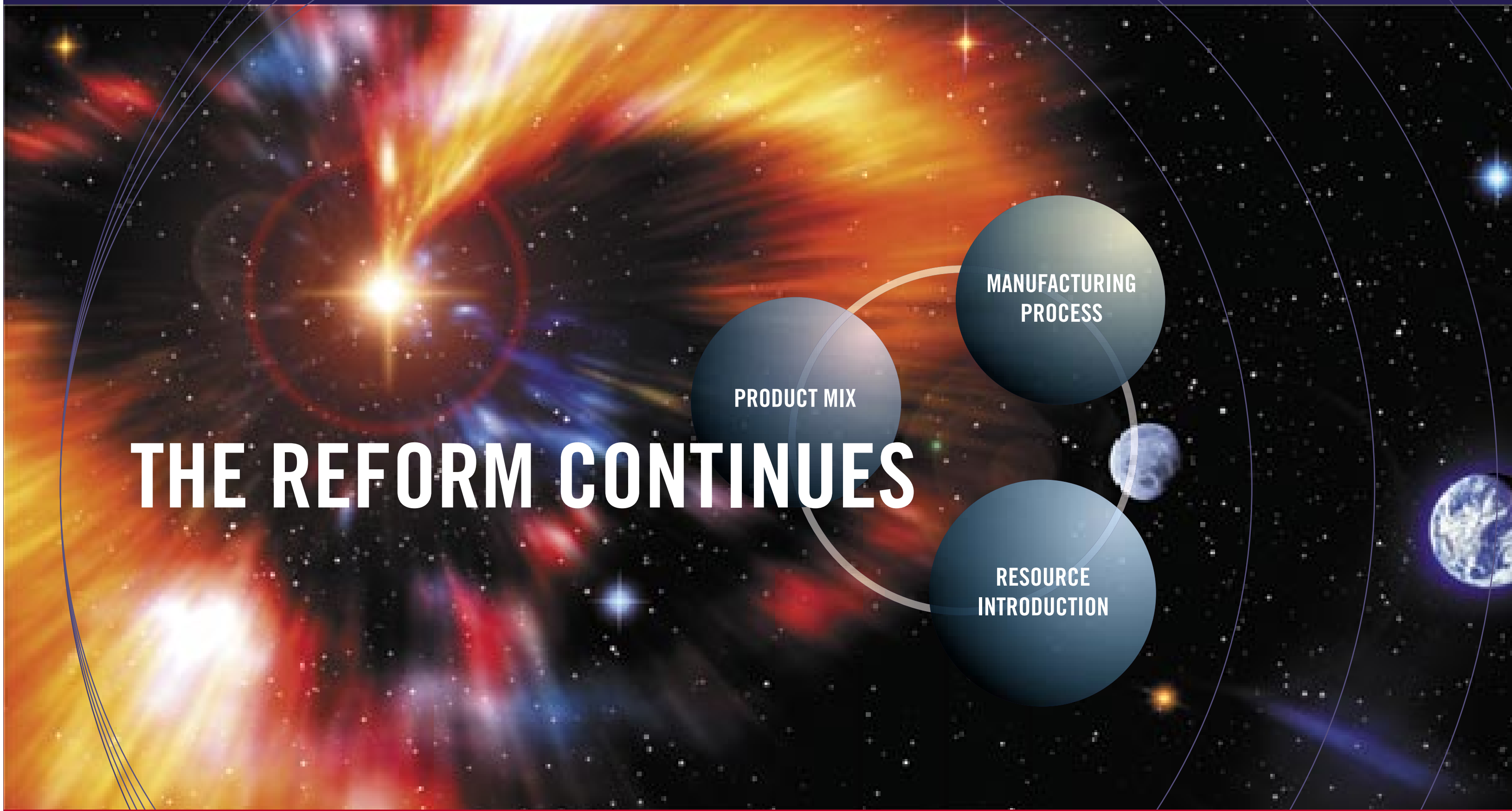
MITSUBISHI HEAVY INDUSTRIES, LTD.



THE REFORM CONTINUES

ANNUAL REPORT 2007

For the Year Ended March 31, 2007

Three Reforms

In April 2006, the MHI Group formulated its 2006 Business Plan (medium-term business plan) as the basis for driving further growth. The plan incorporates three basic strategies—build a solid earnings structure, strengthen the production technology base, and establish society and customer trust.

Under this plan, MHI is working on three areas of reform: product mix reform, manufacturing process reform and resource introduction reform.

While steady progress is being made with the 2006 Business Plan, MHI intends to continue accelerating strategic initiatives toward achieving the plan's final-year goals in fiscal 2008.

SEE PAGE 13

Strengthen thoroughly manufacturing capabilities

MANUFACTURING PROCESS REFORM

SEE PAGE 11

RESOURCE INTRODUCTION REFORM

Channel management resources into growth business

TARGET (FY 2008)

Net sales: 3,000 billion yen

Operating income: 120 billion yen

ROE: 4.5%

FINANCIAL HIGHLIGHTS

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

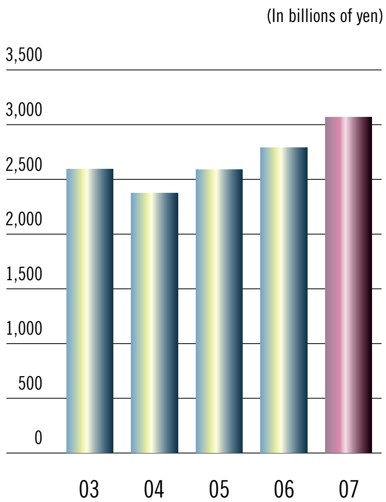
	In millions of yen except per share amounts						In thousands of U.S. dollars except per share amounts(*)
	2007	2006	2005	2004	2003	2002	**2007**
Net sales	**¥3,068,505**	¥2,792,109	¥2,590,733	¥2,373,441	¥2,593,894	¥2,863,985	**$25,993,264**
Operating income	**108,912**	70,913	14,773	66,631	115,308	78,655	**922,594**
Interest expense —net of interest income	**(4,808)**	(1,968)	(5,590)	(6,333)	(8,394)	(9,407)	**(40,728)**
Income before income taxes and minority interests	**83,711**	52,383	16,399	50,124	66,162	48,028	**709,117**
Net income	**48,840**	29,817	4,050	21,787	34,331	26,447	**413,721**
Per share of common stock: (yen/U.S. dollars)							
Net income—basic	**¥ 14.56**	¥ 8.85	¥ 1.20	¥ 6.46	¥ 10.14	¥ 7.84	**$ 0.123**
Net income—diluted	**14.55**	8.83	1.20	6.46	10.14	7.82	**0.123**
Cash dividends	**6.00**	4.00	4.00	6.00	6.00	4.00	**0.051**
Total assets	**¥4,391,865**	¥4,047,122	¥3,831,144	¥3,715,359	¥3,666,866	¥3,915,276	**$37,203,427**
Net assets**	**1,446,436**	1,376,289	1,309,977	1,324,498	1,270,968	1,282,727	**12,252,742**
Current assets	**2,787,315**	2,543,485	2,465,645	2,402,987	2,389,358	2,598,526	**23,611,310**
Current liabilities	**1,807,412**	1,626,663	1,567,987	1,519,467	1,721,515	1,881,226	**15,310,561**
Short-term borrowings and long-term debt	**1,273,572**	1,198,665	1,172,896	1,101,269	1,122,923	1,049,998	**10,788,413**

Notes: * U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥118.05=U.S.$1, the exchange rate prevailing at March 31, 2007.
** For calculating
in the Balan
Net Assets in the Balance Sheet" (ASBJ Guidance No. 8) since the year ended March 31, 2007.
At March 31,
¥1,427,364 million.

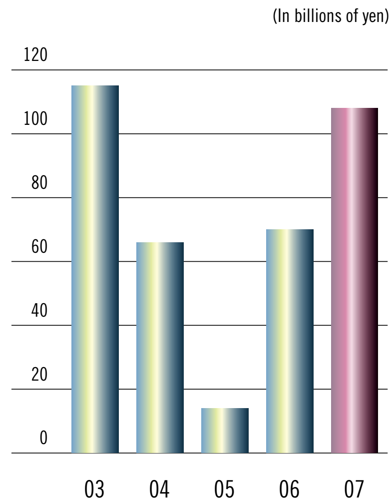
CONTENTS

FINANCIAL PERFORMANCE

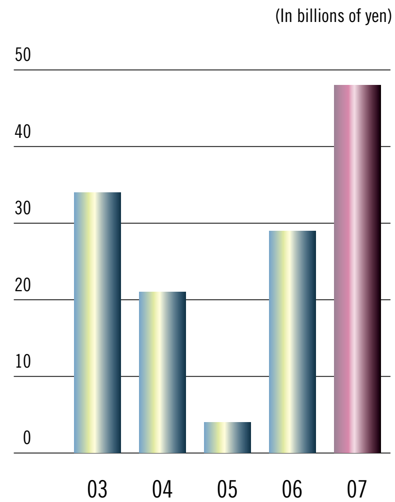
NET SALES



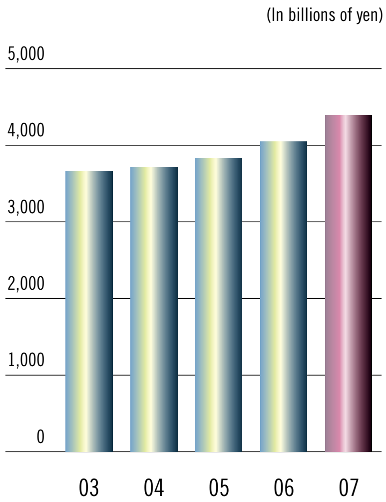
OPERATING INCOME



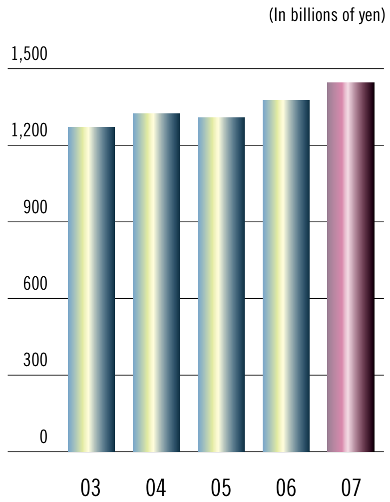
NET INCOME



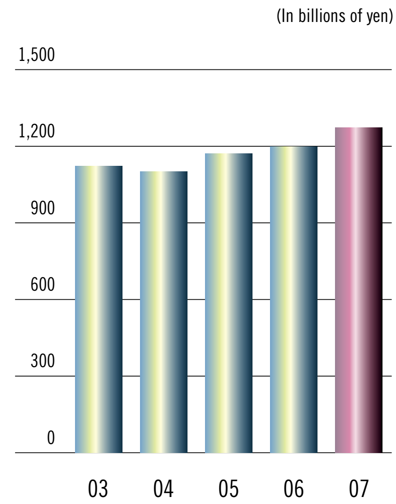
TOTAL ASSETS



NET ASSETS



SHORT-TERM BORROWINGS AND LONG-TERM DEBT



FORWARD-LOOKING STATEMENTS
Forecasts regarding future performance
As such, those projection simply risks and insecurity. For this reason, investors are recommended not to depend solely on these projections for making investment decision. It is possible that actual results may change significantly from these projections for a number of factors. Such factors include, but are not limited to, economic trends affecting the Company's operati
in Japan.

A MESSAGE FROM THE MANAGEMENT

Operating Environment and Performance

During fiscal 2006, ended March 31, 2007, the Japanese economy enjoyed the continued robust performance of corporate earnings, with capital investment maintaining its strong growth and consumer spending remaining on the whole firm. Exports generally remained quite strong due to the sustained solid growth of exports to China and to various countries in Southeast Asia, where economic growth has continued to be healthy.

In this operating environment, Mitsubishi Heavy Industries, Ltd. and its consolidated subsidiaries ("MHI Group") put greater emphasis on profitability and developing its businesses globally, and actively carried out efforts to win orders primarily in growth businesses in overseas markets that have remained strong.

As a result, the value of orders on a consolidated basis for the year under review totaled ¥3,274.7 billion (US$27,740 million), an increase of approximately 11% over the previous year. This was attributed to the large increase in orders won by the Shipbuilding & Ocean Development segment for the construction of merchant ships and a large number of orders obtained by the Power Systems segment for large-scale thermal power plants and wind turbines. The Aerospace segment and the Mass and Medium-Lot Manufactured Machinery segment posted gains, but the Machinery & Steel Structures segment showed a slight decline.

Reflecting the recent strength in orders, the Power Systems segment achieved a sales increase in the construction of thermal power plants overseas, while the Shipbuilding & Ocean Development, Aerospace, and Mass and Medium-Lot Manufactured Machinery segments also posted increases in sales. Although the Machinery & Steel Structures segment posted a slight decrease, consolidated net sales for the year under review increased to ¥3,068.5 billion (US$25,993 million), approximately 10% higher than the previous year.

In terms of earnings, the MHI Group posted operating income of ¥108.9 billion (US$923 million), and ordinary income of ¥83.0 billion (US$704 million), up ¥38.0 billion (US$322 million) and ¥32.7 billion (US$277 million), respectively, from the previous year.

These increases were attributed to the fact that certain negative factors, such as the rising cost of materials, were absorbed by the benefits of the weak Japanese yen. In addition, efforts were made throughout the Group to reduce every type of cost and boost productivity under Action 05, which was undertaken as a part of the 2006 Business Plan (Medium-Term Business Plan) started in the year under review and ending in fiscal 2008.

As a part of the 2006 Business Plan, product mix reform was accelerated. As a result, the decision was made to book special expenditures for business improvement and restructuring charges in extraordinary expenses. Meanwhile, proceeding with revaluation and reorganization of assets, gains on sale of fixed assets and investment securities were included in extraordinary income, resulting in extraordinary income of ¥0.7 billion (US$6 million).

As a result, the MHI Group reported net income of ¥48.8 billion (US$414 million) for the year under review, up ¥19.0 billion (US$161 million) from the previous year.

For the year-end dividend for the year under review, MHI paid a cash dividend of ¥3 per share. Moreover, an interim dividend of ¥3 per share was paid during the year, bringing the total dividend for the 2006 fiscal year to ¥6 per share, an increase of ¥2 per share over the previous fiscal year.

Progress With the 2006 Business Plan

Following poor results in fiscal 2004, the MHI Group began rolling out its Action 05 activities in fiscal 2005 as the first step in achieving a targeted recovery in profitability over a period of two years. As the next step in this process, the Group began implementing its 2006 Business Plan from the year under review. The main aim of this plan is to build a solid earnings structure. In both fiscal 2005 and 2006, the MHI Group saw strong performance in its growth businesses and overseas operations and achieved a turnaround in its underperforming businesses. As a result, we have exceeded our order and earnings forecasts announced at the beginning of fiscal 2006 and achieved our initial Action 05 targets. At the current time, progress toward the goals of the 2006 Business Plan is also good.

Building on this performance, the MHI Group will not let up in implementing its strategic initiatives as it works toward the final-year targets of the 2006 Business Plan, ending in fiscal 2008. The Group's order book is currently strong. While aiming to maintain the current high level of orders, we will focus on enhancing management resources such as facilities and our workforce, and continue to give due consideration to profitability.

