline in public works spending across the board, means the outlook for the Japanese economy is not entirely optimistic.

In addition, the MHI Group will have to take continued steps to counter a range of internal and external issues in its operating environment: a dramatic drop in public-sector projects, a core MHI business field; intensifying global competition; and the problems of a dwindling workforce and the transfer of technological expertise and skills to the next generation, due to the upcoming mass retirement of baby boomers and a declining birthrate.

Against this backdrop, MHI announced its 2006 Business Plan in April 2006. The plan incorporates three basic strategies—build a solid earnings structure, strengthen the production technology base, and establish society and customer trust.

The plan targets three reforms: product mix reform, production system reform and resource introduction reform. Under product mix reform, MHI will strengthen and expand growth businesses and enhance initiatives in mature or low-margin businesses. Specific steps will include boosting output of gas turbines, engines, wind turbines and other energy-related products; building a mass production framework for the Boeing 787 commercial transport aircraft; and expanding global operations for turbochargers, printing equipment and other mass and medium-lot manufactured products. MHI will also steadily develop and roll out new products in energy, aerospace and other fields; expand its lineup of automotive products, such as automotive thermal systems and components for hybrid electric vehicles; and create new products to support MHI's operations well into the future.

With production system reform, our objective will be to realize manufacturing site innovation in three key ways: bolstering internal manufacturing capabilities, enhancing production technology and raising the skills of personnel through more training. In parallel, we will extend mass production methods such as standardization and use of shared components to all other areas of our product lineup. By enhancing product testing at the design stage through greater use of simulation technology and other approaches, we plan to win an even greater level of trust from customers for our products.

MHI will need to reinforce its management resources to implement these two areas of reform. The third and final reform area, resource introduction reform, is designed to ensure these resources are optimally channeled into target fields.

Specifically, we will increase recruitment to secure the people we need to drive forward our business activities. Additionally, we plan to concentrate investment in growth businesses; increase investment for operational rationalization, particularly in manufacturing process reforms; and channel other funds into R&D for new products, businesses and manufacturing technology.

In executing these reforms, we also hope to win the trust of customers and society as a whole by fulfilling our corporate social responsibility—an issue of paramount importance to the MHI Group. In addition to helping drive the development of society through our business activities, this will mean complying with all relevant laws and accepted standards of business, and giving due consideration to the environment, human rights and our employees. In particular, we will strive to ensure full compliance with the Antimonopoly Act by continuing to actively focus on a raft of measures already in place, including committees that have been fully active since last year and strengthening our internal auditing processes.

Although the MHI Group will continue to face challenging business conditions, by steadily implementing the above measures, we believe we can build a solid earnings structure and strengthen our production technology base to support our future development. Going forward, our commitment to business from the standpoint of the customer and society, and a desire to contribute to the development of society will not waver. Your support, as ever, will be vital to our endeavors.

July 2006

Takashi Nishioka, *Chairman*

Kazuo Tsukuda, *President*

AN INTERVIEW WITH PRESIDENT KAZUO TSUKUDA
— DISCUSSING THE 2006 BUSINESS PLAN —

In the following interview, we asked President Kazuo Tsukuda for his views on the content of the 2006 Business Plan, a new three-year medium-term business plan announced on April 28, 2006, and how MHI plans to achieve its goals.

Q1

Please tell us how the two-year action plan Action 05, which got under way last year, and the 2006 Business Plan are positioned in the Company's management strategies?

A1. Let's start with Action 05. We implemented this plan after the first year of our 2004 Business Plan, in which orders and sales expanded as expected, but earnings fell substantially below target. As a result, we initiated Action 05 as the first step toward a recovery in our profitability.

Although the sharp increase in material prices and other external factors were partially responsible for our deterioration in profitability, the real underlying reason was the emergence of some basic issues regarding our profit structure and our production technology capabilities. To rectify this situation, we implemented a full-scale drive to reduce costs and increase confidence in our products while also strengthening our product business divisions.

After the first year, results began to emerge from this initial step, but we were still not satisfied. We therefore introduced the 2006 Business Plan as step two in our efforts to drive a turnaround in earnings, further accelerating the process by making the plan one year shorter than our regular medium-term business plans. Although our fiscal 2008 targets for orders received and sales still do not represent levels we can be satisfied with, we believe our initiatives over the next three years will underpin further growth in sales and earnings from fiscal 2009 onward.

Q2

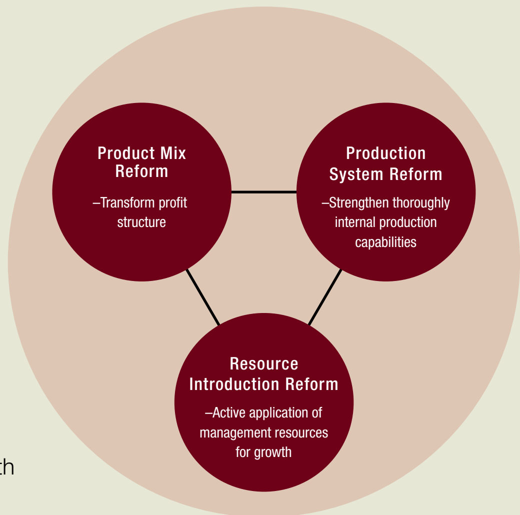
Please give us a summary of the 2006 Business Plan.

A2. The plan is formulated around three basic strategies:
- Build a solid earnings structure
- Strengthen the production technology base
- Win the trust of society and customers

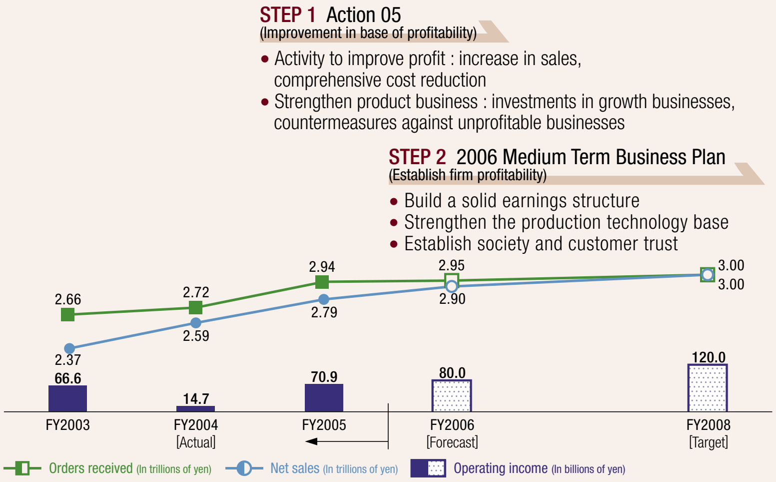
These basic strategies were chosen for various reasons, with the recovery in profitability being of course an urgent issue. We decided to focus on further strengthening our production technology base, the lifeblood of all manufacturers, to ensure we can offer products and services that meet the expectations of our customers and enable us to continue developing as a company worthy of society's trust.

The key measures we are implementing to attain our goals under the plan are:
- Product mix reform (shifting MHI to a profit-oriented business structure)
- Production system reform (reinforcing MHI's manufacturing base)
- Resource introduction reform (channeling resources into growth businesses to support the first two reforms)

Three Reforms



Target & Road Map to Achievement



Target (Consolidated)

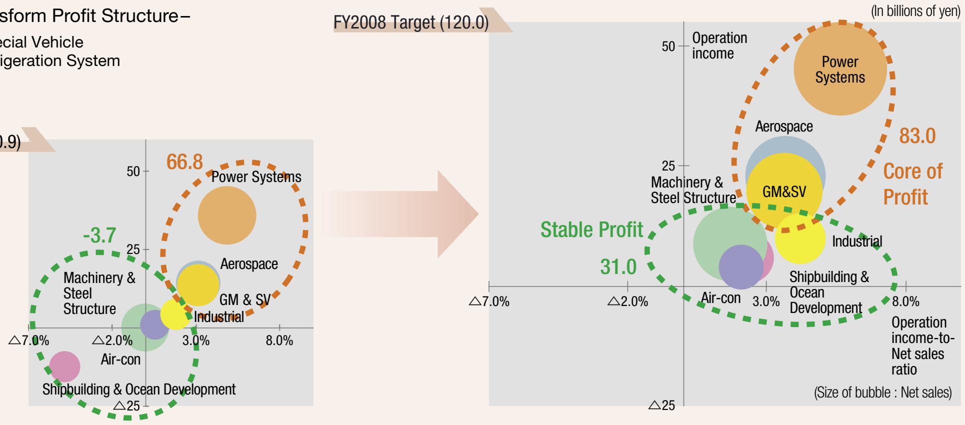
(In billions of yen)

	FY2004 Actual	FY2005 Actual	FY2006 Forecast	FY2008 Target
Orders received	¥2,722.8	¥2,942.0	¥2,950.0	¥3,000.0
Net sales	2,590.7	2,792.1	2,900.0	3,000.0
Operating income	14.7	70.9	80.0	120.0
Ordinary income	12.5	50.3	63.0	100.0
ROE	0.3%	2.2%	3.0%	4.5%
Interest-bearing debt	1,172.8	1,198.6	1,250.0	1,500.0
Number of employees	59,200	62,200	63,500	63,500
Export ratio*	44%	49%	50%	52%

* Orders received, Non-consolidated

Product Mix Reform –Transform Profit Structure–

GM & SV: General Machinery & Special Vehicle
Air-con: Air-conditioning and Refrigeration System
Industrial: Industrial Machinery



Let me look next at the performance goals of the plan. By focusing on the above three key measures, we are targeting operating income of ¥120 billion and ordinary income of ¥100 billion in fiscal 2008, the final year of the plan.

Our goal for interest-bearing debt at the end of the plan is ¥1.5 trillion. This represents an increase of about ¥300 billion compared to the end of the year under review. The additional funds will be actively invested in mainstay businesses, such as aerospace and power systems and in strengthening our production technology base.

We also are aiming for growth in our overseas business, setting an export ratio target of 52% on a non-consolidated basis. Additionally, we plan to boost our total workforce by 1,300 from the end of the year under review to 63,500 in fiscal 2008.

Q3

Please explain your plans for businesses positioned as capable of driving earnings—areas where you aim to channel resources in support of product mix reform.

A3. There are three such businesses—power systems, aerospace, and general machinery and special vehicles.

Together, sales in these businesses totaled ¥1.5 trillion in the fiscal year under review, representing 55% of consolidated net sales. Under the plan, we are seeking to increase this figure to ¥1.78 trillion. At the same time, we are aiming to increase this group's combined operating income by ¥16.2 billion from the ¥66.8 billion recorded in fiscal 2005, to ¥83.0 billion.

In the power systems business, we intend to position ourselves on the global stage as an electric power plant manufacturer with a full lineup of products covering oil, coal, and natural gas-fueled power plants, nuclear energy, and renewable energy sources such as wind and solar power. Of these areas, we will focus on accelerating the development of strategic nuclear power plants in preparation for growing energy demand worldwide.

Our efforts in the aerospace business hinge on firmly establishing our presence in the global market by demonstrating our technological capabilities in manufacturing wings made of composite materials for such new development projects as Boeing's B787 passenger aircraft.

Our fiscal 2008 operating income targets for the power systems and aerospace businesses are not particularly ambitious. However, the benefits of aggressive investment in wind turbines, solar power generation systems, B787-related projects and other areas will begin emerging in the form of higher earnings in these businesses from fiscal 2009 onward.

The main focus of our activities in the general machinery and special vehicles business will be the development of environmental and energy-saving technology and accelerating the international development of the business. Centered on engines, turbochargers, and forklifts, we plan to expand our business and boost earnings.

Product Mix Reform

(In billions of yen)

	Net sales		Operating income	
Segment and business	FY2005 actual	FY2008 target	FY2005 actual	FY2008 target
Power Systems	¥ 710.9	¥ 880.0	¥ 38.3	¥ 50.0
Aerospace	445.9	480.0	16.5	18.0
General Machinery & Special Vehicle	393.2	420.0	12.0	15.0
Total (Core of Profit)	1,550.0	1,780.0	66.8	83.0
Industrial Machinery	219.7	230.0	4.5	10.0
Air-conditioning & Refrigeration System	192.1	180.0	0.3	3.0
Shipbuilding & Ocean Development	222.6	240.0	(10.6)	6.0
Machinery & Steel Structures	538.7	490.0	2.3	12.0
Total (Low of Profit)	1,173.1	1,140.0	(3.7)	31.0
Other	68.7	80.0	7.5	6.0
Grand Total	¥2,792.1	¥3,000.0	¥ 70.9	¥120.0

Q4 Please tell us about your policies for businesses with the potential to generate stable profits.

A4. We have positioned four businesses in this group—industrial machinery, air-conditioning and refrigeration systems, shipbuilding & ocean development, and machinery & steel structures. Over the past few years, reform measures in the industrial machinery and air conditioning and refrigeration systems businesses have yielded fruit, moving both businesses into the black. We will continue to implement reforms to drive a further recovery in profitability.

The real issue, therefore, is our customer order-based businesses: shipbuilding & ocean development and machinery & steel structures.

Our shipbuilding & ocean development business has struggled recently with issues such as orders won when the Japanese yen was weak and the impact of the sharp increase in prices for steel and other materials. However, in fiscal 2008, we expect to begin booking sales of ships with revised higher prices. Because of this factor and an increase in productivity due to a planned reform of our construction methods through the incorporation of 3D design data, we expect this business to also move into the black.

Machinery & steel structures presents our biggest challenge. Because of its vast and varied range of products, business resources are highly dispersed. In addition, conditions in the public-sector market, its core market in the past, are extremely tight. As a result, we are taking drastic measures to restructure and withdraw from businesses that show little promise of recovery, and focusing our business resources on growth areas such as transportation systems, chemical plants, steelmaking equipment, and wind power machinery.

Q5

What systems or structures will MHI use to reform its production technology base?

A5. Since production technology is the lifeblood of our operations, we will emphasize the following four measures:

- Introduce a volume production system into our customer order-based businesses
- Strengthen supply chain management
- Train and enhance human resources involved in manufacturing
- Build a structure to enable continuous reform of production processes

Since this reform process will require strong leadership, in April 2006, we established the Production System Innovation Planning Department. This department reports directly to me, so I will personally take responsibility for accelerating our reforms at the manufacturing frontline.

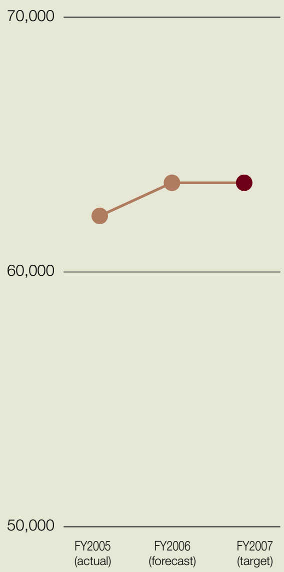
Q6

Finally, please give us some specific details of resource introduction reform.

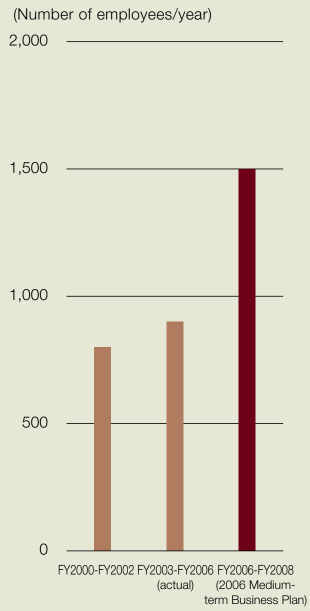
A6. In support of product mix and production system reforms, we will conduct resource introduction reform to channel investment into strategic areas, thereby establishing a solid profit structure.