Initiatives to Strengthen Group Management

With regard to the management of the Group, we will strive to further strengthen consolidated management by promoting the globalization of our businesses and increasing the establishment of specialist companies in order to boost our competitiveness. In addition to these efforts, we established the Group Management Department in April of this year to enable such initiatives as the strengthening of internal controls throughout the entire Group to be carried out.

In order to make it absolutely clear that corporate social responsibility (CSR) is positioned as the cornerstone of the MHI Group's management approach, we established the CSR Committee, a new committee with the President of the Group at its head, in October of last year. This Committee will oversee the implementation of the various efforts related to CSR such as compliance, the environment, and the fair acquisition of orders across the entire Group, and strategically and comprehensively promote CSR.

Based on the understanding that CSR is founded upon compliance, particularly with regard to the Antimonopoly Act, the MHI Group will continue its comprehensive and thorough efforts to ensure compliance.

Looking to the future, we will continue to carry forth our business from the standpoint of the customer and society, and provide trustworthy products and services backed by our unsurpassed technology in order to contribute to the development of a society where people can live a safe and fulfilling life. So that we may continue our ceaseless efforts to accomplish these aims, the support of our shareholders, as ever, will be deeply and sincerely appreciated.

August 2007

T. Nishioka

Takashi Nishioka, Chairman

K. Tsukuda

Kazuo Tsukuda, President

AN INTERVIEW WITH PRESIDENT
Kazuo Tsukuda

Q. First of all, please tell us about progress with the 2006 Business Plan in fiscal 2006.

Major efforts are being put into implementing the 2006 Business Plan. These include aggressively carrying out capital investment as well as building up our sales and production bases to strengthen and expand growth businesses that form the main pillars of our profits. In addition, efforts are being made to strengthen the competitiveness of mature businesses.

Specifically, Power Systems is working to expand its business by securing orders for gas turbines, an area growing with worldwide rising demand for electric power and increasing concern for environment protection. In addition to reinforcing manufacturing capabilities which we implemented through capital investment in Japanese domestic facilities and cooperative efforts with Chinese manufacturers, we established a new subsidiary in Singapore as our Southeast Asian base, thereby enhancing our marketing and sales capabilities. Further, to respond to the healthy number of orders for wind turbines primarily in the United States and the rapid increase in demand for photovoltaic modules, particularly in European countries, we increased our manufacturing capabilities through initiatives such as building new facilities.

In Nuclear Energy Systems, we focused on the steady development of our mainstay domestic business. In addition, we sought to expand our overseas business. We established a local subsidiary in the United States where construction of a large number of new electric power plants is expected, and started marketing the US-Advanced Pressurized Water Reactor (APWR) developed by MHI, resulting in its selection in March this year by an electric power company in the state of Texas. To meet growth in worldwide demand for the future construction of new electric power plants, we signed a Memorandum of Understanding with the French company AREVA to jointly develop a 3rd-generation 1,000 MWe nuclear power plant.

AN INTERVIEW WITH PRESIDENT

In Aerospace, we finished construction of a factory to manufacture wing boxes made of composite material for the Boeing 787 and have already started production. Mass and Medium-Lot Manufactured Machinery also undertook capital investment, intending to expand its market share for turbochargers, focusing on Europe, where orders have been on the rise.

Shipbuilding & Ocean Development has begun modernizing its production facilities, while Machinery & Steel Structures consolidated some of its product businesses, which were facing intense competition, into subsidiaries to form specialist companies in order to boost their competitiveness.

To expand its international business, MHI set out to strengthen its organization, with the establishment of local representative offices in Hanoi, Vietnam, a country where economic growth has been striking, and in Dubai in the Middle East, a region where a number of projects such as transportation systems, chemical plants, and thermal power plants, are underway or being planned.

Q. The 2006 Business Plan incorporates three key measures: product mix reform, manufacturing process reform, and resource introduction reform. Please tell us about progress in the first area.

We are implementing product mix reform from the perspective of rebuilding our business and profit structures. The benefits are already emerging in efforts to create a new business structure, illustrated by the increase in orders in fiscal 2006 compared to fiscal 2004, prior to the launch of Action 05.

In the 2006 Business Plan, we have positioned Power Systems, Aerospace, and General Machinery & Special Vehicles as three businesses that drive profits. During the year under review, we channeled resources into these businesses to implement the kind of initiatives I talked about in my previous answer. Our aim is to increase orders received in these businesses by around 40% and we are realizing a fundamental shift in their business structure to achieve this target. We have also boosted the ratio of exports to consolidated sales to 54% by steadily growing their operations in overseas growth markets.

In the plan, we have also identified a number of other businesses that were expected to generate stable profits. In these businesses, we are implementing priority measures to drive a recovery in profitability while ensuring they retain a certain operational scale. Specifically, we are reforming production processes, working to increase manufacturing conducted overseas, and moving forward steadily with business integration and transfers.

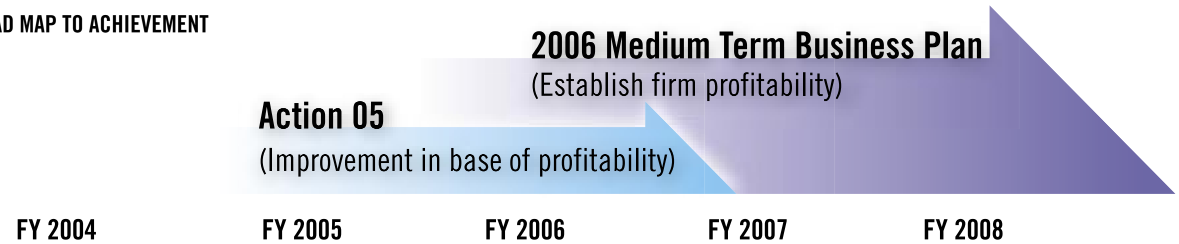
As with efforts to rebuild our business structure, we are also seeing progress with steps to create a new profit structure. Comparing the situation in fiscal 2004 and fiscal 2006, consolidated operating income increased from ¥14.7 billion to ¥108.9 billion, recovering to the ¥100 billion level for the first time in four fiscal years. Power systems and other businesses identified as growth drivers provided ¥87.9 billion of this figure, while unprofitable businesses in fiscal 2004 such as Industrial Machinery, Air-conditioning & Refrigeration Systems, and Machinery & Steel Structures all returned to profitability. We believe the foundations for generating stable profits are now in place in these businesses.

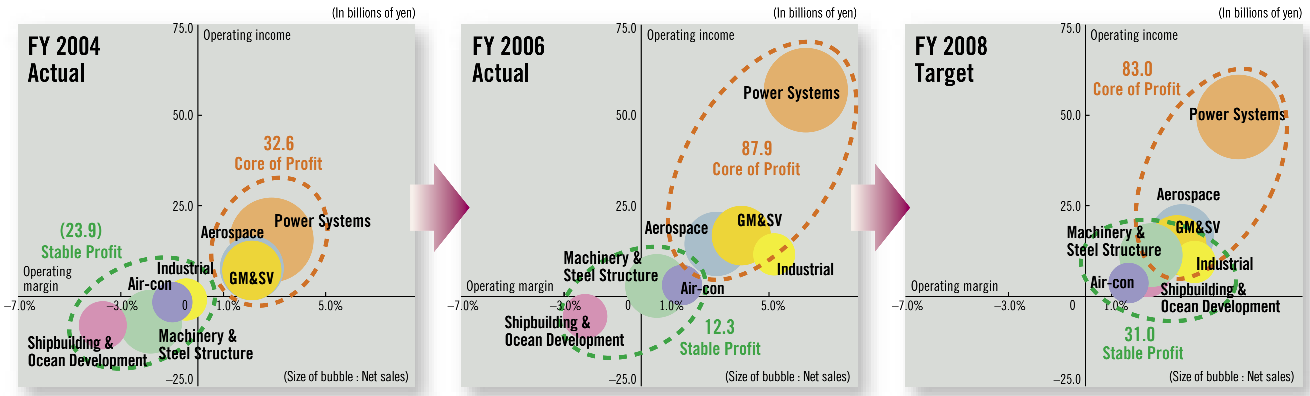
THREE REFORMS PRODUCT MIX

PRODUCT MIX REFORM

Transform Profit Structure

TARGET & ROAD MAP TO ACHIEVEMENT





ROE 0.3%	ROE 3.5%	ROE 4.5%

GM&SV: General Machinery & Special Vehicle **Air-con:** Air-conditioning & Refrigeration Systems **Industrial:** Industrial Machinery

NET SALES/EARNINGS BY SEGMENT

(In billions of yen)

Segment		Net sales			Operating income		
		actual		target	actual		target
		FY2004	FY2006	FY2008	FY2004	FY2006	FY2008
Core of Profit	Power Systems	629.7	890.8	880.0	16.1	56.8	50.0
	Aerospace	408.0	495.0	480.0	8.7	14.4	18.0
	General Machinery & Special Vehicle	363.0	431.1	420.0	7.8	16.7	15.0
Total		**1,400.7**	**1,816.9**	**1,780.0**	**32.6**	**87.9**	**83.0**
Stable Profit	Industrial Machinery	216.2	219.4	230.0	(1.4)	11.5	10.0
	Air-conditioning & Refrigeration Systems	178.7	198.5	180.0	(2.1)	3.2	3.0
	Shipbuilding & Ocean Development	271.6	247.1	240.0	(11.7)	(5.4)	6.0
	Machinery & Steel Structures	459.4	511.7	490.0	(8.7)	2.9	12.0
	Total	**1,125.9**	**1,176.7**	**1,140.0**	**(23.9)**	**12.2**	**31.0**
	Others	64.1	74.9	80.0	6.0	8.8	6.0
	Grand Total	2,590.7	3,068.5	3,000.0	14.7	108.9	120.0

AN INTERVIEW WITH PRESIDENT

The Shipbuilding & Ocean Development business was unprofitable in the year under review. Going forward, orders received when ship prices were low will have increasingly less impact on profitability, and we are also making steady progress with manufacturing process reforms and shipyard modernization. Accordingly, we expect the business to become profitable in fiscal 2007, meaning all our business segments should be in positive territory.

As you can see, our product mix reforms are progressing as planned due to the roll out of measures to boost profitability in Action 05 and the implementation of strategies in the 2006 Business Plan.

Q. How is manufacturing process reform moving forward?

We have established a Production System Innovation Planning Department under the direct control of the President. This organization is working to thoroughly reinforce our in-house production capabilities by enhancing three key areas we collectively call 3M—Manufacturing Methods, Machines and Men.

In terms of manufacturing methods, we are introducing volume production approaches such as modular design into our customer-order based businesses, promoting extensive use of digital data, and working to reinforce global supply-chain management.

In machines, we are implementing capital investment plans at each of our facilities with the aim of creating world-class plants. This also involves tapping into the considerable expertise and knowledge of in-house experts across the MHI Group. Additionally, we are calling on our research centers to play a more central role in helping manufacturing sites rapidly overcome today's highly challenging technical hurdles.

Finally, in order to develop and enhance our manufacturing workforce, we are significantly boosting recruitment, strengthening training programs, and revising pay and benefits packages for workers.

Our business operations depend on efforts to innovate our manufacturing processes. Accordingly, we remain committed to pushing forward with powerful innovation initiatives in this area.

Q. What progress are you making with resource introduction reform?

Resource introduction reform is an essential element of the two other areas of reform.

In line with the basic policy of the 2006 Business Plan, we are channeling capital expenditure and R&D investment into growth businesses—Power Systems, Aerospace, and General Machinery and Special Vehicles. We are also investing in production system reform and measures to strengthen in-house manufacturing, bringing forward investment plans where necessary.

In addition, we are using management resources to increase recruitment and accelerate the shift of personnel into growth businesses. In order to secure sufficient personnel to cope with the mass retirement of baby boomers and other factors, we will dramatically increase the number of new graduates and mid-career workers that we hire, and put priority on placing them in power systems, aerospace and other growth businesses, thereby enabling us to strengthen our business structure.

THREE REFORMS MANUFACTURING PROCESS

MANUFACTURING PROCESS REFORM

Strengthen Thoroughly Manufacturing Capabilities

Strengthen Thoroughly 3M: Method, Machine, Man

Method:

- Adopt standardized production method for custom-made on-off products
- Reform to digital production system
- Strengthen supply-chain management

- Accelerate the Modular Design Promotion Project
- Develop an integrated business process including design, production, and after-sales service, using digital data
- Share information with partners worldwide, bolster alliances, provide technical assistance, support the handing down of technologies

Machine:

- Upgrade infrastructure
- Promote in-house production of key parts and units
- Enhance production technologies

- Modernize obsolete infrastructure
- Create world-class plants, bringing together wisdom and knowledge across the board
- Research centers to solve production technology issues (turning implicit knowledge into formal knowledge)

Man:

- Educate and strengthen personnel resources for production system

- Hire more people for key professional jobs
- Make it obligatory to provide education for design, production and product assurance engineers by year
- Bolster manufacturing ability, improve staff treatment to assist in recruitment

AN INTERVIEW WITH PRESIDENT

Q. Please tell us how you plan to address key issues and develop your business going forward.

In Japan, continued robust corporate earnings are expected to sustain rising capital investment. Consumer spending is also forecast to remain healthy, underpinning stable domestic demand. On the whole, exports are expected to maintain solid growth. Although the direction of the US economy is somewhat unclear, indications are that the economies of Asian countries, including China, will continue to expand and drive export growth. The EU economy is also projected to remain firm.

The MHI Group will put even greater emphasis on these expanding overseas markets, and strive towards greater achievements amid increasingly harsh global competition. We are focusing all our energies on implementing the initiatives in our 2006 Business Plan, and we will continue to devote our resources to ensure that we achieve its targets.

At the moment, it is extremely important that environmental and energy issues are resolved on a worldwide scale to prevent global warming and other environmental crises. The MHI Group will actively contribute to reducing environmental impacts by making use of its outstanding technologies to develop and provide high-efficiency gas turbines, Integrated coal Gasification Combined-Cycle (IGCC) systems, and nuclear power plants, as well as wind turbines, thin-film photovoltaic modules, and other renewable energy-related products.

We will accelerate the establishment of an efficient mass-production framework for the new Boeing 787, which has already entered the production phase, as well as expand sales of transportation systems mainly in Asia and the Middle East. By strengthening and expanding these growth businesses, MHI will secure greater earnings power. Furthermore, as a leading company in the field of nuclear power, the MHI Group will promote business development in pressurized water reactors (PWR), a field we have been targeting, and focus on the development of fast breeder reactors (FBR), which are seen as the main system for nuclear power generation in the future.

Establishing and maintaining trust in our products is the very foundation of the Group's management. We will continue to press forward with efforts to innovate production facilities, bolster internal manufacturing capabilities and improve production technology, as well as enhance manufacturing methods by expanding standardization and increasing the use of shared components and processes.

As a result of the growth in orders, the volume of our overseas construction work is rapidly increasing. To keep pace with this increase, we will build up production facilities, improve overseas local construction systems, and enhance the operations of our overseas manufacturing bases.