Specifically, we will substantially increase our workforce by hiring 1,500 people per year. We are also planning capital expenditures of ¥465 billion and investment in R&D of ¥360 billion over the next three years, centered on growth fields.

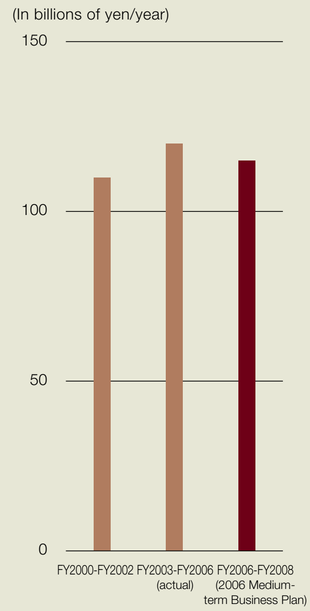
Number of Employees (Consolidated)



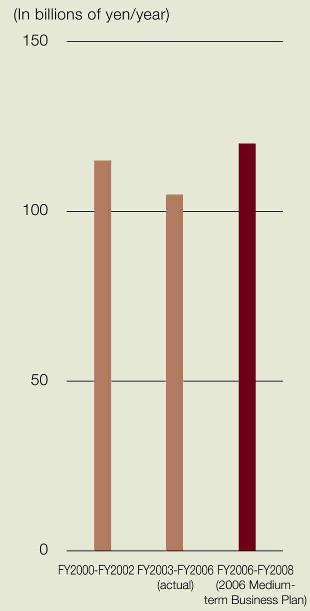
Trend of Number of Employees (Non-consolidated)



Capital Expenditure Trend and Plans



R&D Investment Plans



MHI AT A GLANCE

MHI's businesses are classified below into five business segments along operational lines.

SHIPBUILDING & OCEAN DEVELOPMENT

Share of Net Sales

8.0%

Through its Shipbuilding & Ocean Development segment, MHI plays an extensive role on the world's oceans with the development and construction of a wide range of large vessels and ocean structures that satisfy diverse customer needs. Underpinned by more than a century of tradition and years of technological expertise, MHI is actively working to develop new products that raise the bar on economy, reliability and safety.

POWER SYSTEMS

Share of Net Sales

25.5%

Based on independent research efforts that strike a balance between solving energy supply issues and protecting the environment, MHI's Power Systems business develops energy conservation measures, petroleum substitutes and new forms of energy to help solve some of the common problems faced by mankind today. MHI is also widely involved in the nuclear power field as one of the world's leading manufacturers of nuclear power plants.

MACHINERY & STEEL STRUCTURES

Share of Net Sales

19.3%

In the Machinery & Steel Structures segment, MHI supplies transportation systems, chemical plants, metals machinery and cranes and material handling systems that form an indispensable part of society's infrastructure.

AEROSPACE

Share of Net Sales

16.0%

This segment uses research and development programs underpinned by state-of-the-art technologies to prepare for the advent of the next Space Age. In aerospace products, MHI is working to expand its business into new areas through participation in projects for Japan's Defense Agency and the development of new commercial aircraft. And in space systems, MHI helps to drive forward Japan's space program as a systems integrator in launch vehicle development.

MASS AND MEDIUM-LOT MANUFACTURED MACHINERY

Share of Net Sales

28.8%

In the general machinery & special vehicles business, MHI develops and manufactures products such as engines and forklift trucks for the logistics field. The air-conditioning & refrigeration systems business boasts an extensive lineup of air-conditioning products, while the industrial machinery business manufactures extrusion machinery, used in the production of plastic products, beverage filling and packaging machines and other industrial equipment. This division also includes the paper and printing machinery business, which meets a diverse range of customer needs in Japan and overseas as a specialist player in the paper-related equipment field. Through its machine tools business, this division also supplies the "mother machines" of industry.

Note: MHI's operations also include an Others business division, not shown above.

REVIEW OF OPERATIONS

SHIPBUILDING & OCEAN DEVELOPMENT

LNG Carrier **“ARCTIC PRINCESS”**

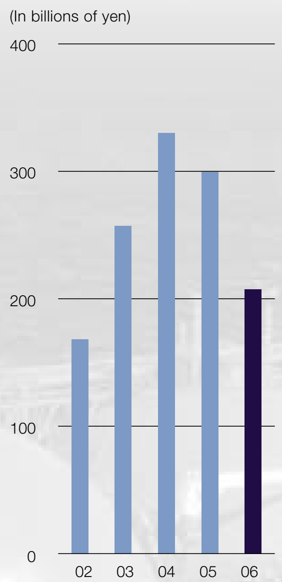
Demand for new shipbuilding remained high during the year. Given a sufficiently strong order book, the segment focused on winning new orders for high-value-added vessels—an MHI specialty. These efforts paid off with orders received for a total of 19 new vessels (all figures in this section exclude vessels of less than 100 gross tons). By vessel type, MHI secured contracts for nine pure car and truck carriers, two LNG carriers, two container carriers, two LPG carriers and two car ferries. However, compared to last year when the segment won a large number of orders, the total value of new orders declined to ¥207.5 billion (US$1,766 million). As of March 31, 2006, MHI had outstanding orders for 59 vessels totaling approximately 3.8 million gross tons.

The segment posted a decline in net sales to ¥222.7 billion (US$1,895 million), mainly due to a lower number of ship deliveries, and an operating loss of ¥10.6 billion (US$90 million) This reflected the booking of sales for projects secured during a period of stagnation in shipbuilding market, and the impact of surging prices for steel and other materials.

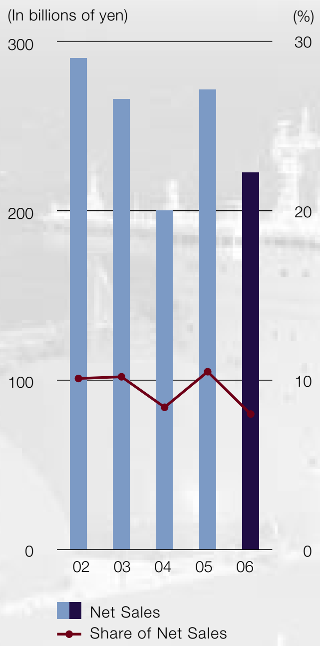
Products

Manufacturing, installation, sale and repair of crude oil carriers, container ships, cruise ships, car ferries, LPG carriers, LNG carriers and various other ships, defense vessels, offshore structures, etc.

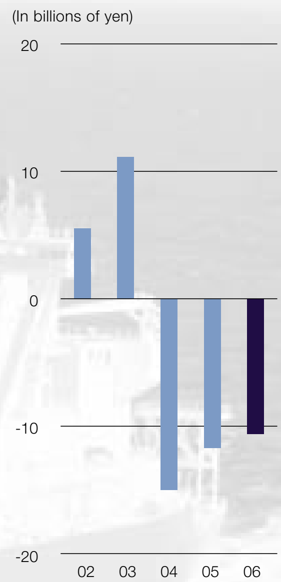
Orders Received



Net Sales
Share Of Net Sales



Operating Income (loss)



Car and General Cargo Carrier “TOYOFUJI MARU”

Container Carrier “HATSU SIGMA”

REVIEW OF OPERATIONS

POWER SYSTEMS

Elbistan Power Plant (Turkey)

A strong track record helped the segment to win an order from Saudi Arabia for a large-scale power generation and water desalination plant, and efforts to secure new orders overseas, particularly in Asia where demand is running high, were successful. This resulted in new orders for large-scale thermal power plants in Mexico, Vietnam, Thailand, China and Chile. The segment also signed its first ever contract for replacement steam generators for a nuclear power plant in France.

In Japan, the segment won an order for a large-scale thermal power plant as demand for new power plant construction picked up. Marketing efforts also led to an increase in orders for the upgrade, refurbishment and repair of existing power plants.

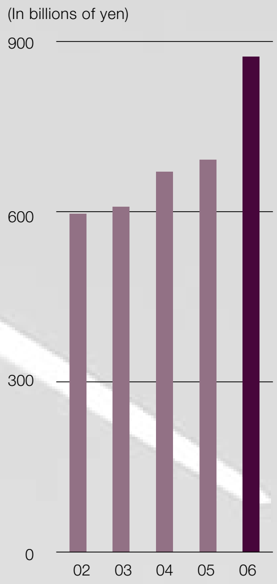
As a result, the total value of new orders increased year on year to ¥872.8 billion (US$7,430 million).

Net sales grew year on year to ¥711 billion (US$6,052 million), resulting from an increase in the implementation of large-scale thermal power plant projects derived from a strong backlog over the last few years. Operating income was ¥38.3 billion (US$326 million).

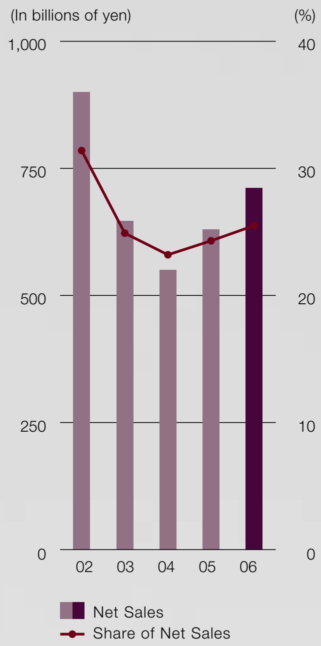
Products

Manufacturing, installation, sale and repair of boilers, steam turbines, gas turbines, diesel engines, water turbines, wind turbines, nuclear power equipment, nuclear fuel, denitrification equipment, marine machinery, desalination plants and pumps, etc.

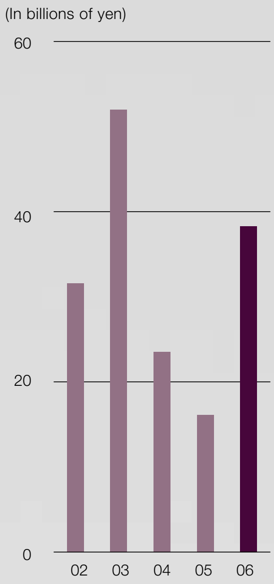
Orders Received



Net Sales
Share Of Net Sales



Operating Income



San Juan Mesa Wind Farm (U.S.A.)

125MW Steam Turbine Plant (Brazil)

REVIEW OF OPERATIONS

MACHINERY & STEEL STRUCTURES

Methanol Plant (Saudi Arabia)

In the machinery business, the value of new orders was significantly higher than a year earlier. Despite a drop in waste treatment facilities in the domestic market, higher orders were recorded from overseas customers. With many projects taking shape, the segment actively sought to secure new orders, resulting in contracts for an urban transportation system in Dubai, a chemical plant in Saudi Arabia and a succession of orders for flue gas desulfurization systems in Italy and Spain.

The steel structures business won a new order for large LNG tanks in Italy and secured a major contract for cultural, sports and leisure facilities in Singapore. However, this failed to cover a decline in bridge construction projects in Japan, resulting in a drop in the value of new orders secured in the steel structures business.

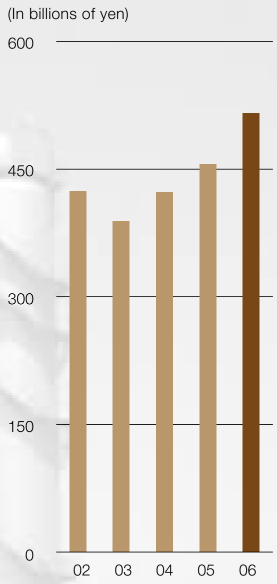
The total value of new orders in the segment as a whole, however, increased to ¥515.8 billion (US$4,391 million).

Net sales were higher at ¥538.8 billion (US$4,586 million), primarily reflecting progress with large-scale chemical plant construction projects and stronger sales of steel manufacturing machinery. Operating income was ¥2.3 billion (US$20 million).

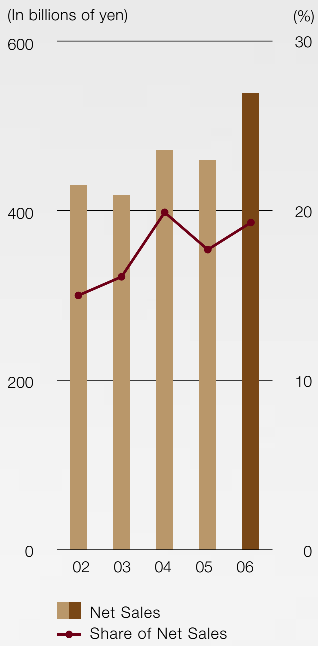
Products

Manufacturing, installation, sale and repair of waste treatment equipment, flue gas desulfurization systems, flue gas treatment systems and various other environmental control systems, transportation systems and equipment, petrochemical plants and various other chemical plants, oil and gas production systems, chemical machinery, iron and steel manufacturing machinery, blowers, packing machinery, bridges, hydraulic gates, cranes, stacks, parking systems, tanks, entertainment facilities, sports and leisure-related facilities, and various other steel structures, etc.

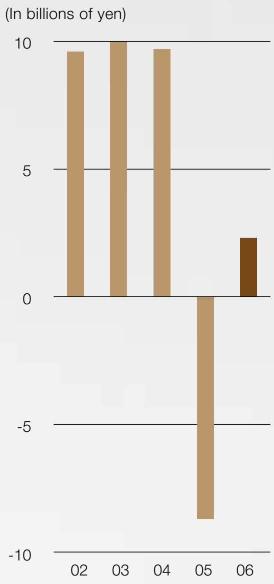
Orders Received



Net Sales
Share Of Net Sales



Operating Income (loss)



LNG Above-ground Storage Tank

LRV Green Mover max

REVIEW OF OPERATIONS

AEROSPACE

H-II A Launch Vehicle

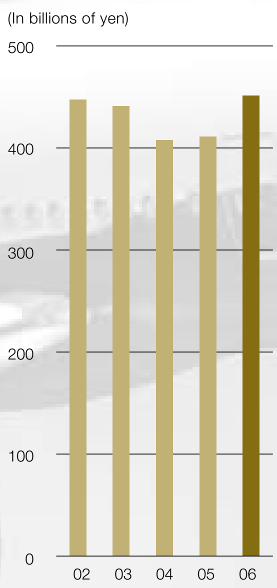
Against the backdrop of a recovery in air passenger traffic, the segment secured an increase in orders in commercial aircraft products, primarily wing boxes for the Boeing 787 and aft fuselage and other components for the Boeing 777. Orders in defense-related products also rose, primarily reflecting contracts for new Patriot surface-to-air missiles (PAC-3 missiles) related to the deployment of Japan's Ballistic Missile Defense (BMD) system. As a result, despite the impact of a decision to halt the development of a laboratory module for the International Space Station, the total value of new aerospace orders increased year on year to ¥451.5 billion (US$3,844 million).

Net sales were higher at ¥445.9 million (US$3,796 million) due chiefly to an increase in deliveries of commercial transport aircraft represented by aft fuselage and other components for the Boeing 777. Operating income totaled ¥16.5 billion (US$140 million).

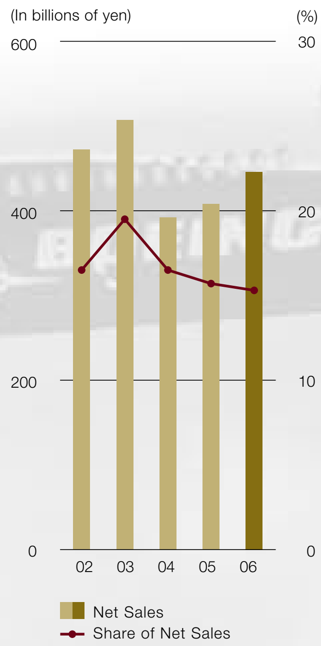
Products

Manufacturing, installation, sale and repair of fighters and other aircraft, helicopters, structural parts and components of commercial transport aircraft, aero engines, missiles, torpedoes, hydraulic equipment for aircraft and space systems, etc.