THREE REFORMS RESOURCE INTRODUCTION

RESOURCE INTRODUCTION REFORM

Channel Management Resources into Growth Business

Capital Expenditure

¥360 billion
over the previous 3 years

¥465 billion
over the next 3 years
(FY 2006–FY 2008)

R&D Investment

¥315 billion
over the previous 3 years

¥360 billion
over the next 3 years
(FY 2006–FY 2008)

Secure Human Resources

Number of new recruits: 900/year
(Non-consolidated: 3 years average)

1,500/year

Number of employees: 62,200 (March 2006)

63,500 (March 2009)

- **Accelerating investment in growth businesses**
  - Increased production capacity (GTCC, wind turbine, solar power generation, turbochargers etc.)
  - Boeing 787 construction of composite material main wing center etc.
- **Accelerating the expansion of internal production capacity**
  - Reforming production processes and modernizing equipment

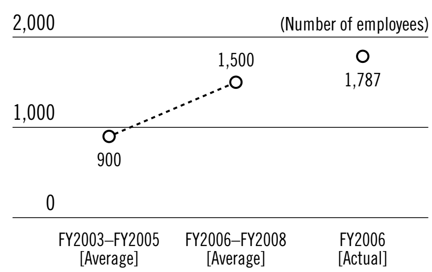
GTCC: Gas Turbine Combined Cycle

- **Expanding of production capacity in growth businesses**
  - Focusing on the development of next-generation gas turbines, IGCC, US-APWR, new joint development of advanced reactor with AREVA Boeing 787 (composite material wing/engine), environmentally-compatible engines, etc.
- **Promoting innovation in manufacturing**
  - QI-I, DE-I, MD-PJ
    Promoting digital manufacturing, solving production technology issues

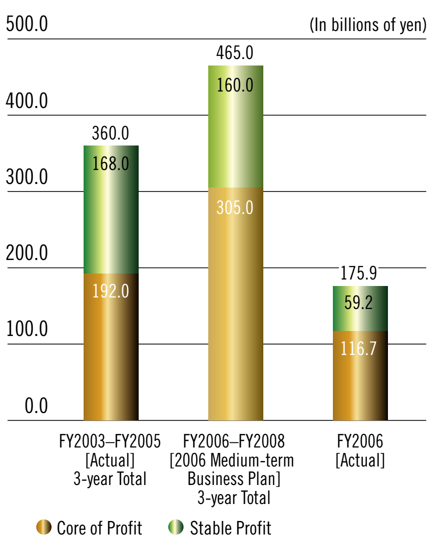
QI-I: Product Reliability Enhancement Program
DE-I: Operating Process Reforms Through Digital Engineering
MD-PJ: Modular Design Project

- **Hiring more people**
- **Shifting human resources to growth businesses**

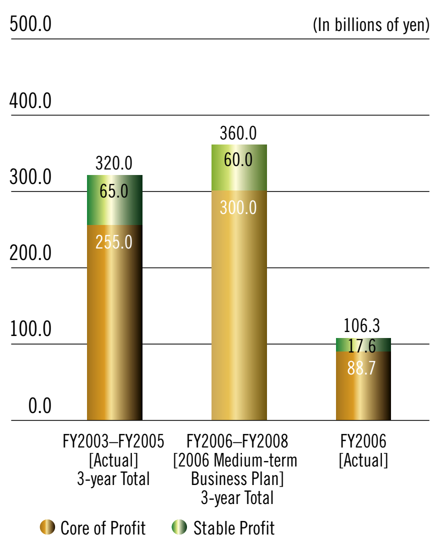
HIRING (NON-CONSOLIDATED)



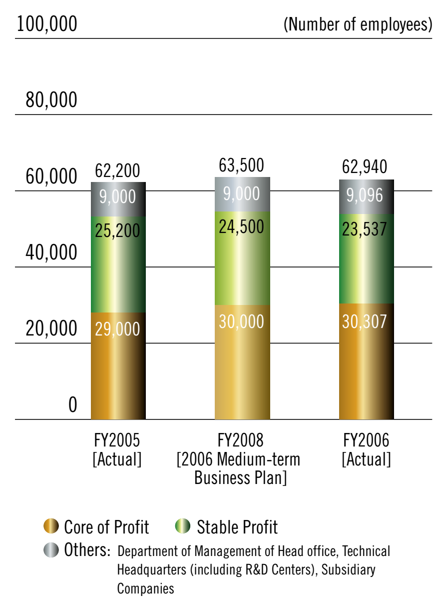
CAPITAL EXPENDITURE



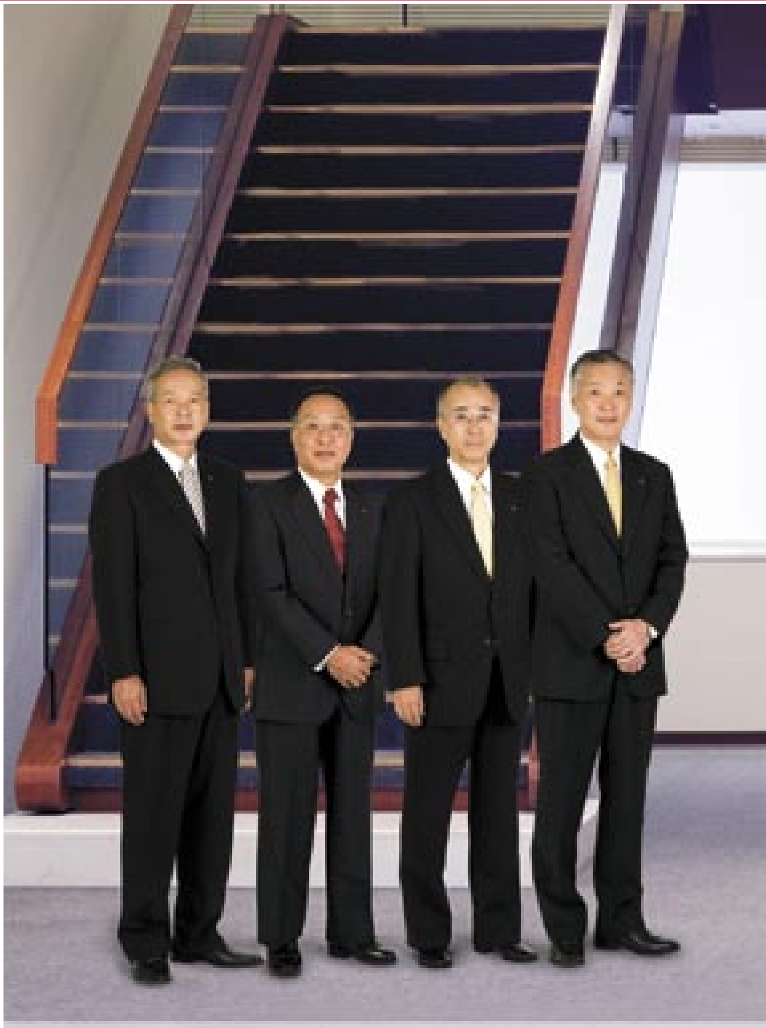
R&D INVESTMENT



NUMBER OF EMPLOYEES



BOARD OF DIRECTORS



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EXTERNAL DIRECTORS

[15] [16] [17]

CHAIRMAN

Takashi Nishioka [1]

PRESIDENT

Kazuo Tsukuda [2]

SENIOR EXECUTIVE VICE PRESIDENTS

Hideo Egawa [3]
Providing assistance to the President.
General Manager, Presidential Administration Office,
also in charge of Internal Audit, Corporate Social Responsibility, General Affairs, Legal, Personnel, Global Strategic Planning & Operations, Air-Conditioning & Refrigeration Systems, Paper & Printing Machinery, Machine Tool and other matters specially assigned by the President

Hideaki Omiya [4]
Providing assistance to the President, also in charge of Production System Innovation
Planning and other matters specially assigned by the President

[5] [3] [1] [2] [4] [6] [8] [10] [12] [14]

EXECUTIVE VICE PRESIDENTS

Yoshimi Uratani [5]
General Manager, Nuclear Energy Systems Headquarters

Tsutomu Takaoka [6]
General Manager, Machinery & Steel Structures Headquarters

Ichiro Fukue [7]
General Manager, Power Systems Headquarters

Nobuo Toda [8]
General Manager, Aerospace Headquarters

Hiroshi Kan [9]
In charge of Accounting, Finance and Material

Sunao Aoki [10]
General Manager, Technical Headquarters, also in charge of Information Systems & Communications

Katsuhiko Yoshida [11]
General Manager, General Machinery & Special Vehicles Headquarters

Shiro Iijima [12]
General Manager, Shipbuilding & Ocean Development Headquarters

SENIOR VICE PRESIDENTS

Fumio Wakisaka [13]
General Manager,
Paper & Printing Machinery Division

Ken Watabe [14]
General Manager,
Machine Tool Division

DIRECTORS

Mikio Sasaki [15]
Chairman of Mitsubishi Corporation

Akihiro Wada [16]
Executive Adviser,
Aisin Seiki Co., Ltd.

Yoshihiro Sakamoto [17]

STATUTORY AUDITORS

Toyohiko Inaguma

Koshin Nakamoto

Satoru Kishi
Senior Adviser,
The Bank of Tokyo-Mitsubishi UFJ, Ltd.

Toyoshi Nakano
Senior Adviser,
Mitsubishi UFJ Trust and Banking Corporation

Kichisaburo Nomura
Executive Adviser,
All Nippon Airways Co., Ltd.

(As of June 27, 2007)

MHI AT A GLANCE

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

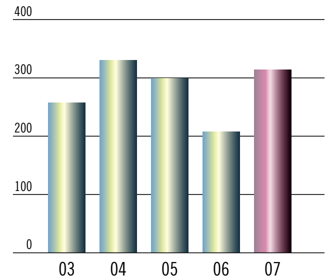
SHARE OF NET SALES

ORDERS RECEIVED

(In billions of yen)

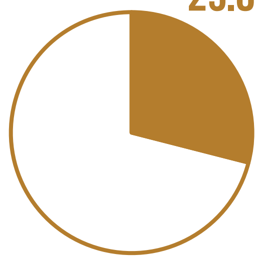
SHIPBUILDING & OCEAN DEVELOPMENT

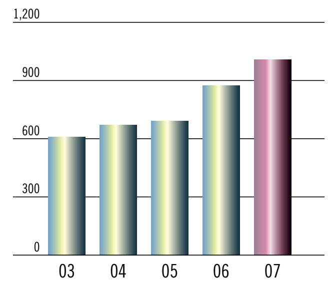
8.1%



POWER SYSTEM

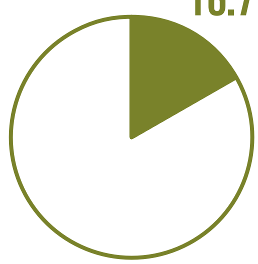
29.0%

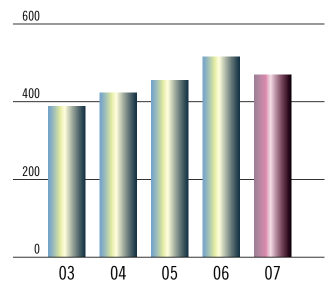




MACHINERY & STEEL STRUCTURES

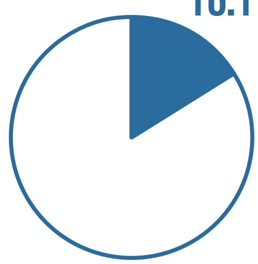
16.7%

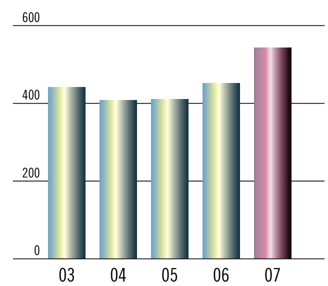




AEROSPACE

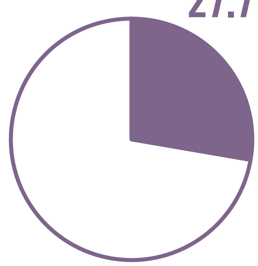
16.1%

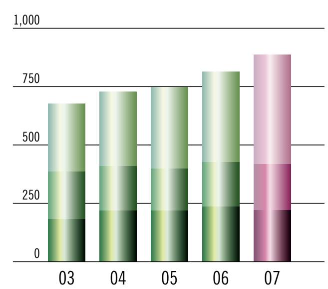




MASS AND MEDIUM-LOT MANUFACTURED MACHINERY

27.7%



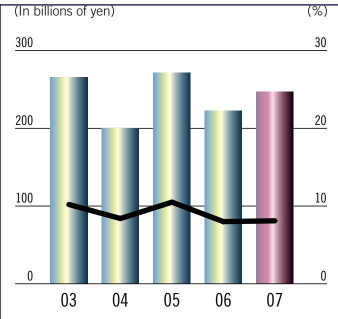


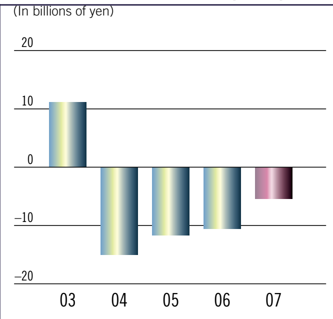
Note: MHI's operations also include an Others segment, not shown above.

General Machinery and Special Vehicles
Air-conditioning and Refrigeration Systems
Industrial Machinery

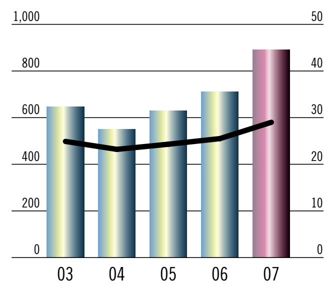
NET SALES/SHARE OF NET SALES

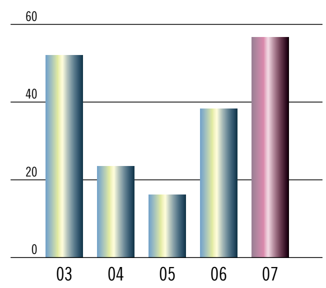
OPERATING INCOME (LOSS)



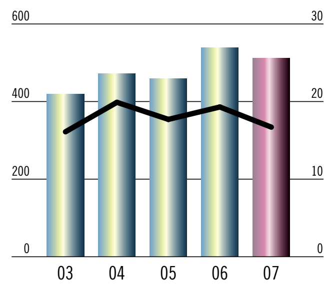


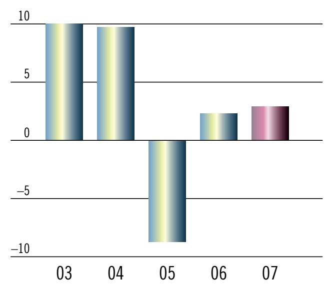
Through its Shipbuilding & Ocean Development segment, MHI plays an extensive role on the world's oceans with the development and construction of a wide range of large vessels and ocean structures that satisfy diverse customer needs. Underpinned by more than a century of tradition and years of technological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



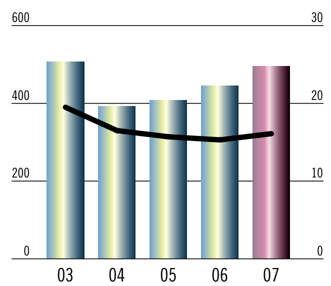


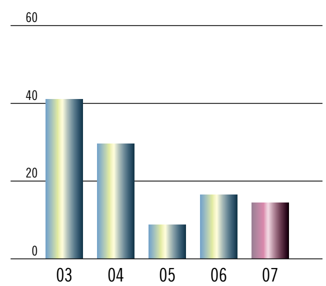
Based on independent research efforts that strike a balance between solving energy supply issues and protecting the environment, MHI's Power Systems segment develops energy conservation measures, petroleum substitutes and new forms of energy to help solve some of the common problems faced by mankind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



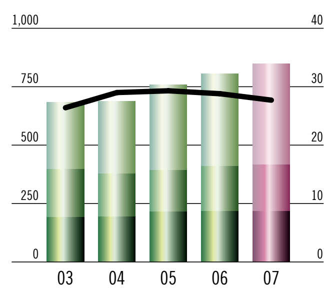


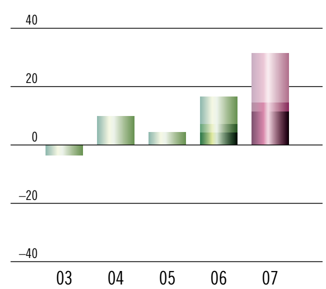
In its Machinery business, MHI boasts an extensive product range in fields as diverse as environmental control systems, chemical plants and transport systems. Through its Steel Structures business, MHI supplies bridges, stacks, hydraulic gates, transportation equipment, tunneling machinery and other products that support industry and are vital to infrastructure in society today. MHI is also moving into new fields such as cultural, sports and leisure facilities.





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.





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. This segment 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. The Industrial Machinery business manufactures extrusion machinery, used in the production of plastic products, beverage filling and packaging machines and other industrial equipment.

General Machinery and Special Vehicles
Air-conditioning and Refrigeration Systems
Industrial Machinery
Share of Net Sales

General Machinery and Special Vehicles
Air-conditioning and Refrigeration Systems
Industrial Machinery

REVIEW OF OPERATIONS

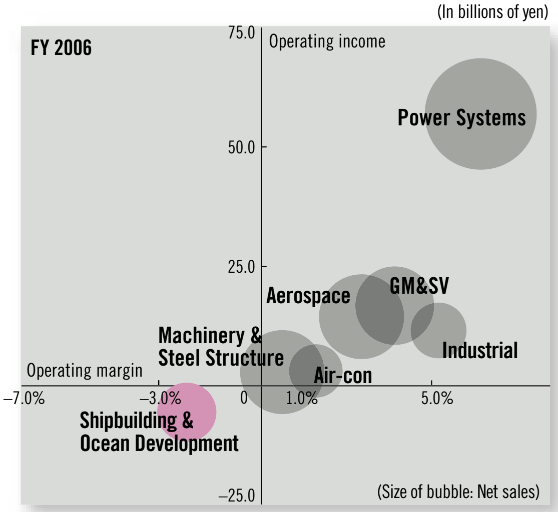
SHIPBUILDING & OCEAN DEVELOPMENT

SHIRO IIJIMA [General Manager, Shipbuilding & Ocean Development Headquarters]

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.

(In billions of yen)



(Size of bubble: Net sales)

Fiscal 2006 Review

Demand for new shipbuilding was at its highest point ever in the industry. Amid these booming market conditions, the segment undertook efforts to win new orders for many different types of vessels, focusing on high-value-added vessels, an MHI specialty. These efforts resulted in orders received for a total of 23 new vessels (all figures in this section exclude vessels of less than 100 gross tons), including five container carriers, six LPG carriers, eight car carries, two LNG carriers, and one submarine ordered by Japan's Ministry of Defense. As a result of the large number of orders, the value of new orders showed a significant increase over the previous year, reaching a total of ¥314.3 billion (US$2,662 million). As of March 31, 2007, MHI had outstanding orders for 61 vessels totaling approximately 3.92 million gross tons.

Due to an increase in the number of ships delivered, net sales also increased over the previous year to ¥247.1 billion (US$2,094 million). As the amount booked for sales reflects the severe conditions that existed for ship prices at the time the conditions were negotiated, and due to other factors such as the impact of surging prices for steel and other materials, the segment reported an operating loss of ¥5.4 billion (US$46 million).

LPG Carrier “BRITISH COURAGE”

Initiatives to Achieve Business Plan Targets (FY 2008)
—Implement manufacturing process reforms to reinforce business base, achieve profitability and then boost earnings—

Accelerate countermeasure for mature and low profitability products

- Centered on vessel types where MHI is a leader, maximize benefits of similar ship/batch order manufacturing and competitive technologies
- Convert design information into a 3D base
- Reform production methods to improve productivity
- Modernize Koyagi Plant of Nagasaki Shipyard & Machinery Works and concentrate large scale investment
  - Introduce 1,200 gantry-type cranes (Nagasaki)
  - Expand production facility of aluminum alloy high-speed vessels, increase capacity of cranes, etc. (Shimonoseki)

Products to support next generation businesses

- Develop efficiency-promoting plant
- Develop fuel efficient ships
- Developed 47kg-class high-tensile strength steel plate for shipbuilding (FY 2006)

LNG Carrier “ARCTIC LADY”

Container Ship “EVER SUPERB”

POWER SYSTEMS

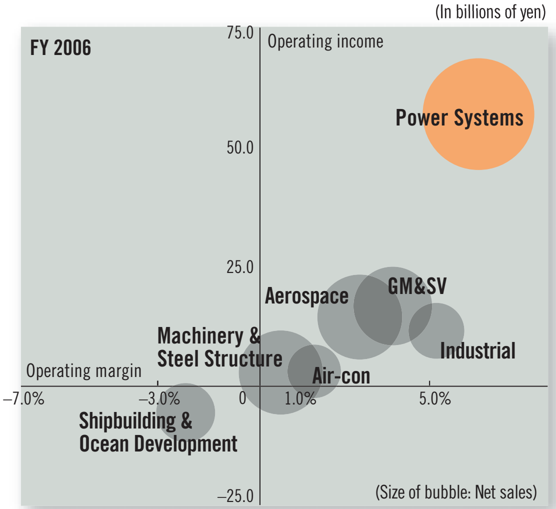
ICHIRO FUKUE [General Manager, Power Systems Headquarters]
YOSHIMI URATANI [General Manager, Nuclear Energy Systems Headquarters]

PRODUCTS

Power Systems
Manufacturing, installation, sale and repair of boilers, steam turbines, gas turbines, diesel engines, water turbines, wind turbines, SCR (DeNOx) system, marine machinery, and desalination plants, etc.

Nuclear Energy Systems
Manufacturing, installation, sale and repair of nuclear power plants and equipment, advanced reactor plants, nuclear fuel cycle plants, nuclear fuel, etc.

(In billions of yen)

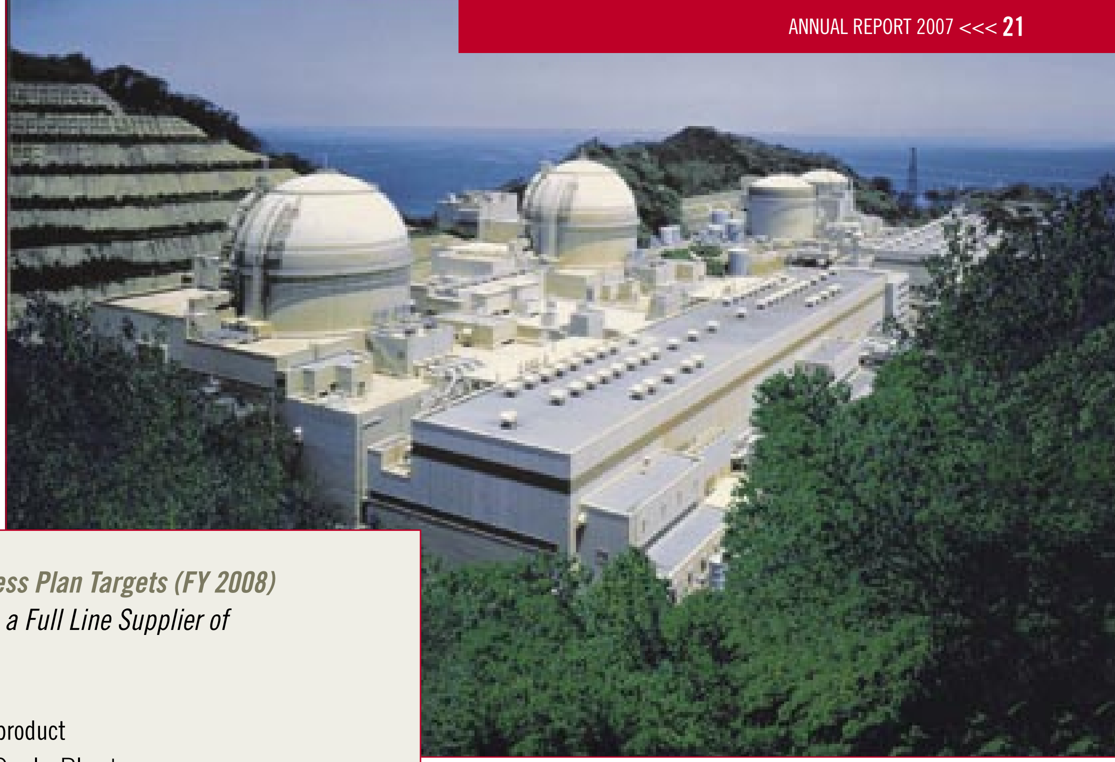


Fiscal 2006 Review

Reflecting increasing interest in power generation using renewable energy sources, the wind turbine market has undergone tremendous growth, resulting in a rapidly rising number of orders received mainly from the United States. This segment also won orders for thermal power plants such as a large-scale power generation and water desalination plant in Saudi Arabia, which followed a similar order received in the previous fiscal year for another project in the country, and gas turbine combined-cycle thermal power plants in Spain, the Ukraine, and Australia.

Domestically, strong capital investment in the private sector was the driving force behind the increase in orders received for industrial boilers and nuclear power-related equipment. As a result, the total value of new orders was ¥1,008.3 billion (US$8,541 million), an increase over the previous year.

Due to such factors as the increase in sales of overseas thermal power plants, net sales increased over the previous year to ¥890.8 billion (US$7,546 million). Operating income also increased over the previous year to ¥56.8 billion (US$481 million).



Ohi Nuclear Power Plant of Kansai Electric Power Inc.

Initiatives to Achieve Business Plan Targets (FY 2008)
—Surge Forward Globally as a Full Line Supplier of Power Generation Plants—

Strengthen and expand growth product

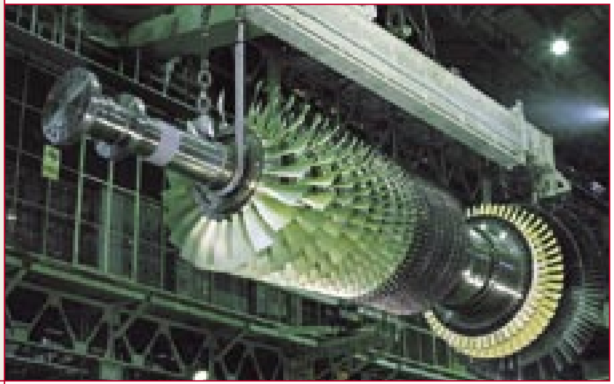
- Gas Turbine Combined Cycle Plant
  - Capture Asian and China markets, expand market share
  - Build a global production network
- Nuclear Power
  - Win more orders for the US-APWR, a large-capacity strategic reactor for the U.S. market
  - Launch medium-capacity strategic global reactor currently under joint development with AREVA
  - Increase preventative maintenance projects to ensure consistent safe operation of existing plants

Products to support next generation businesses

- Renewable Energy
  - Wind turbine: Expand sales in the U.S. and enhance production capacity
  - Solar power generation: Expand sales of new product (amorphous/micro crystalline tandem type) in Europe
- IGCC: Complete construction of demonstration equipment (FY 2007): Complete verification testing (FY 2009)
- FBR: Drive forward development of FBRs as a core company in the field

US-APWR: 1.7 GW new-type PWR
IGCC: Integrated Coal Gasification Combined Cycle
FBR: Fast Breeder Reactor

Buena Vista Project Wind Turbine Plants (U.S.A.)



M501G Gas Turbine

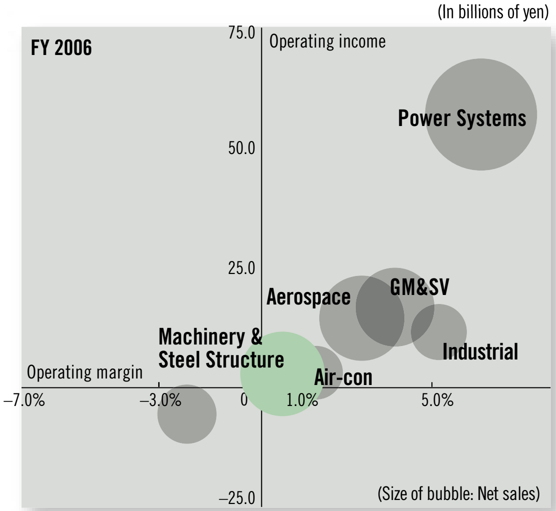
MACHINERY & STEEL STRUCTURES

TSUTOMU TAKAOKA [General Manager, Machinery & Steel Structures Headquarters]

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.

(In billions of yen)



(Size of bubble: Net sales)

Fiscal 2006 Review

Demand for overseas plant construction has been increasing, particularly in the Middle East and Southeast Asia, resulting in an increase in orders received for Compressor & Mechanical Drive Turbines for plants in these regions. However, orders decreased for transportation systems and chemical plants, which were the focus of negotiations in the previous fiscal year. Domestically, although strong capital investment in the private sector helped boost orders received for chemical plants and rubber and tire machinery, orders received for stacks and other steel structure products decreased. As a result, the total value of new orders was ¥469.0 billion (US$3,973 million) for the segment overall, a decrease compared with the previous year.

Compared with the previous year, which saw sales for a number of large-scale projects, net sales decreased slightly to ¥511.7 billion (US$4,335 million). However, operating income increased over the previous year to ¥2.9 billion (US$25 million).

APM "CRYSTAL MOVER"

Initiatives to Achieve Business Plan Targets (FY 2008)
—Boost earnings capabilities in four key businesses and implement initiatives in low-profitability businesses—

Strengthen and expand growth product

- Accelerate overseas business of traffic systems and strengthen core technologies (APM, etc.)
- Chemical plant: Pursue areas of strength (petrochemical, gas)
- Steel production equipment: Expand business in downstream production facilities areas
- Heavy-duty compressor: Start up new production capacity, expand the business of the gas areas

Products to support next generation businesses

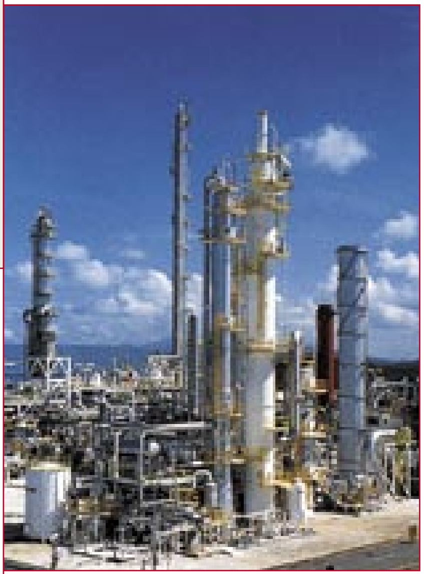
- Environmental area: Commercialize CO_2 recovery, biomass power generation
- Automobile-related system: ETC, servomotors
- New business field: Medical equipment

Accelerate countermeasure for mature and low profitability products

- Implement initiatives for steel bridges, existing environmental products and small and medium-size products
  - Strengthen competitiveness through incorporation of specialized companies

APM: Automatic People Mover
ETC: Electric Toll Collection
PCVD: Plasma Chemical Vapor Deposition

On Board Equipment for ETC System "MOBE-400"



Flue Gas CO_2 Recovery Plants

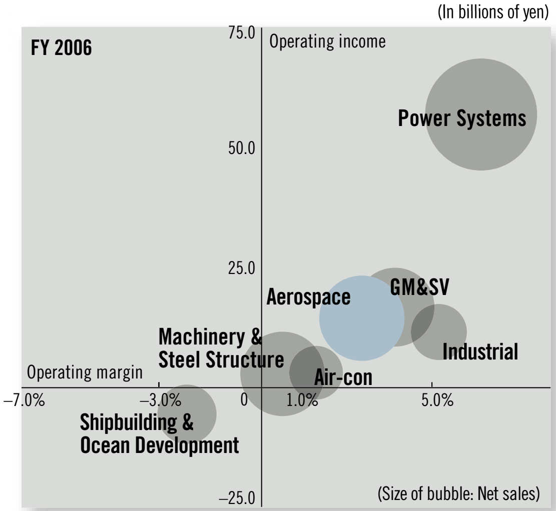
AEROSPACE

NOBUO TODA [General Manager, Aerospace Headquarters]

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.