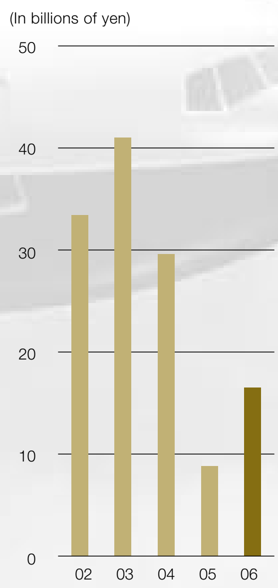
Orders Received



Net Sales
Share Of Net Sales



Operating Income



Boeing 777 Transport Aircraft

SH-60K Maritime Patrol Helicopter

REVIEW OF OPERATIONS

MASS AND MEDIUM-LOT MANUFACTURED MACHINERY

Wafer Bonder Using Surface Activated Bonding at Room Temperature

In the general machinery and special vehicles business, demand was strong for small and medium-size engines for industrial use, resulting from sustained efforts to win new orders from customers mainly in the U.S., Europe and Southeast Asia. Marketing efforts for forklifts targeting overseas markets also produced an increase in orders. This, together with rising orders for turbochargers in Europe, where stricter exhaust emission regulations are driving demand, led to an increase in both the value of new orders secured and net sales, to ¥386.6 billion (US$3,291 million) and ¥393.2 billion (US$3,347 million), respectively. Operating income was ¥12.0 billion (US$102 million).

In the air-conditioning and refrigeration systems business, there was strong demand for automotive thermal systems due to firm car sales in Japan, an increase in orders for commercial-use air-conditioners, mainly in Europe and China, as new products were rolled out and the sales network was upgraded, and continued robust sales of centrifugal liquid chillers. As a result, the business overall recorded an increase in both the value of new orders secured and net sales, to ¥191.0 billion (US$1,626 million) and ¥192.2 billion (US$1,636 million), respectively. Operating income totaled ¥0.3 billion (US$3 million).

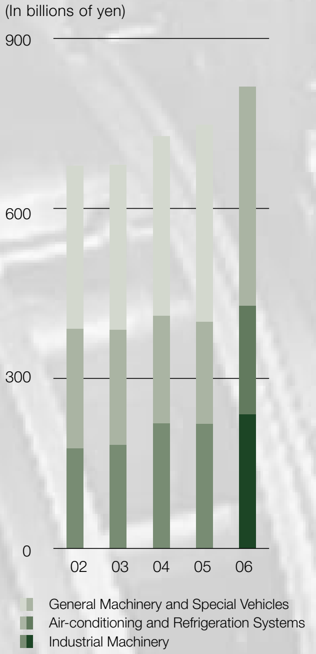
In the industrial machinery business, overseas orders for sheet-fed offset presses increased, as did those for newspaper offset presses resulting from a major new order in India. However, intensifying competition for orders in a shrinking market led to a drop overall in overseas orders for both commercial web offset presses and extrusion machinery. In Japan, there were new large-scale contracts for newspaper offset presses, as the segment tapped into demand driven by capital investment related to the shift to full-page color printing by newspaper publishers. Sales of commercial web offset presses also grew, as did those for machine tools against the backdrop of rising capital investment in the robust automotive industry.

As a result, both the value of orders secured and net sales rose from a year earlier to ¥237.2 billion (US$2,019 million) and ¥219.7 billion (US$1,870 million), respectively. Operating income totaled ¥4.5 billion (US$38 million).

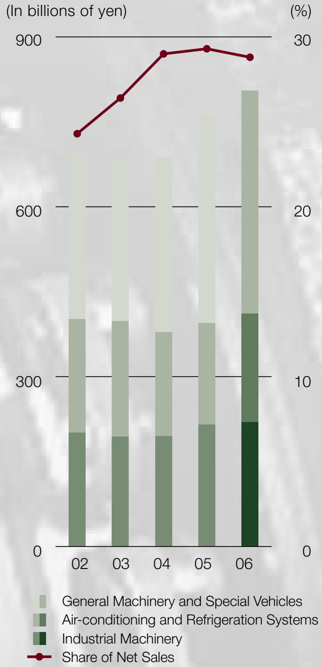
Products

Manufacturing, installation, sale and repair of forklift trucks, construction machinery, earthmoving and grading machinery, medium and small sized engines, turbochargers, agricultural machinery, tractors, special vehicles, air-conditioners (commercial use, residential), automotive thermal systems, chilling systems, plastic processing machinery, food machinery, industrial robots, transmissions, pulp and paper making machinery, box making machinery, printing machinery and machine tools, etc.

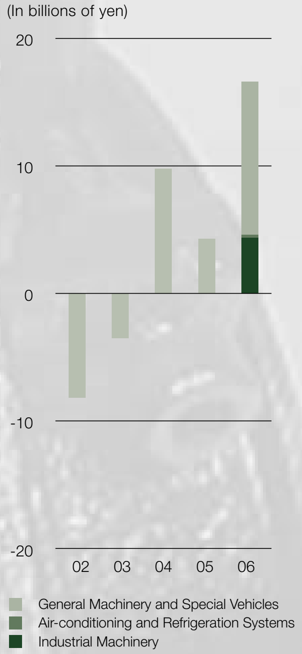
Orders Received



Net Sales
Share Of Net Sales



Operating Income (loss)



Note: Up to the fiscal year ended March 31, 2005, no separate operating income data was supplied for three businesses.

Variable Geometry Turbocharger for Vehicle Car

Multi-indoor Inverter Air-conditioner for Office Building

MHI Secures Basic Design and Procurement Orders for Small-scale Nuclear Reactor

In December 2005, MHI was awarded two contracts by PBMR (Pty) Ltd. of the Republic of South Africa related to the core barrel assembly (CBA) of the demonstration unit of the pebble bed modular reactor (PBMR). One contract calls for MHI to undertake the basic design of the CBA, an integral component of the reactor pressure vessel. The other is for the provision and procurement of related materials. PBMR nuclear power plants are free from risk of reactor core meltdown, making them a highly safe option. Our success in winning these orders was based on PBMR (Pty)'s high evaluation of MHI's solid record in design and production, demonstrated by its vast experience in the nuclear field, and our recognized success in working with South African companies. Buoyed by the latest orders, we aim to further strengthen our cooperative relationship with PBMR (Pty) and take a proactive approach toward PBMR projects in South Africa as well as worldwide.

MHI Develops Wind Turbine With Highest Output in Japan

MHI has developed and installed Japan's largest wind turbine in terms of output, the MWT92/2.4. Verification testing has been under way since January 2006 at MHI's Yokohama Dockyard & Machinery Works.

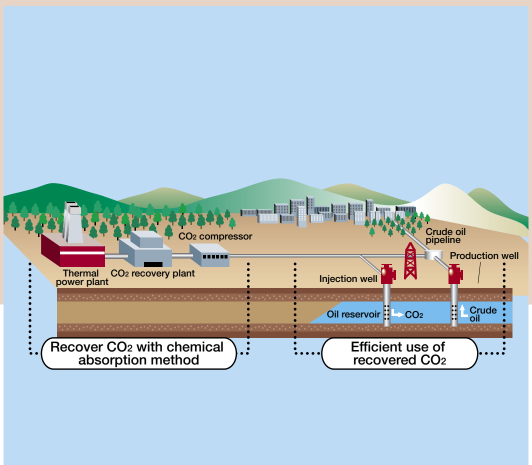
This wind turbine has a tower height of 70 meters and a rotor diameter of 92 meters, with the highest point reached by the blade tips 116 meters above ground. Its rating capacity is 2.4 MW and can efficiently generate power in relatively poor wind resource environments where wind speeds average a modest 8.5m/s. It has also been designed to withstand powerful typhoon-force winds of 70m/s. Wind turbines are playing a key role as a renewable energy source to prevent global warming. With demand growing worldwide, MHI is working to develop bigger wind turbines, including marine versions, which offer even better economic performance.

Configuration of PBMR Power Generation Facility

MWT92/2.4

MHI and Shell Sign Strategic Alliance in CO_2 EOR Business Field

In December 2005, MHI signed a comprehensive strategic alliance with international oil major Royal Dutch Shell Group to cooperate in an enhanced oil recovery (EOR) project in the Middle East. EOR involves injecting CO_2 recovered from gas emissions at industrial plants into existing oil fields to efficiently recover residual oil reserves. MHI's CO_2 recovery technology was jointly developed with The Kansai Electric Power Company, Inc. and uses a proprietary solvent to absorb CO_2 from power plant and factory flue gas. The recovery of oil can be boosted dramatically by injecting this captured CO_2 into existing oil fields. With oil producing nations expected to increasingly adopt this approach to secure oil resources, MHI will work to further enhance its technology to expand its CO_2 capture business. EOR is also seen as a promising means of preventing global warming by storing underground CO_2 that would have been emitted into the atmosphere.



MHI to Build Plant to Volume Produce New Thin-film PV Module

MHI has successfully developed an amorphous-silicon/microcrystalline-Si tandem PV module, which will be produced at a new plant in Isahaya City, Nagasaki Prefecture. Construction of the new facility got under way in February 2006. Using MHI's proprietary plasma enhanced chemical vapor deposition (CVD) technology at the core of the manufacturing process, the plant will have an output of roughly 270,000 modules per year, an amount equivalent to 40 MW at peak generation. Seeking to respond to surging demand for solar cells—an effective means of preventing global warming—MHI will reinforce its production framework with the target of generating ¥15.0 billion in PV business in fiscal 2008.

New Tandem Type PV Thin-film Module

Completion Image of a New PV Production Plant

CORPORATE GOVERNANCE

1. Fundamental Policy

Committed to the ethos of customer-first, MHI conducts its business activities as a responsible corporate citizen based on consideration for all stakeholders.

MHI is implementing a number of initiatives to enhance management efficiency and strengthen compliance, including reforming the management system to allow more effective decision-making in response to radical changes in the economic environment, and promoting fair and sound management. MHI is also working to make management more transparent by disclosing information rapidly and accurately to shareholders and other external stakeholders.

2. Corporate Governance Initiatives

(1) Corporate Governance Framework

The Board of Directors makes important management decisions and oversees the execution of business operations. MHI is strengthening management oversight functions through the appointment of outside directors. Currently, of the Company's 17 directors, two are from outside MHI. Additionally, MHI has established an Executive Committee to provide a forum for discussing important matters related to business execution. This allows for a more cohesive approach to discussion as part of the operational execution framework centered on the President, and consequently leads to more appropriate management decisions and business execution.

MHI overhauled its corporate governance framework in June 2005 to improve the soundness and transparency of management and increase efficiency and flexibility. The main components of this reform included streamlining the Board of Directors while increasing the number of outside directors, shortening the terms of directors, and introducing an executive officer system. These modifications were aimed at enhancing the oversight functions of the Board of Directors and clearly delineating the roles and responsibilities of directors and executive officers. Directors are responsible for general oversight of the Company's operations and making important business decisions, while executive officers are responsible for the day-to-day business and affairs of the Company.

(2) Enhancing Internal Control Systems

Based on the Corporate Law and the Enforcement Regulations of the Corporate Law, the Board of Directors has formulated a basic policy for internal control systems to ensure business operations are conducted appropriately and effectively. Details of this policy are as follows:

1. *System to ensure the execution of duties by directors is in compliance with relevant laws and the Articles of Incorporation*
   (i) Directors shall lead by example in realizing the Company's fundamental principle of fair and honest business activities that comply with all relevant laws and emphasize social norms and business ethics.
   (ii) The Board of Directors shall fully discuss all matters raised and reports submitted by directors and monitor the Company's operations from the perspectives of sound and efficient management. The views of outside directors shall be employed to introduce greater objectivity and enhance the effectiveness of oversight.

2. *System to store and manage information related to the execution of duties by directors*
   (i) Principle matters related to the management of documents shall be specified in Company regulations, and information related to the execution of duties by directors shall be appropriately recorded, stored and managed.
   (ii) Directors and statutory auditors shall be given access to such information at any time where it is deemed necessary to supervise and audit actions by the directors.

3. *Regulations and other systems to manage risk*
   (i) Systems designed to manage each type of risk shall be implemented and responsibilities shall be clearly defined to ensure the appropriate management of risk.

(ii) Risk shall be regularly evaluated and analyzed and necessary avoidance or mitigating measures taken; internal audits shall monitor the effectiveness and appropriateness of these measures and reports shall be regularly submitted to the Board of Directors.

(iii) To prepare for cases where significant risk may materialize, the Company shall ensure the means to immediately communicate information to senior management to respond promptly and accurately to emergency situations; individuals responsible for crisis management shall also be appointed in each business division.

4. *System to ensure directors execute their duties efficiently*

(i) The Board of Directors shall formulate business plans and establish Companywide management policy and objectives; business execution, led by the President, shall be conducted with the aim of achieving these objectives.

(ii) The Company's organizational structure, division of duties, and lines of authority shall be specified in Company regulations to ensure steps to achieve management objectives are conducted efficiently.

5. *System to ensure the duties and actions of employees comply with relevant laws and the Articles of Incorporation*

(i) The Company shall create a framework comprising the Compliance Committee and other bodies to raise awareness of compliance among employees by formulating a code of conduct, implementing various training programs and taking other steps.

(ii) The Company shall establish a whistleblower system and other mechanisms to enhance the effectiveness of compliance, conduct internal audits of the compliance framework, and report the results to the Board of Directors.

6. *System to ensure appropriate business activities by the MHI Group*

(i) The presidents of Group companies shall be responsible for the independent management of their companies as autonomous bodies; in addition, the Company shall create a system to define the management responsibilities of Group companies, determine operational procedures and provide support and guidance with the aim of improving consolidated operating performance through sound and efficient Groupwide management.

(ii) To ensure appropriate Groupwide operations, the Company shall promote various compliance and risk measures in conjunction with Group companies and create internal control systems tailored to the size and specific nature of each company; the respective departments in the Company responsible for managing Group companies shall also monitor the status of compliance at these companies.

7. *Matters related to employees requested by statutory auditors to support audit activities*

(i) In response to requests by the statutory auditors, the Company shall establish a Statutory Auditor's Office with a dedicated staff to support the smooth conduct of audit activities.

8. *Independence of employees in 7. above from directors*

(i) To ensure independence from the executive bodies of the Company, Auditing Office staff shall not be subject to the orders of directors, and the appointment, transfer and evaluation of these employees shall be conducted with the agreement of the statutory auditors.

9. System to allow directors and employees to report information to the statutory auditors and other related reporting systems

(i) The Company shall implement arrangements to allow the reporting and provision of information to statutory auditors, and promote appropriate communication through regular exchanges of views.

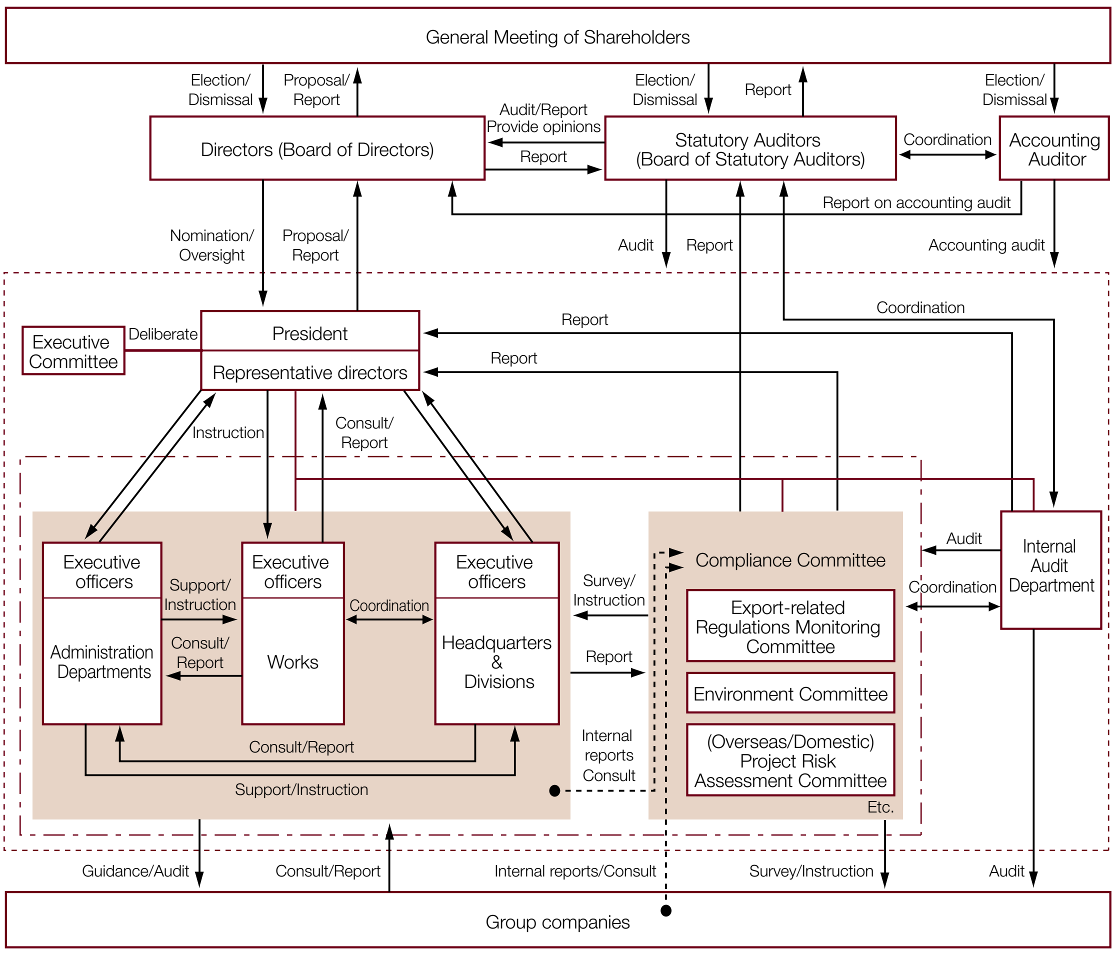
10. Other systems to ensure statutory auditor activities are conducted effectively

(i) Due consideration shall be given to statutory auditors to allow them to conduct audits in an effective manner by gathering information, conducting surveys and taking other steps to ensure appropriate communication with related divisions in the Company, the accounting auditors and other parties.

(3) Internal Audits and Statutory Auditors

The Company conducts internal audits to check the effectiveness of internal control systems. In July 2005, MHI further reinforced monitoring functions with the establishment of an Internal Audit Department as a dedicated internal audit organization. For each fiscal year, this department formulates an internal audit policy and instructs each of the Company's bodies to conduct audits in accordance with this policy. The department confirms the status and results of these internal audits and conducts its own separate audits targeting specific themes.

MHI has adopted the corporate auditor governance model where the statutory auditors are responsible for monitoring the executive actions of directors. The Board of Statutory Auditors is comprised of five members, three of whom are outside appointments. In accordance with auditing policy and allocation of duties determined by the Board of Auditors,



statutory auditors attend meetings of the Board of Directors, the Executive Committee and other key meetings related to business planning, enabling them to accurately assess the status of management execution in a timely manner. Statutory auditors also audit the execution of director duties by conducting spot checks and verifying compliance with relevant laws and regulations, and by monitoring the status and operation of internal control systems.

In addition, statutory auditors work closely with the Internal Audit Department by regularly exchanging information and opinions and by receiving reports on internal audits performed by this department. Statutory auditors also periodically exchange information and opinions with accounting auditors and cooperate closely in other ways, including receiving audit reports and participating in accounting audits as needed.

The Company's corporate governance framework, including internal control systems, is shown in the diagram on page 24.

(4) Accounting Audits

MHI's accounting auditor is Ernst & Young ShinNihon. The firm's certified public accountants (engagement partners and management partners) that audit the Company's financial statements are: Kouichi Hirao, Shin Fujita, Masayuki Ueda and Katsuhiko Hizawa. None of these individuals has been continually auditing the Company's financial statements for longer than seven years.

In addition to the above, the auditing team includes six other certified public accountants and three assistant accountants.

3. Conflicts of Interest Between Outside Directors and Statutory Auditors and the Company

None of the external directors or statutory auditors has any particular conflicts of interest with MHI. Outside director Mikio Sasaki is Chairman of the Board of Directors of Mitsubishi Corporation, which has a business relationship with MHI.

Anchored by the above framework, MHI carries out all its business activities based on its fundamental management philosophy of striving to be a good corporate citizen. This means making a meaningful contribution to society with safe and advanced products and services, observing all relevant laws and social norms, and helping to protect the environment.

4. Director and Statutory Auditor Remuneration and Audit Fees

(1) Director and Statutory Auditor Remuneration

Remuneration paid to directors and statutory auditors in the year under review was as follows:

Directors	¥465 million
Statutory auditors	¥ 59 million
Total	¥525 million

Note: In addition to the above, directors with concurrent positions as employees received a total of ¥36 million for their services in this capacity. Furthermore, in accordance with resolutions passed at the 80th annual general meeting of shareholders held on June 28, 2005, certain directors were paid retirement allowances of ¥459 million.

(2) Audit Fees

Fees paid to the accounting auditors during the year under review were as follows:

Fees related to audit certification ¥49 million

Note: The above amount represents fees paid to Ernst & Young ShinNihon for audit certification pursuant to the former Law for Special Exceptions to the Commercial Code Concerning Audit and the Securities and Exchange Law. The total amount paid to Ernst & Young ShinNihon for audit certification by the Company and its consolidated subsidiaries was ¥145 million. This amount does not include audit fees paid by the Company's overseas consolidated subsidiaries to accounting auditors other than Ernst & Young ShinNihon such as Ernst & Young.

CORPORATE SOCIAL RESPONSIBILITY

In keeping with the spirit of our company creed, corporate activities matching the times form the core of CSR at MHI.

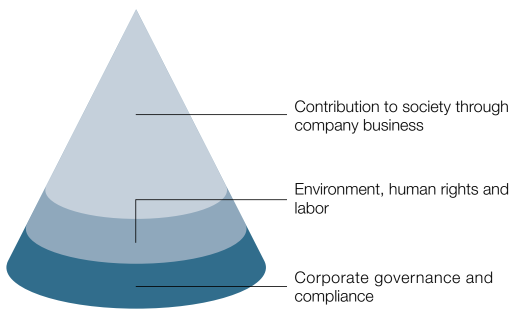
The basic spirit that defines corporate management at Mitsubishi Heavy Industries is in the main twofold: first, we pledge to make useful contributions to society through our business activities; second, we aim to conduct all corporate activities in good faith. This spirit is founded in the "Three Corporate Principles" shared by all Mitsubishi Group companies from the earliest days, as well as in MHI's own company creed formulated in 1970. In line with these principles and our creed, through the years, through fair corporate activities in compliance with all laws, MHI has provided technologies and products that support the social infrastructure, thereby responding to the trust of its customers and contributing to social development. In addition, as one of Japan's leading manufacturers, we consistently carry out activities of a high level in such areas as environmental protection and contributions to local communities.

Our current creed drawn up in 1970 is a contemporary version, in modern wording, of the spirit that has driven our company since its earliest days some 120 years ago. For 120 years, we have staunchly held to our management philosophy elaborated in the first provision of the creed—"We strongly believe that the customer comes first and that we are obligated to be an innovative partner to society"—and we plan to retain this core focus going forward as well. However, while we will staunchly maintain this underlying spirit, the meaning imbued in these words is slowly changing. In former times, making contributions to society equated to developing Japan into a nation economically reliant on its industries. Today, in the 21st century, we see our mission to be to respond to our customers' trust and contribute to a safe and rewarding life for people worldwide, undergoing continuous development while always seeking harmony between economic activities and the global environment.

We fulfill our social responsibilities in three broad ways.

Because corporate social responsibility spans a very expansive range of areas, the definition of CSR varies depending on the format of business, the specific region affected, etc. In keeping with the spirit of our company creed, at MHI we divide our responsibilities to society into three broad categories.

The first is "contribution to society through company business." MHI develops technologies and products of remarkable variety in diverse fields that include power generation, transportation, the environment and industrial infrastructure; and in all cases what we aim for is to contribute to social progress. In other words, we seek, through our superior technologies and products, to respond to the trust of our customers and contribute to safe, secure and fulfilled lives for people worldwide—i.e. to contribute to social development—while pursuing harmony between economic activities and the global environment. This is the greatest value that MHI can provide to society, and one might even say it is the company's de facto corporate identity. However, the definition of "social progress" changes over time, and for that reason we believe it is vital to maintain a solid understanding of society so as to make contributions that match the needs of each point in time.



The second category of CSR at MHI is "environment, human rights and labor." What is important in this regard, we believe, is to firmly recognize the demands of society transcending legal requirements, and to respond to those demands in good faith. Today, we are taking measures to boost our efforts in this respect in all areas of our corporate activities.

The third CSR category is "corporate governance and compliance." This category forms the underlying base of CSR as the foundation of our internal controls. Compliance, in particular, is absolutely indispensable if we are to win the trust of society and achieve sound development, and throughout the company we are taking steps in the area of compliance as a precondition to our continuing existence.

We believe that pursuing achievements in these three categories is our way of fulfilling our corporate social responsibilities.

For more details on our CSR activities, please view the MHI Social and Environmental Report on our website. (URL: http://www.mhi.co.jp/ekankyohozen/main.html)

Support in the Aftermath of Hurricane Katrina

In August 2005, Hurricane Katrina, a storm on a scale rarely experienced—with maximum winds of 78 meters per second and a gale force reaching 902mb—pummeled the southern coast of the United States, resulting in some 1,200 casualties and approximately $50 billion in damage (according to a Standard & Poor's estimate). New Orleans, site of an MHI office, was dealt a particularly devastating blow, with roughly 80% of the city inundated.

MHI has numerous bases in the U.S., starting with Mitsubishi Heavy Industries America, Inc. (MHIA), and from a humanitarian perspective – as a member of both the American and global communities – it was quickly decided to make donations to aid the hurricane's victims. MHI provided a cash donation of ¥10 million, MHIA donated 15 light towers and generators (worth ¥10 million), and other affiliates collectively gave relief support equivalent to ¥10 million.

Subsequent reports described how the light towers and generators donated by MHIA contributed to saving lives through their use at medical facilities that lost regular power supplies as a result of the storm.

MHI is pleased to know that its donations proved useful in aiding the victims of Katrina, and the company pledges to continue making contributions to the international community in times of need.

Light Towers and Generators Donated by MHIA

FINANCIAL SECTION

CONTENTS

CONSOLIDATED SIX-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
	2006	2005	2004	2003	2002	2001	**2006**
Net sales	**¥2,792,109**	¥2,590,733	¥2,373,441	¥2,593,894	¥2,863,985	¥3,045,024	**$23,768,696**
Operating income	**70,913**	14,773	66,631	115,308	78,655	74,889	**603,666**
Interest expense —net of interest income	**(1,968)**	(5,590)	(6,333)	(8,394)	(9,407)	(7,708)	**(16,754)**
Income (loss) before income taxes and minority interests	**52,383**	16,399	50,124	66,162	48,028	(5,121)	**445,928**
Net income (loss)	**29,817**	4,050	21,787	34,331	26,447	(20,351)	**253,824**
Per share of common stock:							
Net income (loss)—basic	**¥8.85**	¥1.20	¥6.46	¥10.14	¥7.84	¥(6.03)	**$0.075**
Net income (loss)—diluted	**8.83**	1.20	6.46	10.14	7.82	–	**0.075**
Cash dividends	**4.00**	4.00	6.00	6.00	4.00	4.00	**0.034**
Total assets	**¥4,047,122**	¥3,831,144	¥3,715,359	¥3,666,866	¥3,915,276	¥4,236,634	**$34,452,392**
Stockholders' equity	**1,376,289**	1,309,977	1,324,498	1,270,968	1,282,727	1,278,242	**11,716,091**
Current assets	**2,543,485**	2,465,645	2,402,987	2,389,358	2,598,526	2,891,271	**21,652,213**
Current liabilities	**1,626,663**	1,567,987	1,519,467	1,721,515	1,881,226	1,965,808	**13,847,474**
Short-term borrowings and long-term debt	**1,198,665**	1,172,896	1,101,269	1,122,923	1,049,998	1,090,696	**10,204,008**

Note: U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥117.47=U.S.$1, the exchange rate prevailing at March 31, 2006.

SEGMENT INFORMATION

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	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
INDUSTRY SEGMENT	**2006**	2005	**2006**	**2006**	2005	**2006**
Shipbuilding & Ocean Development	**¥ 222,651**	¥ 271,578	**$ 1,895,386**	**¥(10,608)**	¥(11,735)	**$ (90,303)**
Power Systems	**710,966**	629,665	**6,052,321**	**38,343**	16,089	**326,406**
Machinery & Steel Structures	**538,758**	459,366	**4,586,349**	**2,333**	(8,702)	**19,860**
Aerospace	**445,942**	407,956	**3,796,221**	**16,507**	8,751	**140,520**
Mass and Medium-Lot Manufactured Machinery	**805,058**	757,857	**6,853,306**	**16,756**	4,315	**142,638**
Others	**129,119**	111,006	**1,099,165**	**7,582**	6,055	**64,545**
Subtotal	**2,852,494**	2,637,428	**24,282,748**	**70,913**	14,773	**603,666**
Eliminations or Corporate	**(60,385)**	(46,695)	**(514,052)**	**–**	–	**–**
Total	**¥2,792,109**	¥2,590,733	**$23,768,696**	**¥ 70,913**	¥ 14,773	**$603,666**

	Total Assets			Depreciation and Amortization		
	In millions of yen		In thousands of U.S. dollars	In millions of yen		In thousands of U.S. dollars
INDUSTRY SEGMENT	**2006**	2005	**2006**	**2006**	2005	**2006**
Shipbuilding & Ocean Development	**¥ 234,674**	¥ 205,424	**$ 1,997,735**	**¥ 5,744**	¥ 6,220	**$ 48,898**
Power Systems	**778,085**	754,185	**6,623,693**	**23,142**	22,220	**197,002**
Machinery & Steel Structures	**567,362**	584,315	**4,829,842**	**8,906**	9,646	**75,815**
Aerospace	**697,210**	634,543	**5,935,218**	**18,191**	17,485	**154,855**
Mass and Medium-Lot Manufactured Machinery	**805,884**	754,960	**6,860,341**	**26,947**	25,329	**229,396**
Others	**226,098**	211,521	**1,924,726**	**17,880**	18,283	**152,211**
Subtotal	**3,309,313**	3,144,948	**28,171,555**	**100,810**	99,183	**858,177**
Eliminations or Corporate	**737,809**	686,196	**6,280,837**	**–**	–	**–**
Total	**¥4,047,122**	¥3,831,144	**$34,452,392**	**¥100,810**	¥99,183	**$858,177**

	Impairment Losses on Fixed Assets			Capital Expenditures		
	In millions of yen		In thousands of U.S. dollars	In millions of yen		In thousands of U.S. dollars
INDUSTRY SEGMENT	**2006**	2005	**2006**	**2006**	2005	**2006**
Shipbuilding & Ocean Development	**¥–**	¥ 39	**$–**	**¥ 5,960**	¥ 5,292	**$ 50,738**
Power Systems	**–**	113	**–**	**21,852**	18,722	**186,022**
Machinery & Steel Structures	**–**	262	**–**	**12,805**	8,808	**109,009**
Aerospace	**–**	72	**–**	**42,225**	25,687	**359,454**
Mass and Medium-Lot Manufactured Machinery	**–**	66	**–**	**33,537**	28,714	**285,496**
Others	**–**	5,556	**–**	**24,191**	25,073	**205,925**
Subtotal	**–**	6,108	**–**	**140,570**	112,296	**1,196,644**
Eliminations or Corporate	**–**	–	**–**	**–**	–	**–**
Total	**¥–**	¥6,108	**$–**	**¥140,570**	¥112,296	**$1,196,644**

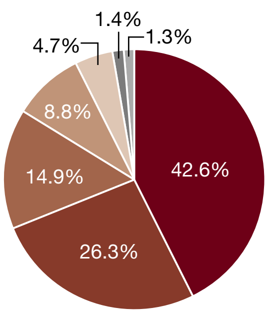
	In millions of yen		In thousands of U.S. dollars
Overseas Sales	**2006**	2005	**2006**
Overseas Sales	**¥1,225,989**	¥1,049,368	**$10,436,618**
Ratio to Total Net Sales	**43.9%**	40.5%	

Notes: 1. U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥117.47=US$1, the exchange rate prevailing at March 31, 2006.
2. The accompanying consolidated financial statements for the years ended March 31, 2006 and 2005 have been compiled in accordance with accounting principles and practices generally accepted in Japan.