(In billions of yen)



Fiscal 2006 Review

As demand remained strong for commercial aircraft, the segment secured a year-on-year increase in orders received for aft fuselage and other components for the Boeing 777, as well as for engine and other parts. Although orders for some defense-related products, such as patrol helicopters, declined, the high priority given to deployment of Japan's Ballistic Missile Defense (BMD) system led to increased orders for guided missiles such as the Patriot surface-to-air missiles (PAC-3 missiles). This resulted in a stronger performance by the segment in defense-related products compared to a year earlier. Contracts related to development and production projects such as the H-II Transfer Vehicle (HTV) for the International Space Station also increased, resulting in an increase in orders in space systems over the previous year. As a result, the value of new orders was ¥543.4 billion (US$4,603 million) for the segment overall, an increase over the previous year.

Due to increases achieved in commercial transport aircraft and other businesses, net sales increased over the previous year to ¥495.0 billion (US$4,193 million). Reflecting such factors as the rise in research and development costs, operating income declined to ¥14.4 billion (US$122 million).

Boeing 787 Transport Aircraft (international collaboration)

Initiatives to Achieve Business Plan Targets (FY 2008)
—Establish Global Position as Global Player in New Development Projects—

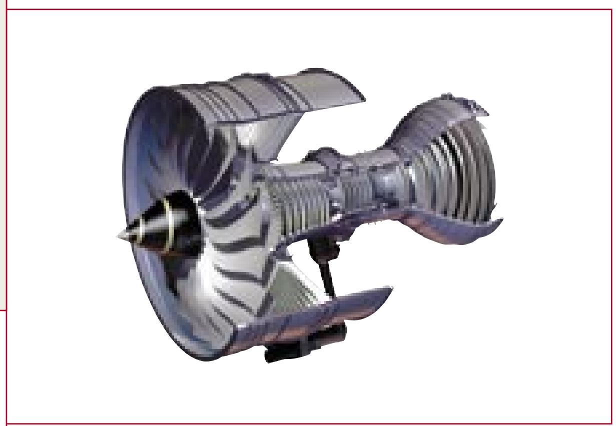
Strengthen and expand growth product

- Accelerated, full-scale production of the next generation airliner Boeing 787
  - Establish position as the world's composite material main wing center
  - Promotion and smooth transition to mass production of composite material main wing and engine development (May 2007, first composite wing boxes shipped; Jan. 2008, new plant to produce engine components scheduled to come on stream)
- Establish expanded capacity in existing main businesses (Boeing 777, others)
- Begin licensed domestic production of the PAC-3 missile, the core of BMD

Products to support next generation businesses

- Promote joint Japan US development of next generation BMD
- Participation in FX program and support to joint operations of Ministry of Defense
- Promote H-II A privatization and development of H-II B (Proposal for joint commercial satellite launch service in conjunction with Arianespace)
- Examine potential for commercializing Mitsubishi Regional Jet (MRJ)
  (Cabin mockup exhibited at International Paris Airshow)

SH-60K Maritime Patrol Helicopter



Trent 1000 Turbofan Engine (international collaboration)

MASS AND MEDIUM-LOT MANUFACTURED MACHINERY

(from left)

KATSUHIKO YOSHIDA
[General Manager, General Machinery & Special Vehicle Headquarters]

KIYONOBU TOMA
[General Manager, Air-conditioning & Refrigeration Systems Headquarters]

FUMIO WAKISAKA
[General Manager, Paper & Printing Machinery Division]

KEN WATABE
[General Manager, Machine Tool Division]

PRODUCTS

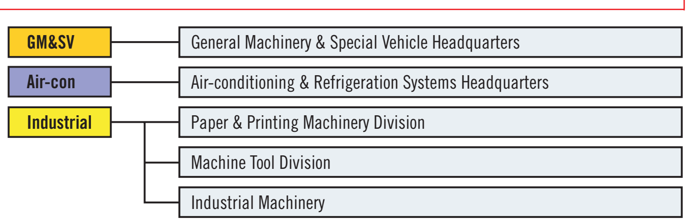
GM&SV
Manufacturing, installation, sale and repair of forklift trucks, construction machinery, earthmoving and grading machinery, medium and small sized engines, turbochargers, agricultural machinery, tractors, special vehicles, etc.

Air-con
Air-conditioners (commercial use, residential), automotive thermal systems, chilling systems, etc.

Paper & Printing Machinery
Pulp and paper machinery, paper converting machinery and printing machinery.

Machine Tool
Large machine tools, gear cutting machinery, precision cutting tools, engine valves, power transmissions, etc.

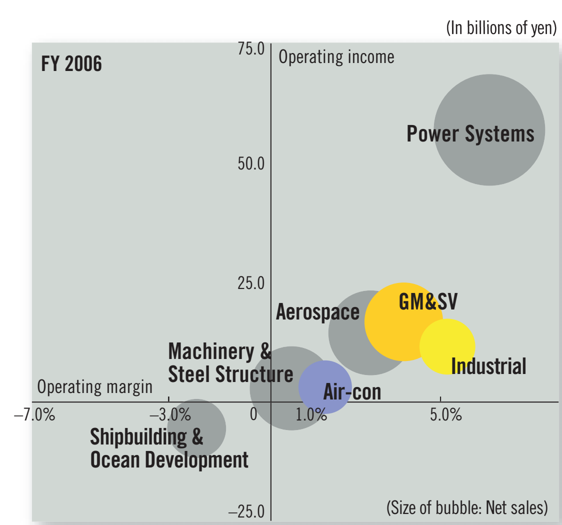
* GM&SV: General Machinery & Special Vehicle
Air-con: Air-conditioning and Refrigeration System
Industrial: Industrial Machinery



Fiscal 2006 Review

The General Machinery & Special Vehicles business recorded continued growth in orders received for small and medium-size engines for industrial use from customers in North America and Europe, where the markets remain strong. This, together with growing demand for forklifts, primarily overseas, and an increase in orders for turbochargers, primarily in Europe where stricter exhaust emission regulations are driving demand, led to increases over the previous year in both the value of new orders and net sales, to ¥437.5 billion (US$3,706 million) and ¥431.1 billion (US$3,652 million), respectively. Operating income was ¥16.7 billion (US$142 million).

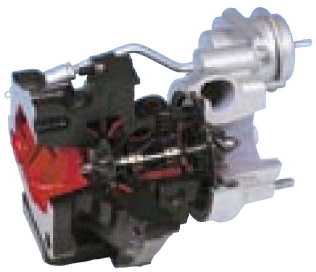
In the Air-conditioning & Refrigeration Systems business, we made efforts to promote sales through such means as strengthening the overseas sales network, resulting in increased sales of commercial use air-conditioners and residential



use air-conditioners mainly in the European market. Domestically, strong capital investment was reflected in the increase in sales of centrifugal liquid chillers particularly to IT-related companies, while sales of automotive thermal systems saw robust growth. As a result, the business overall recorded increases over the previous year in both the value of new orders and net sales, to ¥197.4 billion (US$1,672 million) and ¥198.5 billion (US$1,682 million), respectively. Operating income was ¥3.2 billion (US$27 million).

In the Industrial Machinery business, orders received increased for paper converting machinery, primarily from North America. Orders received also rose for machine tools, mainly from automotive industry. However, a decline in such areas as orders from China for sheet-fed offset presses and orders for newspaper offset presses, which achieved better-than-usual sales during the previous year, resulted in decreases compared with the previous year in both the value of new orders and net sales to ¥221.8 billion (US$1,879 million) and ¥219.4 billion (US$1,858 million), respectively. Operating income was ¥11.5 billion (US$97 million).

Miller Cycle Gas Co-generation Systems (GS12R)



Automotive Turbocharger

Marine Diesel Engine S6RG-MTK

Packaged air-conditioners for shops & offices “FDTVA Series”

Residential air-conditioners “SRK Series”

Initiatives to Achieve Business Plan Targets (FY 2008)

General Machinery & Special Vehicle

–Develop Environmental and Energy Conservation Technologies and Accelerate Global Business Development–

Strengthen and expand growth product

- Engine:
  - Expand global business opportunities through development of emission standards compliant engines
  - Develop and expand Energy Management Service business overseas
- Turbocharger:
  - Expand business centering on small turbochargers for passenger cars
  - Introduce new highly efficient, emission standards compatible products
  - Overseas production expansion in response to increasing demand

Products to support next generation businesses

- Forklift:
  - Developing a new business model (Proposal-based business, after sales business, etc.)
  - Establish optimal procurement and production structure through a global supply chain

Air-conditioning and Refrigeration Systems

—Ensure Stable Profits Through Expanded Overseas Production and High-End Product Introductions—

Strengthen and expand growth product

- Car Air-conditioners:
  - Establish a supply structure to respond to automobile manufacturer globalization
  - Development of new high-end products (new compressor types) and market introduction

Products to support next generation businesses

- Residential Air-conditioners/Packaged Air-conditioners:
  - Develop and introduce world standard equipment tailored to market characteristics
- Large-size Freezers, Refrigerator Vehicles:
  - Maintain market share through introduction of energy saving and environmentally friendly models

Accelerate countermeasure for mature and low profitability products

- Packaged Air-conditioners:
  - Expand overseas production (Thailand, China)
  - Expand European and China marketing network

Industrial Machinery

—Expand Revenues through a Concentration of Management Resources in Areas of Strength—

Strengthen and expand growth product

- Machine Tool:
  - Strengthen gear cutting machinery, large machine and specialty machine products mainly for the automobile industry
  - Improve productivity and expand production capacity through active capital expenditures

Products to support next generation businesses

- Printing Equipment
  - Business expansion through new product introductions (Sheet feed presses, etc.)
  - Increase market share through local production overseas (China)

Accelerate countermeasure for mature and low profitability products

- Injection modeling, food packaging and commercial washing machines
  - Recover profitability through incorporation of specialized companies

INTELLECTUAL PROPERTY AND R&D

Intellectual Property: An Integrated Approach Linking Business Activities and R&D

MHI's intellectual property activities are an integral part of its business and R&D strategies.

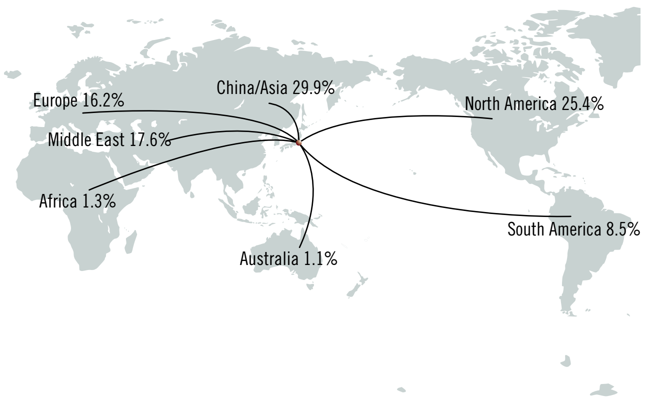
MHI has established a team made up of members from its business divisions (sales and design personnel), and R&D and intellectual property departments for each core, mainstay and new product line. By sharing information from a wide variety of sources—business plans, business schemes, product development, R&D policy, technology roadmaps, and analysis of R&D trends and patents at both MHI and other companies—the team works to formulate an optimal intellectual property strategy.

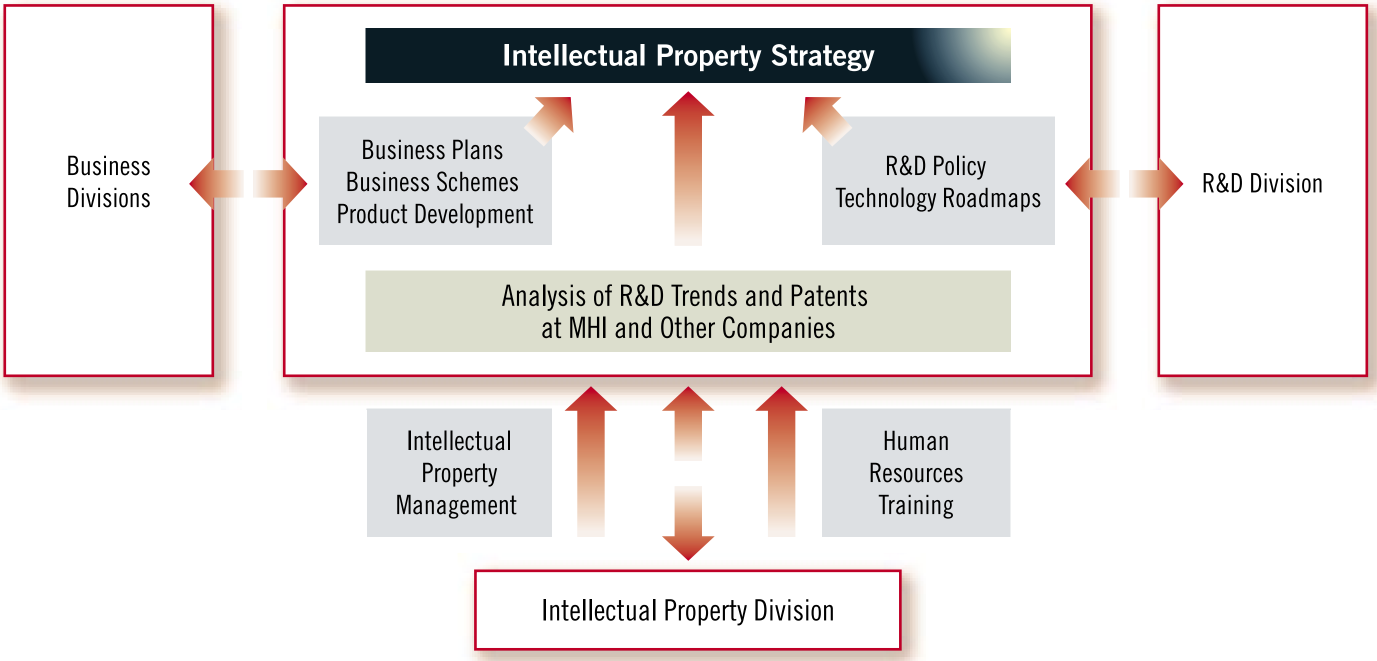
To promote activities in line with this strategy, the Intellectual Property Division develops effective and efficient business processes, takes steps to manage intellectual property appropriately, and develops highly specialized and skilled personnel.