GEOGRAPHIC DISTRIBUTION	Net Sales			Operating Income		
	In millions of yen		In thousands of U.S. dollars	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006	2006	2005	2006
Japan	¥2,598,402	¥2,416,826	$22,119,708	¥60,089	¥ 9,148	$511,527
North America	200,644	166,332	1,708,045	6,354	2,726	54,093
Asia	70,208	59,045	597,664	1,528	1,709	13,005
Europe	97,166	84,311	827,155	1,641	474	13,966
Others	14,078	7,467	119,846	1,301	716	11,075
Subtotal	2,980,498	2,733,981	25,372,418	70,913	14,773	603,666
Eliminations or Corporate	(188,389)	(143,248)	(1,603,722)	–	–	–
Total	¥2,792,109	¥2,590,733	$23,768,696	¥70,913	¥14,773	$603,666

GEOGRAPHIC DISTRIBUTION	Total Assets		
	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Japan	¥3,014,463	¥2,902,734	$25,661,560
North America	150,293	131,162	1,279,413
Asia	52,473	37,359	446,697
Europe	76,879	64,546	654,454
Others	15,205	9,147	129,431
Subtotal	3,309,313	3,144,948	28,171,555
Eliminations or Corporate	737,809	686,196	6,280,837
Total	¥4,047,122	¥3,831,144	$34,452,392

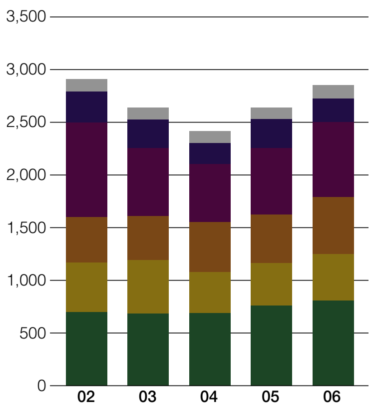
COMPOSITION OF OVERSEAS NET SALES BY GEOGRAPHIC DISTRIBUTION



- Asia
- North America
- Europe
- Central and South America
- The Middle East
- Africa
- Oceania

NET SALES BY INDUSTRY SEGMENT

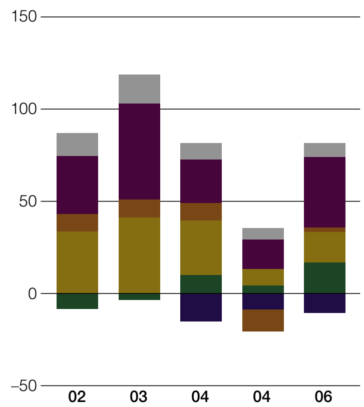
(In billions of yen)



- Others
- Shipbuilding & Ocean Development
- Power Systems
- Machinery & Steel Structures
- Aerospace
- Mass and Medium-Lot Manufactured Machinery

OPERATING INCOME (LOSS) BY INDUSTRY SEGMENT

(In billions of yen)



- Others
- Shipbuilding & Ocean Development
- Power Systems
- Machinery & Steel Structures
- Aerospace
- Mass and Medium-Lot Manufactured Machinery

MANAGEMENT'S DISCUSSION AND ANALYSIS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

Analysis of Operating Results

In fiscal 2005, ended March 31, 2006, consolidated net sales of Mitsubishi Heavy Industries, Ltd. (MHI) and its consolidated subsidiaries (MHI Group) increased ¥201,376 million, or 7.8%, from the previous year, to ¥2,792,109 million (US$23,768,696 thousand). This was mainly the result of strong growth in Power Systems, centered on thermal power stations for overseas customers, and Machinery & Steel Structures, centered on chemical plants. The Mass and Medium-Lot Manufactured Machinery and Aerospace segments also contributed to higher consolidated net sales. However, the Shipbuilding & Ocean Development segment recorded lower sales due to a decline in the number of vessels delivered.

Operating income rose ¥56,140 million, or 380.0%, to ¥70,913 million (US$603,666 thousand). Despite a rise in the cost of materials and other adverse factors, operating income rose thanks to a number of positive developments. These included higher sales, improvement in the product mix, higher productivity helped by factors such as capacity upgrades in response to an increase in project volume, and improved margins, achieved through reductions in product warranty costs resulting from activities aimed at boosting product quality and reliability. Cuts in selling, general and administrative (SG&A) expenses and reductions in manufacturing costs also contributed to the increase.

Net non-operating expenses were ¥20,548 million (US$174,916 thousand), ¥18,314 million more than in the previous year. This was mainly due to deterioration in foreign exchange gains and losses and in equity in earnings of unconsolidated subsidiaries and affiliates. Ordinary income rose ¥37,826 million, or 301.7%, to ¥50,365 million.

Extraordinary income totaled ¥13,676 million (US$116,418 thousand), solely from sales of fixed assets. Extraordinary expenses totaled ¥11,658 million, and included business improvement and restructuring charges and expenses for the treatment of PCB waste.

Income before income taxes and minority interests increased ¥35,984 million, or 219.4%, to ¥52,383 million, and net income rose ¥25,767 million, or 636.2%, to ¥29,817 million.

Key Factors Affecting Operating Results

Key factors which affect the management of MHI Group include external factors such as market trends, foreign exchange rate fluctuations and changes in material costs, and internal factors such as risks associated with various overseas business contracts, accidents and disasters. Another key factor is the risk of diminished manufacturing capabilities due to technology and skill transfer issues associated with generational change.

Market trends

Trends in the domestic power generation and public works fields, which are some of MHI Group's key operating areas, include ongoing curbs on public capital investment and intensifying price-based competition. These have resulted in a challenging operating environment characterized by an increasingly shrinking market. With few prospects of significant market growth going forward, MHI Group will continue to strive to maintain its position in this field as a vital partner to its customers. This will mean offering products and services which satisfy customers' needs by leveraging MHI Group's industry-leading technologies. MHI Group will also work aggressively to strengthen its overseas presence in China, Southeast Asia, the Middle East, Europe and the U.S., targeting markets where there is potential for substantial growth.

Exchange rate fluctuation

Foreign exchange rate fluctuation can significantly affect MHI Group's competitiveness and operating results. In order to minimize exchange rate risk, MHI Group is increasing its liabilities denominated in foreign currencies by expanding the procurement of overseas materials, promoting greater use of yen-denominated contracts, and hedging risk with timely forward foreign exchange contracts.

Changes in costs of materials

Rapidly rising prices for materials such as steel products are driving up the cost of steel and other raw materials. There is also a concern about the increasing difficulty of securing a steady supply of certain materials. In response, MHI Group is working harder to reduce costs by promoting design standardization, increasing its utilization of common components, employing standardized parts, signing comprehensive procurement contracts, and expanding its overseas production activities. MHI Group is also passing the price rises of materials on to customers. In order to secure the supply of materials, MHI Group is strengthening relationships with its business partners, promoting an even greater level of information sharing, and moving even more rapidly to secure the materials essential to its business activities.

Overseas business contracts

MHI Group is exposed to a number of risks associated with business contracts it concludes in overseas markets. These include the quality and delivery dates of locally procured materials and the skill levels and specific labor practices of the local staff, as well as the risks inherent in its contractual obligations such as performance guarantees and the payment of late delivery penalties. In order to mitigate these risks, all contracts undergo a rigorous internal assessment process prior to their formal conclusion. In addition to the business headquarters and the segments concerned, the Global Strategic Planning & Operations Headquarters, as well as the Legal, Corporate Planning, Accounting, and Finance departments are all involved in this process, which includes the verification of local contractual obligations, the removal of unilateral conditions, and other prudent steps.

Accidents and disasters

Accidents and disasters can have a significant impact on the management of MHI Group. In managing this type of risk, MHI Group is taking steps to minimize the probability of accidents and disasters occurring, by training worksite employees to be more aware of risks and by reforming worksite management.

Technology and skill transfer

MHI Group is at risk of diminished manufacturing capabilities due to technology and skill transfer issues associated with generational change. In response, MHI Group invests in production process improvement aimed at rationalization and carries out focused investment in R&D related to manufacturing technology. MHI Group also strives to enhance its manufacturing base through programs to train and improve the skills of its employees.

Source of Funds and Liquidity

Cash Flow analysis

Operating activities provided net cash of ¥73,928 million (US$629,337 thousand), ¥33,138 million less than in the previous year. This mainly reflected an increase in working capital, primarily trade receivables and inventories, associated with higher orders and sales resulting from business expansion.

Investing activities used net cash of ¥104,065 million (US$885,888 thousand), ¥59,257 million less than the previous year. This decline was mainly due to a ¥86,285 million drop in payments for the purchase of investment securities compared to the previous year, when ¥90,000 million was used for the purchase of newly issued shares of Mitsubishi Motors Corporation. Payments to purchase property, plant and equipment and intangible assets increased, as a result of business growth, while proceeds from sales and redemptions of marketable securities and investments decreased. As such, cash used in investing activities effectively increased.

Financing activities provided net cash of ¥7,974 million (US$67,885 thousand), due to borrowing in accordance with funding requirements.

Primary funding requirements

MHI Group primarily requires funds for working capital for manufacturing activities (materials, outsourcing and personnel costs), order preparation costs and other sales expenses related to winning new orders, and funds for R&D activities that strengthen the product lineup and enhance the competitiveness of its technologies. In investing activities, funds are required for capital investment to grow the business and enhance productivity, and for the purchase of investment securities related to the execution of business strategies.

MHI Group foresees growth in working capital requirements in the coming years because of expected growth in sales. MHI Group is pursuing business expansion centered on such areas as gas turbines, components for the Boeing 787, and engines in the Power Systems segment, Aerospace segment, and the general machinery and special vehicles business, which have been positioned as growth fields. As such, MHI Group expects increased requirements for working capital and investment funds in these growth areas. In addition, MHI Group is planning capital investment to overhaul its manufacturing base through efforts to reinforce frontline production sites and production process reforms.

Breakdown of interest-bearing debt and its applications

The breakdown of interest-bearing debt as of March 31, 2006, was as follows:

	(Millions of yen)			In thousands of U.S. dollars		
	Total	Due within one year	Due after one year	Total	Due within one year	Due after one year
Short-term borrowings . . .	¥ 307,772	¥307,772	¥ –	$ 2,620,008	$2,620,008	$ –
Long-term loans	659,481	95,732	563,748	5,614,033	814,950	4,799,083
Export loans . .	17,801	5,885	11,916	151,534	50,094	101,440
Bonds	213,611	300	213,311	1,818,433	2,554	1,815,879
Total	¥1,198,665	¥409,689	¥788,976	$10,204,088	$3,487,606	$6,716,402

MHI Group is involved in numerous projects with comparatively long construction schedules. MHI Group also owns a number of manufacturing facilities, which employ large-scale equipment and machinery. Consequently, MHI Group must secure a stable level of working capital and funds for capital investments. Taking into account these factors and future interest rate projections, MHI Group's funding procurements for the current year resulted in short-term borrowings and long-term debt of ¥409,689 million (US$3,487,606 thousand) due within one year, and of ¥788,976 million (US$6,716,402 thousand) due after one year.

Short-term borrowings and long-term debt are utilized as working capital and for capital investment. MHI Group plans to use these funds mainly in key growth fields including the Power Systems segment, Aerospace segment, and the general machinery and special vehicles business.

Financial Policy

MHI Group, in general, funds its working capital and capital investments from its operating cash flows. Any additional requirements can be met with short-term borrowings and long-term debt.

In appropriately determining the amounts and methods of procuring long-term funds through long-term loans, bonds, and other means, MHI Group takes into account the funding requirements of its business plans in effect at that time, interest-rate trends and various other factors, as well as the amount of and repayment schedule for its existing debt.

Additionally, MHI Group strives to efficiently utilize surplus funds within the Group using a cash management system. At the same time, MHI Group is working to improve asset efficiency by reducing trade receivables and inventories and by raising the utilization rate of its property, plant, and equipment.

MHI Group flexibly considers the repurchase of treasury stock based on the financial position of the Group, the stock price, as well as recent earnings forecasts and other factors.

CONSOLIDATED BALANCE SHEETS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
As of March 31, 2006 and 2005

	In millions of yen		In thousands of U.S. dollars (Note 3)
ASSETS	2006	2005	2006
Current assets:			
Cash and deposits (Notes 7 and 13)	¥ 195,186	¥ 211,912	$ 1,661,580
Trade receivables (Note 7):			
Notes	49,815	47,857	424,067
Accounts	1,047,589	1,001,036	8,917,925
Allowance for doubtful receivables	(7,749)	(6,613)	(65,960)
Securities (Notes 4 and 7)	1,549	2,572	13,189
Inventories (Note 5)	971,509	958,513	8,270,271
Advances to suppliers	68,695	56,405	584,785
Deferred income taxes (Note 6)	75,978	65,501	646,787
Prepaid expenses and other current assets (Note 7)	140,913	128,462	1,199,569
Total current assets	2,543,485	2,465,645	21,652,213
Property, plant and equipment (Note 7)**:**			
Land	139,952	138,290	1,191,383
Buildings and structures	693,318	672,250	5,902,085
Machinery and equipment	1,415,048	1,382,966	12,046,041
Construction in progress	33,659	25,440	286,532
	2,281,977	2,218,946	19,426,041
Less accumulated depreciation	(1,516,740)	(1,482,446)	(12,911,725)
Net property, plant and equipment	765,237	736,500	6,514,316
Intangible assets	35,770	33,727	304,501
Investments and advances:			
Investments in unconsolidated subsidiaries and affiliates accounted for by the equity method	152,483	95,591	1,298,061
Long-term loans and advances	28,443	62,320	242,134
Investment securities (Note 4)	477,592	444,353	4,065,655
Deferred income taxes (Note 6)	10,159	9,745	86,479
Allowance for doubtful accounts	(18,753)	(51,712)	(159,644)
Net investments and advances	649,924	560,297	5,532,685
Other assets	52,706	34,975	448,677
Total assets	¥ 4,047,122	¥ 3,831,144	$ 34,452,392

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

LIABILITIES AND STOCKHOLDERS' EQUITY	In millions of yen 2006	In millions of yen 2005	In thousands of U.S. dollars (Note 3) 2006
Current liabilities:			
Trade payables:			
Notes	¥ 13,346	¥ 14,970	$ 113,608
Accounts	656,322	634,174	5,587,146
Short-term borrowings (Note 7)	307,772	298,269	2,620,008
Current portion of long-term debt (Note 7)	101,917	91,840	867,598
Advance payments received on contracts	334,880	363,448	2,850,768
Accrued expenses	74,869	65,819	637,350
Accrued income taxes	8,934	6,023	76,052
Reserve for product warranties	15,999	11,913	136,197
Allowance for losses on construction contracts	6,299	6,401	53,619
Other current liabilities (Note 6)	106,325	75,130	905,128
Total current liabilities	1,626,663	1,567,987	13,847,474
Long-term liabilities:			
Long-term debt (Note 7)	788,976	782,787	6,716,402
Deferred income taxes (Note 6)	95,691	17,465	814,604
Reserve for retirement allowance (Note 8)	108,710	109,798	925,433
Reserve for treatment of PCB waste (Note 1)	4,361	–	37,124
Other long-term liabilities	28,661	27,919	243,984
Total long-term liabilities	1,026,399	937,969	8,737,547
Total liabilities	2,653,062	2,505,956	22,585,021
Minority interests	17,771	15,211	151,280
Stockholders' equity (Note 12):			
Common stock, without par value:			
Authorized-6,000,000,000 shares			
Issued:			
2006-3,373,647,813 shares	265,609		2,261,078
2005-3,373,647,813 shares		265,609	
Capital surplus	203,864	203,855	1,735,462
Retained earnings	718,480	741,234	6,116,283
Net unrealized gains on investment securities	193,373	110,460	1,646,147
Foreign currency translation adjustments	117	(6,007)	999
Treasury stock, at cost:			
2006-18,301,162 shares	(5,154)		(43,878)
2005-18,481,426 shares		(5,174)	
Total stockholders' equity	1,376,289	1,309,977	11,716,091
Total liabilities and stockholders' equity	¥4,047,122	¥3,831,144	$34,452,392

CONSOLIDATED STATEMENTS OF INCOME

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2006 and 2005

	In millions of yen		In thousands of U.S. dollars (Note 3)
	2006	2005	2006
Net Sales	¥2,792,109	¥2,590,733	$23,768,696
Cost of sales	2,460,820	2,300,895	20,948,497
Gross Profit	331,289	289,838	2,820,199
Selling, general and administrative expenses	260,376	275,065	2,216,533
Operating income	70,913	14,773	603,666
Non-operating income (expense):			
Interest and dividend income	13,797	9,907	117,454
Equity in earnings of unconsolidated subsidiaries and affiliates	2,056	10,004	17,501
Foreign exchange gains	–	1,632	–
Other income	5,167	4,229	43,982
Interest expense	(15,765)	(15,497)	(134,208)
Foreign exchange losses	(9,387)	–	(79,905)
Losses on disposal of fixed assets	(5,383)	(4,933)	(45,820)
Other expenses	(11,033)	(7,576)	(93,920)
	(20,548)	(2,234)	(174,916)
Ordinary income	50,365	12,539	428,750
Extraordinary income (expense):			
Gains on sales of fixed assets (Note 9)	13,676	10,357	116,418
Gains on sales of investment securities	–	15,745	–
Business improvement and restructuring charges (Note 10)	(5,559)	(1,779)	(47,323)
Expense for treatment of PCB waste (Note 1)	(4,361)	–	(37,124)
Provision of reserve for directors' retirement allowance	(1,738)	–	(14,793)
Provision of reserve for product warranties	–	(10,889)	–
Losses on impairment for fixed assets (Note 11)	–	(6,108)	–
Losses on damage from natural disasters	–	(3,466)	–
	2,018	3,860	17,178
Income before income taxes and minority interests	52,383	16,399	445,928
Income taxes (Note 6)			
Current	8,113	3,540	69,063
Deferred	13,056	7,927	111,146
Minority interests in income after taxes	1,397	882	11,895
Net income	¥ 29,817	¥ 4,050	$ 253,824

	In yen		In U.S. dollars (Note 3)
Per share of common stock (Note 1):	2006	2005	2006
Net income—basic	¥8.85	¥1.20	$0.075
Net income—diluted	8.83	1.20	0.075
Cash dividends	4.00	4.00	0.034

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2006 and 2005

	In millions of yen		In thousands of U.S. dollars (Note 3)
	2006	2005	2006
Common stock:			
Balance at beginning of year	¥ 265,609	¥ 265,609	$ 2,261,078
Balance at end of year	265,609	265,609	2,261,078
Capital Surplus:			
Balance at beginning of year	203,855	203,854	1,735,378
Gains on sales of treasury stock (Note 12)	9	1	84
Balance at end of year	203,864	203,855	1,735,462
Retained earnings:			
Balance at beginning of year	741,234	747,872	6,309,990
Net income	29,817	4,050	253,824
Cash dividends (Note 12)	(13,421)	(10,107)	(114,250)
Decrease resulting from inclusion of consolidated subsidiaries and companies accounted for by the equity method (Note 12)	(39,142)	(99)	(333,212)
Decrease resulting from exclusion of affiliates accounted for by the equity method	(8)	(482)	(69)
Balance at end of year	718,480	741,234	6,116,283
Net unrealized gains on investment securities:			
Balance at beginning of year	110,460	114,245	940,327
Change during the year	82,913	(3,785)	705,820
Balance at end of year (Note 12)	193,373	110,460	1,646,147
Foreign currency translation adjustments:			
Balance at beginning of year	(6,007)	(5,722)	(51,140)
Change during the year	6,124	(285)	52,139
Balance at end of year	117	(6,007)	999
Treasury stock:			
Balance at beginning of year	(5,174)	(1,360)	(44,043)
Change during the year	20	(3,814)	165
Balance at end of year	(5,154)	(5,174)	(43,878)
Total balance at end of year	¥1,376,289	¥1,309,977	$11,716,091

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2006 and 2005

	In millions of yen		In thousands of U.S. dollars (Note 3)
	2006	2005	2006
Cash flows from operating activities:			
Income before income taxes and minority interests	¥ 52,383	¥ 16,399	$ 445,928
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	100,810	99,183	858,177
Losses on impairment for fixed assets	–	6,108	–
Decrease in reserve for retirement allowance	(2,143)	(4,803)	(18,242)
Interest and dividend income	(13,797)	(9,907)	(117,454)
Interest expense	15,765	15,497	134,208
Equity in earnings of unconsolidated subsidiaries and affiliates	(2,056)	(10,004)	(17,501)
Gains on sales of investment securities	–	(15,745)	–
Gains on sales of fixed assets	(13,676)	(10,357)	(116,418)
Business improvement and restructuring charges	5,559	1,779	47,323
Expense for treatment of PCB waste	4,361	–	37,124
Provision of reserve for directors' retirement allowance	1,738	–	14,793
Provision of reserve for product warranties	–	10,889	–
Losses on damage from natural disasters	–	3,466	–
(Increase) in receivables	(36,939)	(53,198)	(314,454)
(Increase) decrease in inventories and advances to suppliers	(18,430)	53,102	(156,891)
(Increase) in other assets	(16,249)	(41,711)	(138,328)
Increase in payables	8,503	18,759	72,388
(Decrease) increase in advance payments received on contracts	(29,571)	36,249	(251,736)
Increase in other liabilities	19,677	10,917	167,507
Others	(1,142)	(8,119)	(9,726)
Subtotal	74,793	118,504	636,698
Interest and dividend received	20,255	9,690	172,428
Interest paid	(15,711)	(15,670)	(133,746)
Payments for income taxes	(5,409)	(5,458)	(46,043)
Net cash provided by operating activities	73,928	107,066	629,337
Cash flows from investing activities:			
Net decrease in time deposits	6,150	2,984	52,358
Proceeds from sales and redemption of marketable securities and investments	984	155	8,377
Purchases of property, plant, equipment and intangible assets	(123,974)	(108,234)	(1,055,367)
Proceeds from sales of property, plant, equipment and intangible assets	16,738	11,814	142,487
Purchases of investment securities	(4,982)	(91,267)	(42,413)
Proceeds from sales and redemption of investment securities	3,788	23,362	32,249
Disbursement of long-term loans	(6,074)	(3,784)	(51,711)
Collection of long-term loans	3,305	4,071	28,132
Others	–	(2,423)	–
Net cash used in investing activities	(104,065)	(163,322)	(885,888)
Cash flows from financing activities:			
Net increase (decrease) in short-term borrowings	5,626	(2,056)	47,893
Proceeds from long-term debt	111,939	181,077	952,913
Repayment of long-term debt	(63,626)	(106,533)	(541,633)
Payment for redemption of bonds	(33,606)	(300)	(286,084)
Dividends paid to stockholders	(13,384)	(10,110)	(113,938)
Dividends paid to minority stockholders of subsidiaries	(396)	(317)	(3,368)
Others	1,421	(3,828)	12,102
Net cash provided by (used in) financing activities	7,974	57,933	67,885
Effect of exchange rate changes on cash and cash equivalents	5,787	2,799	49,256
Net (decrease) increase in cash and cash equivalents	(16,376)	4,476	(139,410)
Cash and cash equivalents at beginning of year	189,781	184,767	1,615,568
Increase in cash and cash equivalents resulting from inclusion of consolidated subsidiaries	2,869	538	24,430
Cash and cash equivalents at end of year (Note 13)	¥ 176,274	¥ 189,781	$ 1,500,588

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

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 generally accepted in Japan and have been prepared from the consolidated financial statements filed with the Financial Services Agency ("FSA") in Japan. The accounts of consolidated overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles of the respective countries of domicile. Certain items presented in the consolidated financial statements filed with the FSA have been reclassified, and "Consolidated Statements of Stockholders' Equity", which is not required to file with the FSA, has been added to the primary financial statements.

The differences between the accounting principles adopted by MHI and Subsidiaries and those prescribed by International Accounting Standards ("IASs") and International Financial Reporting Standards ("IFRSs") are set forth in Note 2 "Differences with International Financial Reporting Standards".

b) Principles of consolidation

The accompanying consolidated financial statements for the years ended March 31, 2006 and 2005 include the accounts of MHI and Subsidiaries. All significant inter-company transactions and accounts have been eliminated. Investments in unconsolidated subsidiaries and affiliates, with certain minor exceptions, are accounted for by the equity method.

c) Foreign currency translation

Foreign currency monetary assets and liabilities are translated into Japanese yen at the exchange rate in effect at the end of respective fiscal year and the resulting translation gains or losses are included in net income.

All assets and liabilities of overseas subsidiaries and affiliates are translated into Japanese yen at the exchange rate in effect at the end of respective fiscal year, revenues and expenses at the average exchange rate during the year, and stockholders' equity at historical rates. The resulting foreign currency translation adjustments are accounted for as a separate component of stockholders' equity.

d) Securities

Securities include held-to-maturity debt securities, investments in unconsolidated subsidiaries and affiliates, and other securities (available-for-sale securities).

Held-to-maturity debt securities are stated at amortized cost and adjusted for the amortization of premium or discounts. Investments in unconsolidated subsidiaries and affiliates excluding those accounted for by the equity method are stated at cost determined by 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. Unrealized holding gains and losses of other securities with market value are accounted for as a separate component of stockholders' equity, net of tax effect. The cost of other securities sold with market value is computed based on the moving average method. Other securities without market value are stated at cost determined by the moving average method.

As to the presentation of the balance sheet, MHI and Subsidiaries have classified securities due within one year as securities in current assets and others as investment securities in Investments and advances.

e) 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, while some prospective products are stated at the lower of cost or market, the cost being determined by the moving average method.

Some of standardized steel materials for building new ships are stated at cost determined by the specific identification method.

Inventories held by certain business units are stated at cost determined by the yearly average method.

f) Property, plant and equipment and depreciation
Property, plant and equipment, including significant renewals and additions, are carried at cost.

Depreciation has principally 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.

When an asset is retired or otherwise disposed of, the cost and the related depreciation are relieved from the respective accounts and the net difference, less any amounts realized on disposal, is reflected in earnings.

g) Intangible assets
Amortization of intangible assets is computed by the straight-line method based on the useful lives of assets, which are substantially the same as those provided for in the Corporation Income Tax Law.

Goodwill have been amortized on a straight-line basis over certain periods, which were estimated based on the investment recovery within 20 years.

h) Leases
Non-cancelable 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 accounted for as either finance leases or operating leases in conformity with generally accepted accounting principles in the respective countries of domicile.

i) Allowance for doubtful receivables
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) a ratio based on MHI's and Subsidiaries' historical experience of write-offs of receivables other than those covered in Item (1) above.

j) Reserve for product warranties
Reserve for product warranties is provided for the purpose of reserving for the product warranty expenditure after products have been delivered, which is estimated based on the historical experience with consideration given to the expected level of future warranty costs.

k) Allowance for losses on construction contracts
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, 2006 and 2005) exceed their respective contract revenues at the end of year, the excess of such costs is recognized as a loss on revaluation of partially completed construction contracts and, accordingly, is not included in the allowance for losses on construction contracts.

l) Reserve for retirement allowance
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 trust at the end of the fiscal year.

Prior service costs are expensed as incurred by MHI and most of Subsidiaries. Some Subsidiaries amortize those over years, which is shorter than the employees' estimated average remaining service periods. Actuarial gains and losses are amortized from the following year of occurrence by the straight-line method over the employees' estimated average remaining service period.

m) Reserve for treatment of PCB waste

In accordance with the "Law Concerning Special Measure against PCB (poly chlorinated biphenyl) waste" which requires PCB holders to dispose of all PCB waste by July 2016, MHI and Subsidiaries in February 2006 decided to consign the treatment of PCB waste to JESCO (Japan Environmental Safety Corporation). Under the circumstances, reserve for treatment of PCB waste is provided reserving for the estimated costs of the treatment for PCB products or equipment as well as their collection and transportation fees in the year ended March 31, 2006.

The reserved amount was ¥4,361 million (US$37,124 thousand) and the amount was recorded as expense for treatment of PCB waste within extraordinary expense, bringing about the decrease of income before income taxes by the same amount for the year ended March 31, 2006.

n) Revenue recognition

Sales of products are principally recognized upon acceptance by the customers. Revenue from long-term contracts with the contracted amount over ¥ 5,000 million (US$ 42,564 thousand) and the contract period of two years or longer are recognized on the basis of the percentage-of-completion method.

o) Hedge accounting

Principally, the "deferral method" is applied where MHI and Subsidiaries defer recognition of gains or losses until the related losses or gains on the hedged items are recognized.

If a forward exchange contract for foreign currency receivable or payable meets conditions of hedged item in terms of amount, currency and period, the "assigning method" is applied where the hedged item is stated at the forward exchange contract rate. (Note: The "assigning method" is not applied in case of comprehensive forward exchange contracts.)

Also, if an interest rate swap contract meets conditions of hedged item in terms of amount, index and period, the "exceptional method" is applied where the net amount to be paid or received under the contract is added to or deducted from the interest.