Guided by MHI's fundamental business strategy of adopting a more international approach in its operations, and the basic R&D strategy of ensuring MHI remains successful in the face of ever-intensifying competition worldwide, the Intellectual Property Division is shifting the focus of patent acquisition from the domestic market to a more aggressive global approach.

Global Strategy

* Figures are ratios of net sales by region.
(Overseas sales of FY 2006: 1,463 billion yen)





Intellectual Property Support Framework

MHI conducts product development and R&D based on close cooperation between business divisions and in each of the Company's five business segments and its five R&D centers. In addition, the Advanced Technology Research Center (ATRC) carries out application-oriented research into advanced technologies that have significant impacts on our business. In the course of research, business headquarters and departments, intellectual property departments in each business office and R&D center, and the Intellectual Property Division itself, work closely with each other, thereby ensuring an approach that integrates business, R&D and intellectual property strategies.

MHI's Intellectual Property Activities

Policy

MHI's priority aim in acquiring patents is to protect its technology assets and competitiveness. Accordingly, we take every possible step to apply for and acquire patents for technologies we have developed that will be used in MHI products. Although this is partly to protect our technology assets from copying by other companies, our main aim here is to ensure our customers can use MHI products with peace of mind.

Against the backdrop of fierce competition in new technology development between companies worldwide, our integrated approach to intellectual property activities is based on two key principles—protect the results of R&D with patents, and promote manufacturing protected by patents.

Management of Assets

MHI formulated operational standards for intellectual property around 40 years ago. Based on these standards, we have been able to conduct intellectual property activities efficiently as common business processes. In order to match the needs of the time such as revisions to laws and regulations, we have continually updated or eliminated sections of these standards. For example, in April 2007, based on our integrated approach to business, R&D and intellectual property strategies, we revised the section on appraisal of inventions to include the evaluation of the invention's impact on all three of these areas.

Our operational standards for intellectual property are mainly concerned with procedures for patent application (from application to acquisition). In October 1998, we moved to an electronic system for domestic patent applications to improve the efficiency of business processes and reduce the use of paper documents. This step was also designed to promote greater information sharing with business and R&D divisions. A similar move for overseas patent applications was delayed because the volume of information handled is large compared to domestic applications. However, as the capabilities and processing power of IT equipment improved, we decided to begin working on an electronic system for overseas patents in 2005. The completed system was launched in April 2006.

This new electronic system for overseas patent applications is groundbreaking because it integrates all data related to the application, including patent offices that handled our patent applications. Very few similar systems exist in Japan or worldwide.

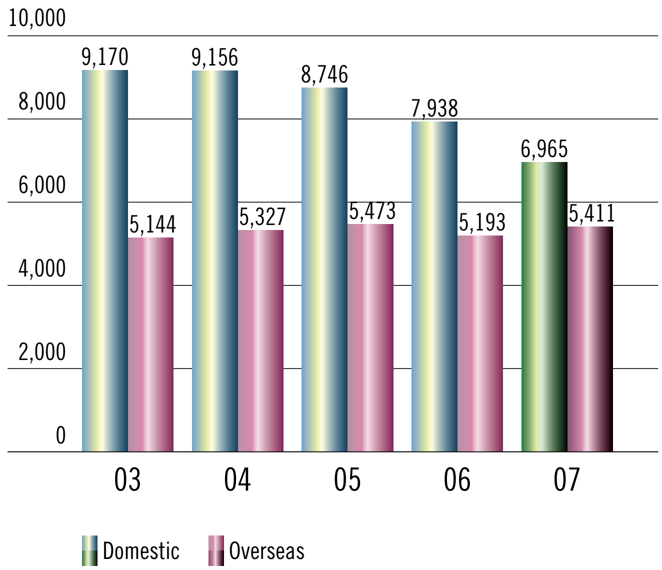
We are also reviewing other systems. For example, with our technology contract management system, which manages a whole host of information related to joint R&D and patent application contracts such as data about the organizations MHI has signed intellectual property contracts with, relevant internal departments, and contract periods, we are taking steps to make the system more watertight. Specifically, we are establishing searchable databases of our patent rights and obligations to other organizations, and linking details of joint R&D projects with products that come under the scope of the research. In this way, we are ensuring we meet our patent obligations to other rights holders and clearly separate information held by others groups and MHI.

In terms of training and utilizing personnel, we are working to boost skill levels of individuals, and therefore all intellectual property departments, by helping our staff acquire the specialist knowledge they need. Examples of this include encouraging participation in domestic and international seminars on intellectual property and systematically rotating employees internally between intellectual property departments and R&D centers. MHI also outsources routine administrative processes related to intellectual property to affiliated companies to allow personnel in the Intellectual Property Division to focus on core activities.

MHI product lines are typically covered by multiple patents because they incorporate numerous technologies. Consequently, it is vulnerable to be involved in disputes with competitors on patents. At MHI, we believe the biggest risk we face in terms of intellectual property is infringement of patents held by other companies. We therefore carry out exhaustive checks of existing patents during the basic product planning, design and manufacturing phases to prevent any possible infringement. In preparation for the possibility that a company issues a patent infringement warning to MHI, we have formulated and upgraded a procedural manual to ensure rapid and appropriate responses in the event of a dispute.

MHI also sees the leak of critical technical data as a major risk. For this reason, we also protect important know-how incorporated in our inventions using means specific to safeguarding expertise, rather than through patents. Based on criteria included in our operational standards for intellectual property, we strictly manage any information judged to require high levels of security.

NO. OF DOMESTIC AND OVERSEAS PATENTS



Research & Development Activities

Through close cooperation between business offices and R&D centers, the MHI Group is working to reinforce its R&D activities to enhance product competitiveness in the shipbuilding & ocean development, power systems, aerospace and other business fields, and drive business expansion. MHI is also using its R&D programs to actively tackle environmental, resource and energy issues.

Shipbuilding & Ocean Development

In this segment, our goal is to improve the performance and reliability of ships and ocean structures. R&D activities cover a wide range of areas—technologies related to the fluid-dynamic technology to improve ship propulsion; technologies that increase structural strength; vibration- and noise-reduction technologies; and technologies that reduce environmental impact. All of these efforts are channeled into developing a variety of ships and other products, including large-scale vessels such as liquefied natural gas (LNG) and liquefied petroleum gas (LPG) carriers and container vessels, which are responsible for the stable transport of goods on a global scale, passenger ships and deep-sea drilling vessels, which make major contributions to our understanding of the oceans.

Power Systems

Aiming to develop pioneering technologies that realize stable energy supplies, protect the environment and achieve greater efficiency, this segment conducts R&D into clean fuel and renewable energy technologies, distributed power systems and high-efficiency generation systems in an effort to meet market needs covering upstream to downstream energy sectors.

Machinery & Steel Structures

R&D in this segment is focused on the development of technologies and products that enable MHI to supply high-added-value products and social infrastructure. These products and infrastructure help prevent global warming and protect the environment, enable land transport and logistics, and support the supply of basic materials and energy to the steel, chemical and other industries.

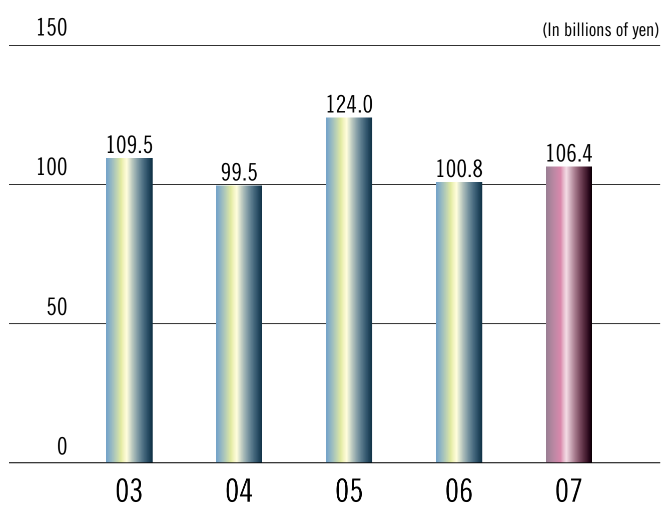
Aerospace

As Japan's leading company in the aerospace sector, MHI develops cutting-edge products leveraging its years of experience in the development of aircraft and aerospace equipment.

Mass and Medium-lot Manufactured Machinery

This segment is involved in the development of technologies related to a wide-range of products that support today's industrial infrastructure. In addition to cutting-edge technologies unique to the products in this segment, MHI also draws on and applies the latest and most advanced pioneering technologies from its extensive product lines in other segments in product development.

R&D INVESTMENT



* Includes expenses related to R&D under contract.

CORPORATE GOVERNANCE

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.

Corporate Governance Initiatives

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, three 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. Subsequently, in June 2007, MHI appointed an additional outside director to make the decision-making process more sound and transparent.

MHI has concluded liability limitation contracts with each of its outside directors and outside auditors based on Article 423, Paragraph 1 of the Corporate Law. The limit of liability pursuant to these contracts is ¥10 million or the statutory minimum liability limit stipulated in Article 425, Paragraph 1 of the Corporate Law, whichever is higher.

Enhancing Internal Control Systems

In accordance with the Corporate Law and the Enforcement Regulations of the Corporate Law, the Board of Directors has approved resolutions to create systems that ensure business operations are conducted in an appropriate manner. Details of these resolutions 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

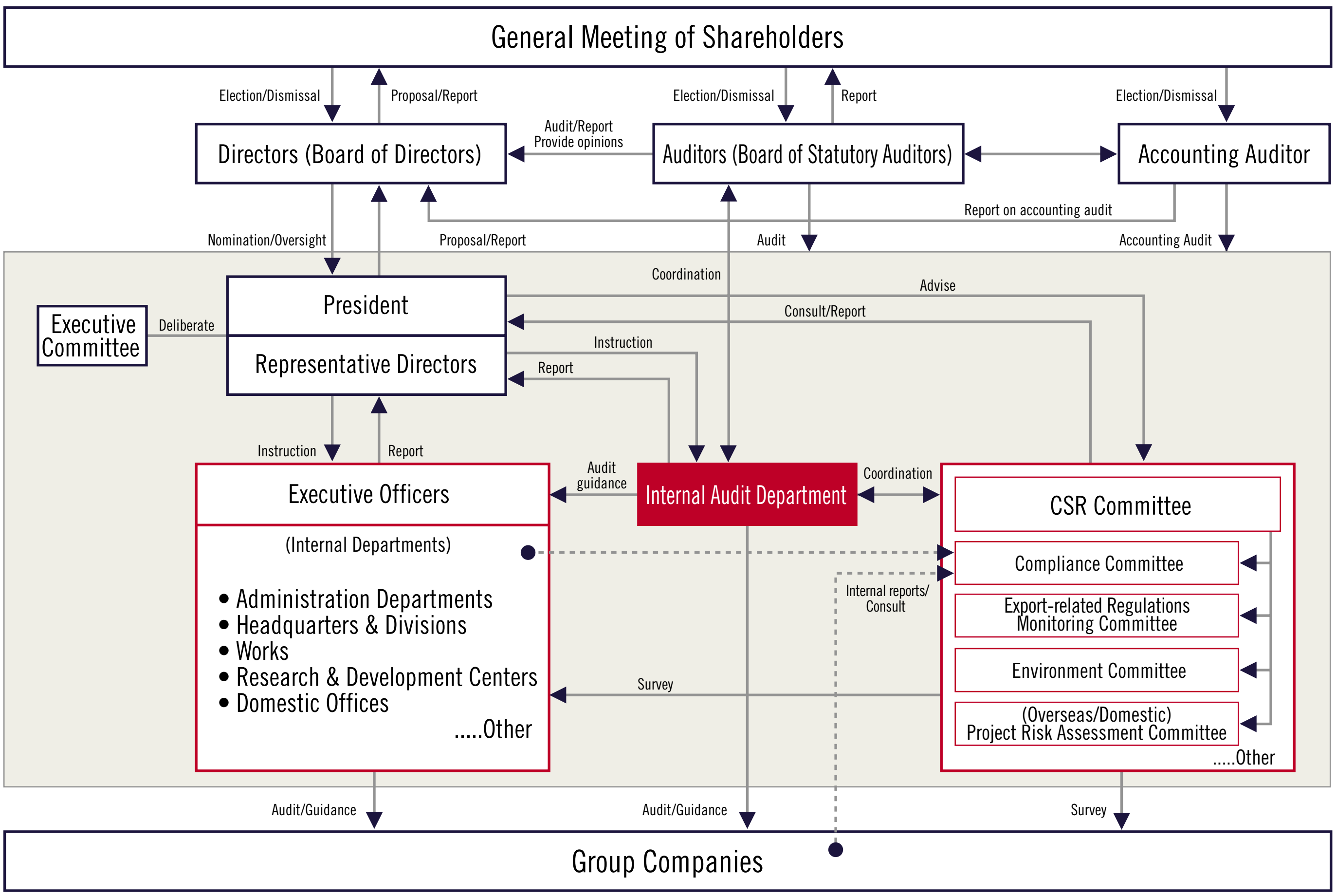
(i) To ensure independence from the executive bodies of the Company, Auditing Office staff shall not be subject to the orders of directors, and the appointment, transfer and evaluation of these employees shall be conducted with the agreement of the statutory auditors.

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.



Internal Audits and Statutory Auditors

The Company conducts internal audits to check the effectiveness of internal control systems. For each fiscal year, the Internal Audit Department, the Company's dedicated internal audit organization, formulates an internal audit policy and instructs each of MHI's departments 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 35.

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, Katsuhiko Hizawa, and Ichiro Ishii. 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 seven other certified public accountants and seven assistant accountants.

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.

Director and Statutory Auditor Remuneration and Audit Fees

Director and Statutory Auditor Remuneration

Position	No. of recipients	Total compensation (millions of yen)
Directors	17	867
(Of which, outside)	(2)	(21)
Auditors	5	118
(Of which, outside)	(3)	(32)
Total	22	985
(Of which, outside)	(5)	(54)

Notes: 1. In accordance with resolutions approved at the 81st annual general meeting of shareholders and a meeting of the Board of Directors on July 31, 2006, the Company has issued stock options to 15 directors, excluding outside directors, worth a total of ¥212 million at the time of allocation.

2. In accordance with a resolution approved at the 81st annual general meeting of shareholders, the Company paid retirement allowances totaling ¥276 million to three directors retiring at the close of the meeting. In addition, the Company will pay amounts totaling ¥1,396 million and ¥93 million to 14 directors and five auditors, respectively, at the time of their retirement as final payments associated with the termination of the retirement allowance system.

Audit Fees

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

Fees related to audit certification ¥80 million

Note: The above amount represents fees paid to Ernst & Young ShinNihon for audit certification pursuant to the Corporate Law 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 ¥184 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

Based on the "Three Corporate Principles" shared by all Mitsubishi Group companies, as well as MHI's own company creed formulated in line with these principles in 1970, we pledge to make useful contributions to society through our business activities, and aim to conduct all corporate activities in good faith. This is the basic spirit that defines corporate management at MHI. 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 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, under-going continuous development while always seeking harmony between economic activities and the global environment.