MHI and Subsidiaries have evaluated the effectiveness of its hedging activities by reference to the accumulated gains or losses on the hedging instruments and the related hedged items from the commencement of the hedges.

p) Tax-effect accounting

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 the 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.

q) Cash and cash equivalents

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.

r) Net income per share

The computation of basic net income per share is based on the average number of shares outstanding. Fully diluted earnings per share are determined on the assumption that the rights attaching to all the dilutive potential common stocks were exercised on the dates of each issue, appropriately adjusted for subsequent redemption.

In the year ended March 31,2006, as the effect of preferred stock issued by an affiliate, net income per share has been diluted.

s) Impairment of fixed assets

Since the year ended March 31, 2005, MHI and Subsidiaries have adopted the accounting standard for impairment of fixed assets.

As a result of this adoption, in the year ended March 31, 2005, impairment losses of ¥6,108 million were recognized and income before income taxes was decreased by the same amount. The accumulated impairment losses were deducted directly from the amount of each fixed asset.

2. DIFFERENCES WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

The accompanying consolidated financial statements of MHI, together with Subsidiaries, have been prepared in accordance with accounting principles generally accepted in Japan.

The differences with International Accounting Standards ("IASs") and International Financial Reporting Standards ("IFRSs") are summarized as follows:

The Accounting Standards Board of Japan is making progress toward convergence between Japanese GAAP and IFRSs. The differences in accounting standards will be reduced in near the future.

a) Scope of consolidation

Under IAS No. 27, a parent which issues consolidated financial statements should consolidate all foreign and domestic subsidiaries.

Certain subsidiaries which give minor effect to the consolidated financial statements have been excluded from consolidation in accordance with accounting principles generally accepted in Japan. Even if IAS No. 27 had been applied, the difference would not have been material.

b) Inventories

Under IAS No. 2, inventories should be measured at the lower of cost and net realizable value.

Inventories are valued as indicated in section e) of Note 1 "Summary of Significant Accounting Policies". Regarding work in process which occupies a significant portion of inventories, the costs which exceed their respective contract revenues have been recognized as loss on revaluation. Even if IAS No. 2 had been applied, the difference in the aggregate value of inventories would not have been material.

c) Reserve for retirement allowance

Under IAS No.19, to the extent that the benefits are already vested, an enterprise should recognize prior service costs immediately.

The accounting procedure for amortization is indicated in Note 8 "Retirement Benefits". In certain Subsidiaries, prior service costs are amortized over 10 to 11 years. Even if IAS No.19 had been applied, the difference would not have been material.

d) Leases

Under IAS No.17, lessees should recognize finance leases as assets and liabilities in their balance sheets and lessors should recognize assets as receivables held under a finance lease in their balance sheets.

In MHI and domestic Subsidiaries, leases, except those which transfer ownership to the lessee, have been treated in the same way as operating leases. However, lease transactions of foreign Subsidiaries are accounted for as either finance leases or operating leases in conformity with generally accepted accounting principles in the respective countries of domicile. Even if IAS No.17 had been applied, the difference would not have been material.

e) Revenue recognition and expected losses on construction contracts

Under IAS No.11, construction contracts should be accounted for by the percentage-of-completion method, and expected losses should be recognized as expenses immediately.

Revenue recognition and expected losses on construction contracts are indicated in sections n) and k) of Note 1 "Summary of Significant Accounting Policies", respectively. Even if IAS No.11 had been applied, the difference would not have been material.

f) Goodwill

Under IFRS No. 3, goodwill should not be amortized and the impairment rule should be applied in accordance with IAS No. 36.

In Japanese accounting standards, goodwill should be amortized and the impairment rule is adopted in some cases. MHI and Subsidiaries have amortized the goodwill as indicated in section g) of Note 1 "Summary of Significant Accounting Policies".

g) Stock options

MHI has stock option plans. Under IFRS No. 2, which is applied in FY2005, share-based payment transactions should be recognized in the financial statements. The same regulation will be adopted in Japanese accounting standards in FY2006. Even if IFRS No.2 had been applied, the difference would not have been material.

h) Discontinuing operations

MHI and Subsidiaries have not had such occurrences as should be accounted for under IFRS No. 5 during the years ended March 31, 2006 and 2005.

3. 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 ¥117.47=US$1 prevailing at March 31, 2006 has been used for the purpose of the presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

4. SECURITIES

a) Other securities with market value, which were included in securities (current assets) and investment securities (investments and advances) at March 31, 2006 and 2005, consisted of the following:

	In millions of yen			In thousands of U.S. dollars		
	2006			2006		
	Acquisition cost	Carrying amount	Unrealized gain (loss)	Acquisition cost	Carrying amount	Unrealized gain (loss)
i) Carrying amounts over acquisition costs:						
Equity securities	¥123,061	¥443,390	¥320,329	$1,047,595	$3,774,498	$2,726,903
Government bonds	242	319	77	2,065	2,719	654
Others	1,194	1,199	5	10,161	10,207	46
Subtotal	¥124,497	¥444,908	¥320,411	$1,059,821	$3,787,424	$2,727,603
ii) Acquisition costs over carrying amounts:						
Equity securities	¥ 801	¥ 335	¥ (466)	$ 6,821	$ 2,851	$ (3,970)
Total (i + ii)	¥125,298	¥445,243	¥319,945	$1,066,642	$3,790,275	$2,723,633

	In millions of yen8		
	2005		
	Acquisition cost	Carrying amount	Unrealized gain (loss)
i) Carrying amounts over acquisition costs:			
Equity securities	¥170,505	¥354,503	¥183,998
Government bonds	242	334	92
Others	794	842	48
Subtotal	¥171,541	¥355,679	¥184,138
ii) Acquisition costs over carrying amounts:			
Equity securities	¥ 1,733	¥ 1,217	¥ (516)
Total (i + ii)	¥173,274	¥356,896	¥183,622

Note: MHI and Subsidiaries treated as impaired those securities whose market values showed a substantial decline and were not judged to recover. The amount reflecting the impairment loss is recorded as the acquisition cost for these securities.

Securities were judged as impaired when their market values had declined 50% or more from their book values at the end of respective fiscal years, or had declined between 30% and 50% from their book values both at the interim period and the end of respective fiscal years.

With respect to other securities with market value, there was no impairment losses for the year ended March 31, 2006. For the year ended March 31, 2005, impairment losses amounted to ¥1,265 million.

b) Sales amounts of other securities and related gains and losses for the years ended March 31, 2006 and 2005 were as follows:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Sales amounts	¥ 2,603	¥425,957	$ 22,158
Gains	1,576	15,666	13,414
Losses	(10)	(5)	(81)

c) Other securities without market value, which were included in securities (current assets) and investment securities (investments and advances) at March 31, 2006 and 2005, mainly consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Equity securities—unlisted	¥26,219	¥ 81,481	$223,196

Note: MHI and Subsidiaries treated as impaired those securities whose equity values were judged to have declined 50% or more from their book values due to financial difficulties of the issuers.

The amount of impairment loss for the year ended March 31, 2006 and 2005 amounted to ¥52 million (US$446 thousand) and ¥89 million, respectively, with respect to other securities without market value.

d) Change in the holding-purpose category

In December 2005, MHI made Mitsubishi Motors Corporation (“MMC”) an affiliated company accounted for by the equity method, and changed the holding-purpose category of securities of MMC from “other securities” to “equity investments in subsidiaries and affiliates”.

By this change, securities of MMC was included in 2005 in above a) “Other securities with market value”, but was not included in 2006. The amount of securities of MMC included in 2005 was as follows:

	In millions of yen		
	2005		
	Acquisition cost	Carrying amount	Unrealized gain
Other securities with market value	¥50,603	¥85,821	¥35,218

Note: In addition, MHI hold preferred stocks of MMC, and it was categorized as “other securities without market value”, and the amount was ¥ 52,475 million at March 31, 2005.

e) The contractual maturities of other securities at March 31, 2006 and 2005 were as follows:

	In millions of yen			In thousands of U.S. dollars		
	2006			2006		
	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
Certificate of deposit	¥1,209	¥ –	¥–	$10,295	$ –	$–
Loan trusts	60	114	–	508	969	–
Bonds:						
Government bonds	250	579	–	2,129	4,929	–
Total	¥1,519	¥693	¥–	$12,932	$5,898	$–

	In millions of yen		
	2005		
	Due within one year	Due after one year through five years	Due after five years
Certificate of deposit	¥1,384	¥ –	¥–
Loan trusts	124	174	–
Bonds:			
Government bonds	–	594	0
Corporate bonds	367	600	–
Foreign bonds	697	–	–
Total	¥2,572	¥1,368	¥0

5. INVENTORIES

Inventories at March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Finished products	¥132,209	¥127,962	$1,125,474
Work in process	764,182	767,381	6,505,336
Raw materials	75,118	63,170	639,461
Total	¥971,509	¥958,513	$8,270,271

6. INCOME TAXES

MHI and Subsidiaries are subject to corporation income tax, inhabitants' tax and enterprise tax, based on income, which in the aggregate resulted in the statutory effective tax rate of approximately 40.5% for the years ended March 31, 2006 and 2005.

a) Significant components of deferred tax assets and liabilities at March 31, 2006 and 2005, which arose as a result of the recognition of the tax effect mentioned in section p) of Note 1 "Summary of Significant Accounting Policies", were as follows:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Reserve for retirement allowance	¥ 115,118	¥ 106,727	$ 979,983
Accrued expenses for product warranty	25,181	24,461	214,360
Tax loss carryforwards	17,653	34,065	150,277
Accrued expenses for construction contracts	13,200	11,650	112,366
Allowance for doubtful receivables	–	13,336	–
Others	57,038	43,132	485,554
Subtotal	228,190	233,371	1,942,540
Valuation allowance	(17,733)	(17,319)	(150,959)
Total gross deferred tax assets	210,457	216,052	1,791,581
Deferred tax liabilities:			
Net unrealized gains on investment securities	(129,768)	(73,786)	(1,104,690)
Gains on contribution of investment securities to trust for retirement allowance	(66,213)	(67,043)	(563,659)
Reserve for reduction in costs of fixed assets	(14,348)	(10,056)	(122,145)
Reserve for accelerated depreciation	(5,595)	(4,559)	(47,634)
Others	(4,154)	(2,855)	(35,360)
Total gross deferred tax liabilities	(220,078)	(158,299)	(1,873,488)
Net deferred tax assets (liabilities)	¥ (9,621)	¥ 57,753	$ (81,907)

Note: 1 "Others" of Deferred tax assets at March 31, 2006 includes "Allowance for doubtful receivables" amounts to ¥6,590 million (US$ 56,099 thousand).
2 Net deferred tax assets (liabilities) at March 31, 2006 and 2005 are reflected in the consolidated balance sheets as follows:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Deferred income taxes in current assets	¥ 75,978	¥ 65,501	$ 646,787
Deferred income taxes in investments and advances	10,159	9,745	86,479
Other current liabilities	(67)	(28)	(569)
Deferred income taxes in long-term liabilities	(95,691)	(17,465)	(814,604)

b) The difference, between the statutory effective income tax rate and the income tax rate as a percentage of income before income tax and minority interests at March 31, 2006, was less than 5% of statutory effective income tax rate. Therefore, reconciliation of these rate at March 31, 2006 was not shown, but that at March 31, 2005 was as follows:

	2005
Japanese statutory effective income tax rate	40.5%
Adjustment:	
Equity in earnings of unconsolidated subsidiaries and affiliates	(24.7)
Items excluded from expenses	9.9
Items excluded from gross income	(4.5)
Valuation allowance	46.9
Others	1.8
Income tax rate as a percentage of income before income taxes and minority interests	69.9%

7. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

a) Short-term borrowings at March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Loans, principally from banks, with weighted-average interest rate of 1.1% at March 31, 2006 and 0.9% at March 31, 2005:			
Secured	¥ 7,376	¥ 7,476	$ 62,791
Unsecured	300,396	290,793	2,557,217
Total	¥307,772	¥298,269	$2,620,008

b) Long-term debt at March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Loans, principally from banks and insurance companies, due 2006 to 2022 with weighted-average interest rate of 1.4% at March 31, 2006 and due 2005 to 2022 with weighted-average interest rate of 1.4% at March 31, 2005:			
Secured	¥ 19,679	¥ 22,387	$ 167,522
Unsecured	639,802	577,929	5,446,511
Export loans, principally from main contractors, due 2006 to 2018 with weighted-average interest rate of 2.7% at March 31, 2006 and due 2005 to 2018 with weighted-average interest rate of 2.9% at March 31, 2005:			
Unsecured	17,801	27,551	151,534
Unsecured bonds:			
2.525% bonds due 2008	50,000	50,000	425,641
1.83% bonds due 2005	–	30,000	–
2.15% bonds due 2008	40,000	40,000	340,512
0.63% bonds due 2010	20,000	20,000	170,256
1.03% bonds due 2013	30,000	30,000	255,384
0.365% bonds due 2010	20,000	20,000	170,256
0.70% bonds due 2013	50,000	50,000	425,641
Unsecured bonds issued by Subsidiaries:			
0.62% bonds, due 2006 to 2010 in 2006 and due 2005 to 2010 in 2005	1,250	1,550	10,641
8.29% bonds due 2005	–	3,126	–
8.39% bonds due 2007	2,361	2,084	20,102
Subtotal	890,893	874,627	7,584,000
Less current portion due within one year	(101,917)	(91,840)	(867,598)
Total	¥788,976	¥782,787	$6,716,402

c) A summary of assets pledged as collateral for short-term borrowings and long-term debt at March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Property, plant and equipment	**¥13,912**	¥14,960	**$118,430**
Trade receivables:			
Notes	**5,520**	6,406	**46,991**
Accounts	**15,267**	13,680	**129,961**
Short-term loans included in prepaid expenses and other current assets	**2,730**	3,801	**23,243**
Securities	**–**	565	**–**
Cash and deposits	**–**	30	**–**
Total	**¥37,429**	¥39,442	**$318,625**

d) The aggregate annual maturities of long-term debt at March 31, 2006 were as follows:

Year ending March 31	In millions of yen	In thousands of U.S. dollars
2007	¥101,917	$ 867,598
2008	107,670	916,571
2009	112,339	956,324
2010	102,965	876,522
2011	92,138	784,354
Thereafter	373,864	3,182,631
Total	¥890,893	$7,584,000

8. 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 section l) of Note 1 “Summary of Significant Accounting Policies”.

Actuarial gains and losses are amortized over a period shorter than the estimated average remaining service period of employees from the following year of the occurrence by the straight-line method. Prior service costs are incurred and expensed in the current year in MHI and most of Subsidiaries, and are amortized over 10 to 11 years from the year of the occurrence by the straight-line method in some Subsidiaries.

a) Benefit obligations and related information at March 31, 2006 and 2005 were as follows:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Benefit obligations	**¥(748,358)**	¥(760,148)	**$(6,370,627)**
Fair value of plan assets	**678,264**	497,460	**5,773,932**
Unfunded benefit obligations	**(70,094)**	(262,688)	**(596,695)**
Unrecognized actuarial losses	**(13,818)**	175,536	**(117,632)**
Unrecognized prior service costs (benefits)	**(605)**	(155)	**(5,150)**
Net benefit liability recognized on the consolidated balance sheet	**(84,517)**	(87,307)	**(719,477)**
Prepaid pension expense	**24,193**	22,491	**205,956**
Reserve for retirement allowance	**¥(108,710)**	¥(109,798)	**$ (925,433)**

b) Benefit expenses for the years ended March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Service cost	**¥ 28,217**	¥ 28,942	**$ 240,201**
Interest cost	**15,128**	15,205	**128,785**
Expected return on plan assets	**(13,666)**	(13,444)	**(116,343)**
Amortization of actuarial losses	**17,791**	16,568	**151,455**
Amortization of prior service costs (benefits)	**(83)**	(28)	**(705)**
Net benefit expenses	**¥ 47,387**	¥ 47,243	**$ 403,393**

c) The principal assumptions used in determining the information above at March 31, 2006 and 2005 were as follows:

		2006	2005
Discount rate		**2.0%**	2.0%
Expected rate of return on plan assets		**4.0%**	4.0%
Amortization period for prior service costs	MHI	**Expensed as incurred**	Expensed as incurred
	Subsidiaries	**Expensed as incurred or 10 to 11 years**	Expensed as incurred or 10 to 11 years
Amortization period for actuarial gains and losses	MHI	**13 years**	13 years
	Subsidiaries	**11 to 20 years**	11 to 20 years

9. GAINS ON SALES OF FIXED ASSETS

Gains on sales of fixed assets for the year ended March 31, 2006 and 2005 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2006	**2006**
Land	**¥14,316**	**$121,873**
Others	**(640)**	**(5,455)**
Total	**¥13,676**	**$116,418**

	In millions of yen
	2005
Land	¥10,328
Others	29
Total	¥10,357

10. BUSINESS IMPROVEMENT AND RESTRUCTURING CHARGES

Business improvement and restructuring charges arising from Mass and Medium-Lot Manufactured Machinery business and Machinery & Steel Structures business for the year ended March 31, 2006 and 2005 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2006	**2006**
Maintenance charges of products	**¥2,824**	**$24,042**
Losses on disposal of inventories	**1,366**	**11,628**
Losses on disposal of fixed assets	**226**	**1,919**
Others	**1,143**	**9,734**
Total	**¥5,559**	**$47,323**

	In millions of yen
	2005
Losses on disposal of inventories	¥ 391
Losses on disposal of fixed assets	358
Losses on special retirement benefit	348
Others	682
Total	¥1,779

11. LOSSES ON IMPAIRMENT FOR FIXED ASSETS

a) The groups of assets for which the MHI and Subsidiaries recognized impairment losses for the year ended March 31, 2005 are as follows:

Function or status	Location	Type of assets
Assets for rent	Shiba, Minato-ku Tokyo and others	Land and Buildings, etc
Idle assets	Oyama-cho, Shuntou-gun Shizuoka Prefecture and others	Land and Buildings, etc

b) The method to group the assets
Assets are grouped mainly by each Works, and each asset for rent or idle asset is treated as one of groups.

c) The circumstances in that impairment losses was recognized
Some of the assets groups, its market price had came down in price, MHI and Subsidiaries reduced the book value of such assets group to the recoverable amounts.

d) The method to calculate the recoverable amounts
The recoverable amounts were calculated with the adjustment reasonably, such as the price of expert opinion, assessment for fixed asset tax, etc.

e) Impairment losses
The amounts of impairment losses for the year ended March 31, 2005 was ¥6,108 million and consisted of the following:

	In millions of yen
	2005
Land	¥5,769
Buildings etc.	339
Total	¥6,108

12. STOCKHOLDERS' EQUITY

a) Capital surplus
The increase in the capital surplus account is due to the gains on sales of treasury stock.

b) Retained earnings
Retained earnings include a legal reserve provided in accordance with the Commercial Code of Japan. The Code provides that an amount equal to at least 10% of the amount to be disbursed as distributions of earnings be appropriated to the legal reserve until the total of such reserve and the additional paid-in capital account equals 25% of the common stock account.

The Code provides that neither additional paid-in capital nor the legal reserve is available for dividends, but both may be used to reduce or eliminate a deficit by resolution of the shareholders or may be transferred to common stock by resolution of the Board of Directors. The Code also provides that if the total amount of additional paid-in capital and the legal reserve exceeds 25% of the amount of common stock, the excess may be distributed to the shareholders either as a return of capital or as dividends subject to the approval of the shareholders.

Cash dividends 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.

c) Net unrealized gains on investment securities
The accounting policy of this account is described in section d) of Note 1 "Summary of Significant Accounting Policies". The unrealized gains at March 31, 2006 and 2005 were ¥322,947 million (US$2,749,138 thousand) and ¥184,859 million, respectively, and ¥193,373 million (US$ 1,646,147 thousand) and ¥110,460 million, net of tax effect, were accounted for as net unrealized gains on investment securities for the respective year ends.

d) Foreign currency translation adjustments
The accounting policy of this account is described in section c) of Note 1 "Summary of Significant Accounting Policies".

e) Additional information

By converting the preferred stocks of Mitsubishi Motors Corporation ("MMC") to common stocks, MHI and Subsidiaries raised the ratio of voting rights held by MHI and Subsidiaries in MMC to 16.1% and made MMC an affiliate in December 2005. As a result of this conversion, the valuation method for securities of MMC was changed from market value method to equity method.

The effect of this change is to decrease net unrealized gains on investment securities by ¥20,955 million (US$178,386 thousand), resulting from the reversal of unrealized gains, which was recorded in the year ended March 31, 2005 and to decrease retained earnings by ¥40,004 million (US$340,546 thousand) in the year ended March 31, 2006.

13. CASH AND CASH EQUIVALENTS

Cash and cash equivalents at March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Cash and deposits	**¥195,186**	¥211,912	**$1,661,580**
Time deposits with maturities over three months	**(20,112)**	(23,506)	**(171,207)**
Short-term investments with maturities within three months included in securities	**1,200**	1,375	**10,215**
Total	**¥176,274**	¥189,781	**$1,500,588**

14. 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
	2006	2005	**2006**
Equivalent of acquisition cost:			
Tools and equipment	**¥6,282**	¥ 8,237	**$53,477**
Others	**1,645**	2,565	**14,007**
Total	**¥7,927**	¥10,802	**$67,484**
Equivalent of accumulated depreciation:			
Tools and equipment	**¥3,767**	¥ 4,806	**$32,068**
Others	**847**	1,676	**7,211**
Total	**¥4,614**	¥ 6,482	**$39,279**
Equivalent of balance at the balance sheet date:			
Tools and equipment	**¥2,515**	¥ 3,431	**$21,409**
Others	**798**	889	**6,796**
Total	**¥3,313**	¥ 4,320	**$28,205**

ii) The equivalent of undue lease payments (including interest portion) at March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Within one year	**¥1,372**	¥1,762	**$11,677**
Thereafter	**1,941**	2,558	**16,528**
Total	**¥3,313**	¥4,320	**$28,205**

Note: Impairment losses distributed to leases had not been at March 31, 2006 and 2005.

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, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Lease payments	**¥1,784**	¥2,549	**$15,189**
Impairment losses	**–**	–	**–**

iv) Method of computing the equivalent of depreciation expenses
The equivalent of depreciation expenses was computed by the straight-line method by treating the lease periods as the 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
	2006	2005	**2006**
Acquisition cost:			
Machinery and equipment	**¥59,660**	¥58,627	**$507,873**
Others	**7,285**	5,953	**62,021**
Total	**¥66,945**	¥64,580	**$569,894**
Accumulated depreciation:			
Machinery and equipment	**¥25,920**	¥26,814	**$220,655**
Others	**2,446**	2,143	**20,824**
Total	**¥28,366**	¥28,957	**$241,479**
Balance at the balance sheet date:			
Machinery and equipment	**¥33,740**	¥31,813	**$287,218**
Others	**4,839**	3,810	**41,197**
Total	**¥38,579**	¥35,623	**$328,415**

ii) Undue lease income (including interest portion), at March 31, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Within one year	**¥13,374**	¥13,622	**$113,854**
Thereafter	**30,931**	28,866	**263,307**
Total	**¥44,305**	¥42,488	**$377,161**

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, 2006 and 2005 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2006	2005	**2006**
Lease income	**¥14,710**	¥14,836	**$125,224**
Depreciation expenses	**11,360**	10,257	**96,708**

15. DERIVATIVE FINANCIAL INSTRUMENTS

MHI and Subsidiaries utilize derivative financial instruments, which are comprised principally of forward foreign exchange contracts, foreign currency swaps and interest rate swaps. They are utilized for the purpose of reducing the risk of losses resulting from fluctuations in foreign exchange rates and interest rates.

MHI and Subsidiaries believe that market risks are insignificant, because MHI and Subsidiaries utilize such derivative financial instruments solely in order to hedge against certain risks in accordance with internal control procedures. MHI and Subsidiaries also believe that the risk of nonperformance by counterparties is insignificant because of the high credit ratings of the counterparties.

Summarized below are the notional amounts and the fair values of the derivative positions, except for those applied the hedge accounting, outstanding at March 31, 2006 and 2005:

	In millions of yen			In thousands of U.S. dollars		
	2006			2006		
	Notional amount	Fair value	Unrealized gain (loss)	Notional amount	Fair value	Unrealized gain (loss)
Forward foreign exchange contracts						
Sell:						
US$	**¥72,386**	**¥74,171**	**¥(1,785)**	**$616,207**	**$631,403**	**$(15,196)**
Euro	**26,543**	**26,981**	**(438)**	**225,955**	**229,686**	**(3,731)**
Others	**1,674**	**1,723**	**(49)**	**14,250**	**14,666**	**(416)**
Total			**¥(2,272)**			**$(19,343)**

	In millions of yen		
	2005		
	Notional amount	Fair value	Unrealized gain (loss)
Forward foreign exchange contracts			
Sell:			
US$	¥15,800	¥15,892	¥ (92)
Euro	19,079	19,225	(146)
Others	654	646	8
Buy:			
US$	382	366	(16)
Total			¥(246)

16. CONTINGENT LIABILITIES

Contingent liabilities for guarantees to loans of others made in the ordinary course of business amounted to ¥128,732 million (US$1,095,873 thousand) and ¥145,017 million at March 31, 2006 and 2005, respectively.

17. SUPPLEMENTARY INCOME INFORMATION

	In millions of yen		In thousands of U.S. dollars
	2006	2005	2006
Depreciation	**¥100,810**	¥ 99,183	**$858,177**
Research and development costs (including routine or periodic alterations to existing products)	**100,798**	124,023	**858,076**

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

ERNST & YOUNG SHINNIHON

Certified Public Accountants
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Tel: 03 3503 1100
Fax: 03 3503 1197

Report of Independent Auditors

The Board of Directors
Mitsubishi Heavy Industries, Ltd.

We have audited the accompanying consolidated balance sheets of Mitsubishi Heavy Industries, Ltd. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Mitsubishi Heavy Industries, Ltd. and consolidated subsidiaries at March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 3.

June 28, 2006

Ernst & Young ShinNihon

CORPORATE DATA

As of March 31, 2006

Head Office
16-5, Konan 2-chome, Minato-ku,
Tokyo 108-8215, Japan
Phone: +81-3-6716-3111
Fax: +81-3-6716-5800

Established: January 11, 1950

Paid-in Capital: ¥265.6 billion

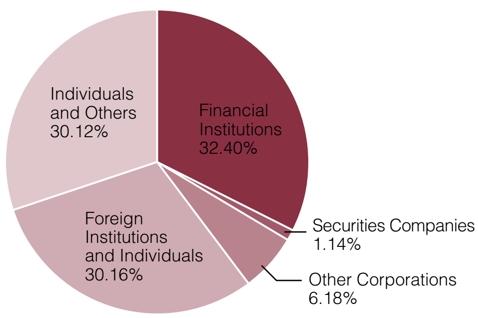
Total Number of
Issuable Shares: 6,000,000,000

Total Number of Shares Issued: 3,373,647,813

Number of Shareholders: 301,189

Number of Employees: 62,212

Composition of Shareholders



Note: Government and Local Public Entities hold less than 0.01 percent of outstanding shares.

Stock Listings: Tokyo, Osaka, Nagoya, Fukuoka and Sapporo Stock Exchanges

Ticker Code: 7011

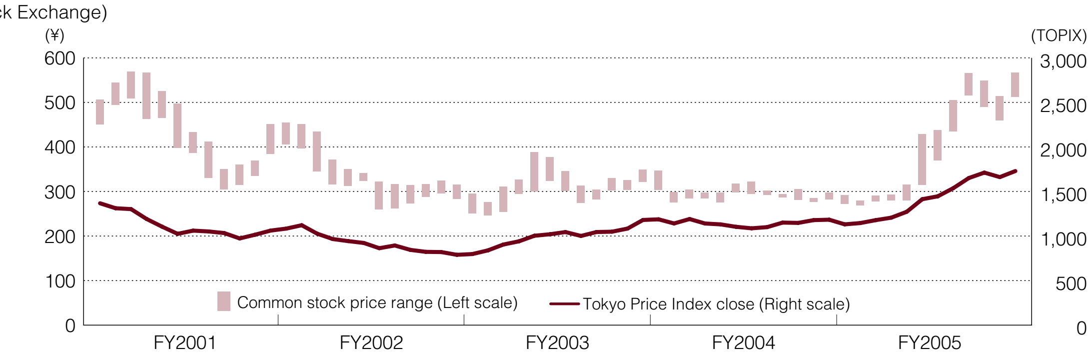
Manager of the Register of Shareholders:
Mitsubishi UFJ Trust and Banking Corporation 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8212, Japan

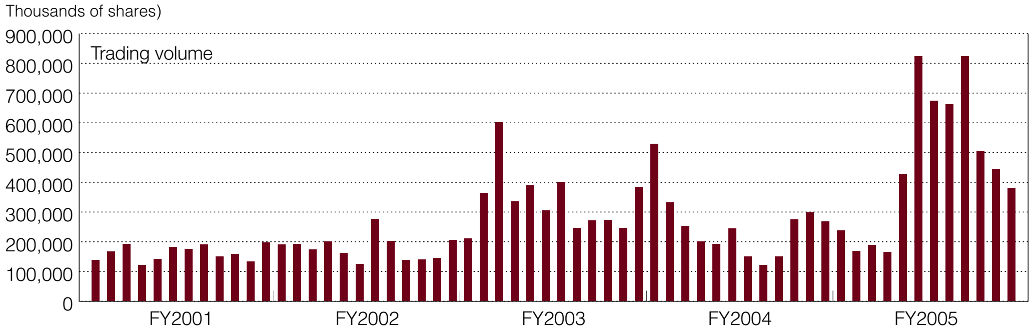
Certified Public Accountants:
Ernst & Young ShinNihon Hibiya Kokusai Bldg., 2-2-3, Uchisaiwai-cho, Chiyoda-ku, Tokyo, Japan 100-0011

Major Shareholders	Number of shares owned by major shareholders	% of total shares
The Master Trust Bank of Japan, Ltd. (Holder in Trust)	174,360,000	5.17%
Japan Trustee Services Bank, Ltd. (Holder in Trust)	147,843,900	4.38
State Street Bank and Trust Company	133,474,226	3.96
The Nomura Trust and Banking Co., Ltd. (Holder in Retirement Benefit Trust for The Bank of Tokyo-Mitsubishi UFJ, Ltd.)	125,666,000	3.72
Meiji Yasuda Life Insurance Company	80,022,741	2.37
Tokio Marine & Nichido Fire Insurance Co., Ltd.	63,000,000	1.87
The Chase Manhattan Bank, N.A. London	49,311,004	1.46
State Street Bank and Trust Company 505103	46,896,425	1.39
The Nomura Trust and Banking Co., Ltd. (Holder in Retirement Benefit Trust for Mitsubishi UFJ Trust and Banking Corporation)	45,934,000	1.36
Japan Trustee Services Bank, Ltd. (Holder in Trust4)	34,923,000	1.04

MONTHLY STOCK PRICE RANGE & TRADING VOLUME

(Tokyo Stock Exchange)





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(As of June 28, 2006)

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HEAVY INDUSTRIES, LTD.

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