Meeting the Demands of Society—With Pride and Responsibility as a Manufacturer

Based on the demands of society, MHI is tackling directly the issue of how to fulfill its responsibilities as a company engaged in manufacturing as its core activity. MHI is one of the few companies that can help resolve the issue of global warming through its products and businesses on a worldwide scale. For example, in the thermal power plant field, the Company is developing and supplying high-efficiency turbines, and helping to reduce emissions of CO_2 by enhancing combustion efficiency. These efforts are also contributing to the conservation of hydrocarbon resources such as oil and coal. Meanwhile, in natural and renewable energy fields, we are developing technologies and products that enable the effective use of solar, wind, geothermal and biomass resources. In addition to promoting the uptake of renewable energy systems, we also supply technologies worldwide that recover CO_2 from emissions. In recent years, nuclear power has been attracting renewed attention as a means of power generation that does not emit CO_2 during the generating process. Consequently, a number of countries around the world are expanding their nuclear power plant construction programs. Aware that products for these plants must be highly reliable, we constantly put top priority on reliability in the manufacture and supply of nuclear power plant equipment.

Launch vehicles are another product where reliability is paramount to support successful launches every time. To ensure MHI also fulfills its mission in the extreme environment of space, we conduct strict quality control for every single component supplied for launch vehicles, which are immensely complex systems, based on a strong sense of responsibility right up to when the launch vehicle actually lifts off.

At MHI, we believe our mission to society is to keep supplying technologies and products that support the sustainable development of the global community well into the future.

CSR Committee Established to Drive Forward Strategic and Comprehensive CSR Activities

In October 2006, in order to more clearly define our focus on CSR in management and business activities, we established a CSR Committee, chaired by the President, and a CSR Promotion Office, controlled directly by the President, to oversee CSR policy in all aspects of our operations. MHI now has a framework to actively implement CSR initiatives.

Based on the principle of CSR at the core of management, and aiming to ensure the MHI Group is respected and trusted by the public by meeting the demands of society, the CSR Committee formulated a set of CSR Action Guidelines in July 2007. These guidelines are designed to promote a shared commitment to CSR principles among MHI Group employees during their business activities. The CSR Committee is working to promote greater understanding and awareness of these guidelines, and in parallel, based on these guidelines, enhance the Group's CSR activities. The committee will do this by implementing CSR initiatives, following up on their outcomes, and identifying issues that still need to be resolved.

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

Overseas Activities

Endowed Course at Hanoi University of Technology, Vietnam

UNESCO, a specialized UN agency that conducts activities aimed at realizing world peace, runs a program called UNISPER with partners in both the public and private sectors. The program is designed to provide financial and technical support for engineering studies and industrial technology in developing countries.

MHI has signed up to the principles of the program, and since 1998 has sponsored an endowed course at Hanoi University of Technology in Vietnam.

One of the course's lectures

MHIA 1% Club Activities

Mitsubishi Heavy Industries America, Inc., headquartered in New York and operating a range of businesses through 17 sites in the U.S., works to give something back to society with its MHIA 1% Club Activities, whereby it donates 1% of pre-tax earnings through charitable activities. The company also makes donations mainly to educational bodies and cultural and artistic sites such as Carnegie Hall.

FINANCIAL SECTION

CONTENTS

SEGMENT INFORMATION

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2007 and 2006

	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	**2007**	2006	**2007**	**2007**	2006	**2007**
Shipbuilding & Ocean Development	**¥ 247,138**	¥ 222,651	**$ 2,093,501**	**¥ (5,385)**	¥ (10,608)	**$ (45,616)**
Power Systems	**890,782**	710,966	**7,545,807**	**56,761**	38,343	**480,820**
Machinery & Steel Structures	**511,693**	538,758	**4,334,541**	**2,921**	2,333	**24,747**
Aerospace	**495,009**	445,942	**4,193,213**	**14,431**	16,507	**122,244**
Mass and Medium-Lot Manufactured Machinery	**849,050**	805,058	**7,192,291**	**31,363**	16,756	**265,676**
Others	**135,782**	129,119	**1,150,208**	**8,821**	7,582	**74,723**
Subtotal	**3,129,454**	2,852,494	**26,509,561**	**108,912**	70,913	**922,594**
Eliminations or Corporate	**(60,949)**	(60,385)	**(516,297)**	**–**	–	**–**
Total	**¥3,068,505**	¥2,792,109	**$25,993,264**	**¥108,912**	¥ 70,913	**$922,594**

	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	**2007**	2006	**2007**	**2007**	2006	**2007**
Shipbuilding & Ocean Development	**¥ 225,139**	¥ 234,674	**$ 1,907,152**	**¥ 6,006**	¥ 5,744	**$ 50,874**
Power Systems	**887,065**	778,085	**7,514,320**	**23,260**	23,142	**197,033**
Machinery & Steel Structures	**557,766**	567,362	**4,724,826**	**8,557**	8,906	**72,489**
Aerospace	**863,316**	697,210	**7,313,137**	**22,739**	18,191	**192,620**
Mass and Medium-Lot Manufactured Machinery	**845,751**	805,884	**7,164,347**	**28,492**	26,947	**241,354**
Others	**216,008**	226,098	**1,829,801**	**17,666**	17,880	**149,652**
Subtotal	**3,595,045**	3,309,313	**30,453,583**	**106,720**	100,810	**904,022**
Eliminations or Corporate	**796,820**	737,809	**6,749,844**	**–**	–	**–**
Total	**¥4,391,865**	¥4,047,122	**$37,203,427**	**¥106,720**	¥100,810	**$904,022**

	Capital Expenditures		
	In millions of yen		In thousands of U.S. dollars
INDUSTRY SEGMENT	**2007**	2006	**2007**
Shipbuilding & Ocean Development	**¥ 6,399**	¥ 5,960	**$ 54,204**
Power Systems	**40,050**	21,852	**339,261**
Machinery & Steel Structures	**9,343**	12,805	**79,141**
Aerospace	**56,846**	42,225	**481,541**
Mass and Medium-Lot Manufactured Machinery	**34,369**	33,537	**291,143**
Others	**28,963**	24,191	**245,345**
Subtotal	**175,970**	140,570	**1,490,635**
Eliminations or Corporate	**–**	–	**–**
Total	**¥ 175,970**	¥ 140,570	**$ 1,490,635**

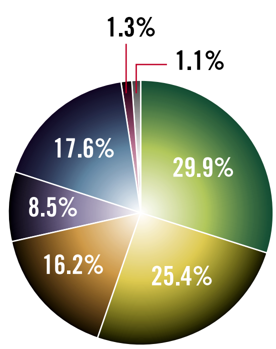
	In millions of yen		In thousands of U.S. dollars
OVERSEAS SALES	**2007**	2006	**2007**
Overseas Sales	**¥1,462,647**	¥1,225,989	**$12,390,062**
Ratio to Total Net Sales	**47.7%**	43.9%	

Notes: 1. U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥118.05=US$1, the exchange rate prevailing at March 31, 2007.
2. The accompanying consolidated financial statements for the years ended March 31, 2007 and 2006 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
	2007	2006	**2007**	**2007**	2006	**2007**
Japan	**¥2,840,556**	¥2,598,402	**$24,062,314**	**¥ 95,444**	¥60,089	**$808,504**
North America	**223,638**	200,644	**1,894,438**	**6,099**	6,354	**51,664**
Asia	**74,311**	70,208	**629,489**	**434**	1,528	**3,679**
Europe	**128,387**	97,166	**1,087,566**	**3,291**	1,641	**27,878**
Others	**33,959**	14,078	**287,665**	**3,644**	1,301	**30,869**
Subtotal	**3,300,851**	2,980,498	**27,961,472**	**108,912**	70,913	**922,594**
Eliminations or Corporate	**(232,346)**	(188,389)	**(1,968,208)**	**–**	–	**–**
Total	**¥3,068,505**	¥2,792,109	**$25,993,264**	**¥108,912**	¥70,913	**$922,594**

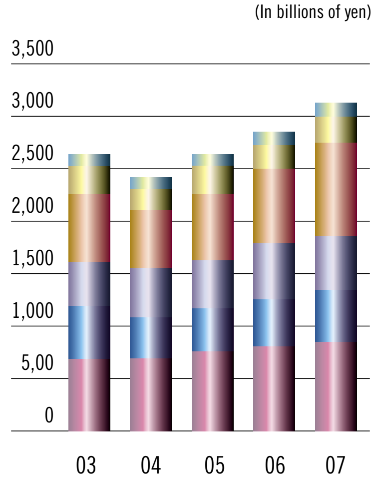
GEOGRAPHIC DISTRIBUTION	Total Assets		
	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Japan	**¥3,234,245**	¥3,014,463	**$27,397,251**
North America	**173,463**	150,293	**1,469,403**
Asia	**64,357**	52,473	**545,170**
Europe	**90,577**	76,879	**767,277**
Others	**32,403**	15,205	**274,482**
Subtotal	**3,595,045**	3,309,313	**30,453,583**
Eliminations or Corporate	**796,820**	737,809	**6,749,844**
Total	**¥4,391,865**	¥4,047,122	**$37,203,427**

COMPOSITION OF OVERSEAS NET SALES BY GEOGRAPHIC DISTRIBUTION



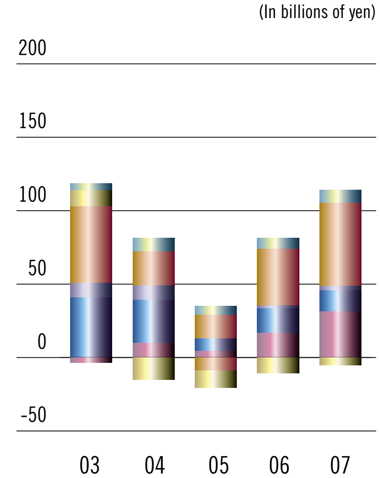
- Asia
- North America
- Europe
- Central and South America
- The Middle East
- Africa
- Oceania

NET SALES BY INDUSTRY SEGMENT



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

OPERATING INCOME (LOSS) BY INDUSTRY SEGMENT



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

MANAGEMENT'S DISCUSSION AND ANALYSIS

Analysis of Operating Results

In fiscal 2006, ended March 31, 2007, consolidated net sales of Mitsubishi Heavy Industries, Ltd. (MHI) and its consolidated subsidiaries (MHI Group) increased ¥276,396 million, or 9.9%, from the previous year, to ¥3,068,505 million (US$25,993,264 thousand). This was mainly the result of year-on-year growth in Power Systems, centered on increased thermal power plant construction for overseas customers, Shipbuilding & Ocean Development, reflecting an increase in the number of ships delivered, Aerospace, due to strong demand for commercial aircraft, and Mass and Medium-Lot Manufactured Machinery, supported by higher sales of forklift trucks and small- and medium-sized engines. However, the Machinery & Steel Structures segment recorded slightly lower sales.

Operating income rose ¥37,999 million, or 53.6%, to ¥108,912 million (US$922,594 thousand). The main factors were the emergence of benefits from lower expenses and higher productivity due to solid progress in the Company's 2006 Business Plan (medium-term business plan), coupled with the weakening of the yen against other major currencies. These factors helped to offset the negative impact on operating income due to higher materials costs.

Net non-operating expenses were ¥25,863 million (US$219,089 thousand), ¥5,315 million more than in the previous year. This was mainly due to deterioration in foreign exchange gains and higher interest expense, which outweighed improvement in equity in earnings of unconsolidated subsidiaries and affiliates. Ordinary income rose ¥32,684 million, or 64.9%, to ¥83,049 million.

Extraordinary income totaled ¥18,665 million (US$158,110 thousand), due to sales of fixed assets and investment securities. Extraordinary expenses totaled ¥18,002 million (US$152,498 thousand), and mainly included business improvement and restructuring charges and unrealized losses on investment securities.

Income before income taxes and minority interests increased ¥31,328 million, or 59.8%, to ¥83,711 million (US$709,117 thousand), and net income rose ¥19,023 million, or 63.8%, to ¥48,840 million (US$413,721 thousand).

Key Factors Affecting Operating Results

Key factors that affect the management of the 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 manufacturing capabilities weakening due to technology and skill transfer issues associated with generational change.

Market trends

Trends in the public works fields, which is one of the 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 a shrinking market. With few prospects of significant market growth going forward, the MHI Group will continue to strive to maintain its position in this field as a vital partner to its customers. This means offering products and services which satisfy customers' needs by leveraging the MHI Group's industry-leading technologies. The 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 growth is expected to continue.

Exchange rate fluctuation

Foreign exchange rate fluctuation can significantly affect the MHI Group's competitiveness and operating results. In order to minimize exchange rate risk, the 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 and non-ferrous metals are driving up the cost of finished materials used to manufacture products. There is also a concern about the potential impact from delayed supply of necessary materials. In response, the 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. The MHI Group also intends to pass the price rises of materials on to customers as much as possible.

In order to secure the supply of materials, the MHI Group is strengthening relationships with its business partners, promoting an even greater level of information sharing, and acting 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 prevent or 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 the MHI Group. In managing this type of risk, the MHI Group is taking steps to minimize the probability of accidents and disasters occurring, by carrying out ongoing work-site management activities, including the training of on-site workers to be more aware of risks.

Technology and skill transfer

MHI Group is at risk of manufacturing capabilities weakening due to technology and skill transfer issues associated with generational change. In response, the MHI Group invests in production process improvement aimed at rationalization and carries out focused investment in R&D related to manufacturing technology. The 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 ¥158,722 million (US$1,344,531 thousand), ¥84,794 million more than in the previous year. This mainly reflected an increase in income before income taxes and minority interests and advances from customers related to firm orders in the Shipbuilding & Ocean Development and the Power Systems segments.

Investing activities used net cash of ¥158,653 million (US$1,343,951 thousand), ¥54,588 million more than the previous year. This increase was mainly due to aggressive capital expenditures in growth fields, mainly gas turbines and commercial aircraft.

Financing activities provided net cash of ¥48,730 million (US$412,793 thousand), due to the procurement of new funds in accordance with future funding requirements.

Primary Funding Requirements

The 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.

The MHI Group foresees growth in working capital requirements and investment funds in the coming years. The 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 & Special Vehicles business, which have been positioned as growth fields. Accordingly, the MHI Group is planning capital investment to reinforce and expand production facilities and to bolster overseas production bases. As such, the MHI Group expects increased requirements for working capital and investment funds in these growth areas.

Breakdown of interest-bearing debt and its applications

The breakdown of interest-bearing debt as of March 31, 2007, was as follows:

(Unit: millions of yen)

	Total	Due within one year	Due after one year
Short-term borrowings	290,412	290,412	0
Long-term loans	721,956	60,002	661,954
Export loans	11,916	3,862	8,054
Bonds	249,288	52,682	196,606
Total	1,273,572	406,958	866,614

(Unit: In thousands of U.S. dollars)

	Total	Due within one year	Due after one year
Short-term borrowings	2,460,076	2,460,076	0
Long-term loans	6,115,682	508,272	5,607,410
Export loans	100,942	32,714	68,228
Bonds	2,111,713	446,270	1,665,443
Total	10,788,413	3,447,332	7,341,081

The MHI Group is involved in numerous projects with comparatively long construction period. The MHI Group also owns a number of manufacturing facilities that employ large-scale equipment and machinery. Consequently, the 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, the MHI Group's funding procurements for the current year resulted in short-term borrowings and long-term debt of ¥406,958 million (US$3,447,332 thousand) due within one year, and of ¥866,614 million (US$7,341,081 thousand) due after one year.

Short-term borrowings and long-term debt are utilized as working capital and for capital investment. The 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

The 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, the 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, the MHI Group strives to efficiently utilize surplus funds within the Group using a cash management system. At the same time, the 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.

The 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, 2007 and 2006

	In millions of yen		In thousands of U.S. dollars (Note 2)
ASSETS	**2007**	2006	**2007**
Current assets:			
Cash and deposits (Note 13)	**¥ 244,234**	¥ 195,186	**$ 2,068,898**
Trade receivables (Note 6):			
Notes	**44,653**	49,815	**378,256**
Accounts	**1,122,049**	1,047,589	**9,504,863**
Allowance for doubtful receivables	**(7,936)**	(7,749)	**(67,224)**
Securities (Note 3)	**2,773**	1,549	**23,486**
Inventories (Note 4)	**1,048,586**	971,509	**8,882,559**
Advances to suppliers	**104,403**	68,695	**884,397**
Deferred income taxes (Note 5)	**87,742**	75,978	**743,264**
Prepaid expenses and other current assets (Note 6)	**140,811**	140,913	**1,192,811**
Total current assets	**2,787,315**	2,543,485	**23,611,310**
Property, plant and equipment (Note 6):			
Land	**144,423**	139,952	**1,223,400**
Buildings and structures	**721,699**	693,318	**6,113,504**
Machinery and equipment	**1,444,522**	1,415,048	**12,236,524**
Construction in progress	**56,399**	33,659	**477,758**
	2,367,043	2,281,977	**20,051,186**
Less accumulated depreciation	**(1,542,298)**	(1,516,740)	**(13,064,784)**
Net property, plant and equipment	**824,745**	765,237	**6,986,402**
Intangible assets	**33,444**	35,770	**283,305**
Investments and advances:			
Investments in unconsolidated subsidiaries and affiliates accounted for by the equity method	**163,180**	152,483	**1,382,297**
Long-term loans and advances	**23,673**	28,443	**200,530**
Investment securities (Note 3)	**512,263**	477,592	**4,339,371**
Deferred income taxes (Note 5)	**6,309**	10,159	**53,445**
Allowance for doubtful accounts	**(15,699)**	(18,753)	**(132,989)**
Net investments and advances	**689,726**	649,924	**5,842,654**
Other assets	**56,635**	52,706	**479,756**
Total assets	**¥ 4,391,865**	¥ 4,047,122	**$ 37,203,427**

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

LIABILITIES AND NET ASSETS	In millions of yen 2007	2006	In thousands of U.S. dollars (Note 2) 2007
Current liabilities:			
Trade payables:			
Notes	**¥ 16,303**	¥ 13,346	**$ 138,100**
Accounts	**730,289**	656,322	**6,186,269**
Short-term borrowings (Note 6)	**290,412**	307,772	**2,460,076**
Current portion of long-term debt (Note 6)	**116,546**	101,917	**987,256**
Advance payments received on contracts	**394,933**	334,880	**3,345,472**
Accrued expenses	**101,628**	74,869	**860,894**
Accrued income taxes	**25,734**	8,934	**217,989**
Reserve for product warranties	**21,224**	15,999	**179,790**
Reserve for losses on construction contracts	**9,535**	6,299	**80,771**
Other current liabilities (Note 5)	**100,808**	106,325	**853,944**
Total current liabilities	**1,807,412**	1,626,663	**15,310,561**
Long-term liabilities:			
Long-term debt (Note 6)	**866,614**	788,976	**7,341,081**
Deferred income taxes (Note 5)	**120,618**	95,691	**1,021,753**
Reserve for retirement allowance (Note 7)	**98,498**	108,710	**834,372**
Reserve for treatment of PCB waste (Note 1)	**4,170**	4,361	**35,321**
Other long-term liabilities	**48,117**	28,661	**407,597**
Total long-term liabilities	**1,138,017**	1,026,399	**9,640,124**
Total liabilities	**2,945,429**	2,653,062	**24,950,685**
Minority interests (Note 11)		17,771	
Stockholders' equity (Note 11):			
Common stock, without par value:			
Authorized— 6,000,000,000 shares			
Issued: 2006—3,373,647,813 shares		265,609	
Capital surplus		203,864	
Retained earnings		718,480	
Net unrealized gains on investment securities		193,373	
Foreign currency translation adjustments		117	
Treasury stock, at cost (Note 11):			
2006—18,301,162 shares		(5,154)	
Total stockholders' equity		1,376,289	
Total liabilities, minority interests and stockholders' equity		4,047,122	
Net assets			
Stockholders' equity (Note 11):			
Common stock, without par value:			
Authorized— 6,000,000,000 shares			
Issued: 2007—3,373,647,813 shares	**265,609**		**2,249,968**
Capital surplus	**203,879**		**1,727,059**
Retained earnings	**744,563**		**6,307,181**
Treasury stock, at cost (Note 11):			
2007—17,863,970 shares	**(5,064)**		**(42,895)**
Total stockholders' equity	**1,208,987**		**10,241,313**
Valuation, translation adjustments and others			
Net unrealized gains on investment securities	**212,165**		**1,797,253**
Deferred gains or losses on hedges	**658**		**5,573**
Foreign currency translation adjustments	**6,211**		**52,614**
Total valuation, translation adjustments and others	**219,034**		**1,855,440**
Share subscription rights (Note 11)	**294**		**2,488**
Minority interests (Note 11)	**18,121**		**153,501**
Total net assets	**1,446,436**		**12,252,742**
Total liabilities and net assets	**¥4,391,865**		**$37,203,427**

CONSOLIDATED STATEMENTS OF INCOME

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2007 and 2006

	In millions of yen		In thousands of U.S. dollars (Note 2)
	2007	2006	**2007**
Net Sales	**¥3,068,505**	¥2,792,109	**$25,993,264**
Cost of sales	**2,681,868**	2,460,820	**22,718,067**
Gross Profit	**386,637**	331,289	**3,275,197**
Selling, general and administrative expenses	**277,725**	260,376	**2,352,603**
Operating income	**108,912**	70,913	**922,594**
Non-operating income (expense):			
Interest and dividend income	**13,002**	13,797	**110,141**
Equity in earnings of unconsolidated subsidiaries and affiliates	**8,663**	2,056	**73,382**
Other income	**3,000**	5,167	**25,416**
Interest expense	**(17,810)**	(15,765)	**(150,869)**
Foreign exchange losses	**(12,993)**	(9,387)	**(110,063)**
Losses on disposal of fixed assets	**(6,507)**	(5,383)	**(55,122)**
Other expenses	**(13,218)**	(11,033)	**(111,974)**
	(25,863)	(20,548)	**(219,089)**
Ordinary income	**83,049**	50,365	**703,505**
Extraordinary income (expense):			
Gains on sales of fixed assets (Note 8)	**9,764**	13,676	**82,709**
Gains on sales of investment securities	**8,901**	–	**75,401**
Business improvement and restructuring charges (Note 9)	**(10,743)**	(5,559)	**(91,000)**
Losses on revaluation of investment securities (Note 10)	**(5,227)**	–	**(44,281)**
Prior service cost due to change in defined interest rate of employee retirement annuity (Note 7)	**(2,033)**	–	**(17,217)**
Expense for treatment of PCB waste	**–**	(4,361)	**–**
Provision of reserve for directors' retirement allowance	**–**	(1,738)	**–**
	662	2,018	**5,612**
Income before income taxes and minority interests	**83,711**	52,383	**709,117**
Income taxes (Note 5)**:**			
Current	**33,088**	8,113	**280,286**
Deferred	**3,162**	13,056	**26,790**
Minority interests in income after taxes	**(1,379)**	1,397	**(11,680)**
Net income	**¥ 48,840**	¥ 29,817	**$ 413,721**

	In yen		In U.S. dollars (Note 2)
Per share of common stock (Note 1)**:**	**2007**	2006	**2007**
Net income—basic	**¥ 14.56**	¥ 8.85	**$ 0.123**
Net income—diluted	**14.55**	8.83	**0.123**
Cash dividends	**6.00**	4.00	**0.051**

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

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2007 and 2006

	In millions of yen											
	Stockholders' equity					Valuation, translation adjustments and others						
	Common stock	Capital surplus	Retained earnings	Treasury stock	Total stockholders' equity	Net unrealized gains on investment securities	Deferred gains or losses on hedges (Note 11)	Foreign currency translation adjustments	Total valuation, translation adjustments and others	Share subscription rights (Note 11)	Minority interests (Note 11)	Total net assets
Balance as of March 31, 2005	¥265,609	¥203,855	¥741,234	¥(5,174)	¥1,205,524	¥110,460	¥ –	¥(6,007)	¥104,453	¥ –	¥ –	¥1,309,977
Cash dividends (Note 11)			(13,421)		(13,421)							(13,421)
Net income			29,817		29,817							29,817
Decrease resulting from inclusion in the scope of consolidation and equity method			(39,142)		(39,142)							(39,142)
Decrease resulting from exclusion in the scope of consolidation and equity method			(8)		(8)							(8)
Purchase of treasury stock				(58)	(58)							(58)
Disposal of treasury stock		9		78	87							87
Net changes in items other than stockholders' equity						82,913		6,124	89,037			89,037
Subtotal	–	9	(22,754)	20	(22,725)	82,913	–	6,124	89,037	–	–	66,312
Balance as of March 31, 2006	265,609	203,864	718,480	(5,154)	1,182,799	193,373	–	117	193,490	–	–	1,376,289
Balance as of April 1, 2006	265,609	203,864	718,480	(5,154)	1,182,799	193,373	–	117	193,490	–	17,771	1,394,060
Cash dividends (Note 11)			(23,488)		(23,488)							(23,488)
Bonuses to directors and statutory auditors			(110)		(110)							(110)
Net income			48,840		48,840							48,840
Increase resulting from inclusion in the scope of consolidation and equity method			841		841							841
Purchase of treasury stock				(93)	(93)							(93)
Disposal of treasury stock		15		183	198							198
Net changes in items other than stockholders' equity						18,792	658	6,094	25,544	294	350	26,188
Subtotal	–	15	26,083	90	26,188	18,792	658	6,094	25,544	294	350	52,376
Balance as of March 31, 2007	¥265,609	¥203,879	¥744,563	¥(5,064)	¥1,208,987	¥212,165	¥658	¥6,211	¥219,034	¥294	¥18,121	¥1,446,436

	In thousands of U.S. dollars (Note 2)											
	Stockholders' equity					Valuation, translation adjustments and others						
	Common stock	Capital surplus	Retained earnings	Treasury stock	Total stockholders' equity	Net unrealized gains on investment securities	Deferred gains or losses on hedges (Note 11)	Foreign currency translation adjustments	Total valuation, translation adjustments and others	Share subscription rights (Note 11)	Minority interests (Note 11)	Total net assets
Balance as of April 1, 2006	$2,249,968	$1,726,935	$6,086,233	$(43,662)	$10,019,474	$1,638,060	$ –	$ 994	$1,639,054	$ –	$150,537	$11,809,065
Cash dividends (Note 11)			(198,968)		(198,968)							(198,968)
Bonuses to directors and statutory auditors			(932)		(932)							(932)
Net income			413,721		413,721							413,721
Increase resulting from inclusion in the scope of consolidation and equity method			7,127		7,127							7,127
Purchase of treasury stock				(787)	(787)							(787)
Disposal of treasury stock		124		1,554	1,678							1,678
Net changes in items other than stockholders' equity						159,193	5,573	51,620	216,386	2,488	2,964	221,838
Subtotal	–	124	220,948	767	221,839	159,193	5,573	51,620	216,386	2,488	2,964	443,677
Balance as of March 31, 2007	$2,249,968	$1,727,059	$6,307,181	$(42,895)	$10,241,313	$1,797,253	$5,573	$52,614	$1,855,440	$2,488	$153,501	$12,252,742

CONSOLIDATED STATEMENTS OF CASH FLOWS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2007 and 2006

	In millions of yen		In thousands of U.S. dollars (Note 2)
	2007	2006	**2007**
Cash flows from operating activities:			
Income before income taxes and minority interests	**¥ 83,711**	¥ 52,383	**$ 709,117**
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	**106,608**	100,810	**903,076**
Increase (decrease) in reserve for retirement allowance	**(12,441)**	(2,143)	**(105,392)**
Interest and dividend income	**(13,002)**	(13,797)	**(110,141)**
Interest expense	**17,810**	15,765	**150,869**
Equity in earnings of unconsolidated subsidiaries and affiliates	**(8,663)**	(2,056)	**(73,382)**
Gains on sales of investment securities	**(8,901)**	–	**(75,401)**
Losses on revaluation of investment securities	**5,227**	–	**44,281**
Gains on sales of fixed assets	**(9,764)**	(13,676)	**(82,709)**
Losses on disposal of fixed assets	**6,507**	–	**55,122**
Business improvement and restructuring charges	**10,743**	5,559	**91,000**
Prior service cost due to change in defined interest rate of employee retirement annuity	**2,033**	–	**17,217**
Expense for treatment of PCB waste	**–**	4,361	**–**
Provision of reserve for directors' retirement allowance	**–**	1,738	**–**
(Increase) decrease in receivables	**(63,857)**	(36,939)	**(540,933)**
(Increase) decrease in inventories and advances to suppliers	**(110,541)**	(18,430)	**(936,389)**
(Increase) decrease in other assets	**(4,276)**	(16,249)	**(36,221)**
Increase (decrease) in payables	**69,460**	8,503	**588,394**
Increase (decrease) in advance payments received on contracts	**59,140**	(29,571)	**500,977**
Increase (decrease) in other liabilities	**41,261**	19,677	**349,518**
Others	**(1,274)**	(1,142)	**(10,793)**
Subtotal	**169,781**	74,793	**1,438,210**
Interest and dividend received	**20,525**	20,255	**173,872**
Interest paid	**(17,090)**	(15,711)	**(144,772)**
Payments for income taxes	**(14,494)**	(5,409)	**(122,779)**
Net cash provided by operating activities	**158,722**	73,928	**1,344,531**
Cash flows from investing activities:			
Net (Increase) decrease in time deposits	**1,690**	6,150	**14,319**
Proceeds from sales and redemption of marketable securities	**60**	984	**506**
Purchases of property, plant, equipment and intangible assets	**(174,397)**	(123,974)	**(1,477,312)**
Proceeds from sales of property, plant, equipment and intangible assets	**15,407**	16,738	**130,514**
Purchases of investment securities	**(15,296)**	(4,982)	**(129,569)**
Proceeds from sales and redemption of investment securities	**11,734**	3,788	**99,396**
Disbursement of long-term loans	**(2,496)**	(6,074)	**(21,145)**
Collection of long-term loans	**3,962**	3,305	**33,557**
Others	**683**	–	**5,783**
Net cash used in investing activities	**(158,653)**	(104,065)	**(1,343,951)**
Cash flows from financing activities:			
Net increase (decrease) in short-term borrowings	**(19,202)**	5,626	**(162,656)**
Proceeds from long-term debt	**161,790**	111,939	**1,370,517**
Repayment of long-term debt	**(105,941)**	(63,626)	**(897,427)**
Proceeds from issuance of bonds	**35,819**	–	**303,422**
Payment for redemption of bonds	**(300)**	(33,606)	**(2,541)**
Dividends paid to stockholders	**(23,401)**	(13,384)	**(198,227)**
Dividends paid to minority stockholders of subsidiaries	**(530)**	(396)	**(4,486)**
Others	**495**	1,421	**4,191**
Net cash provided by financing activities	**48,730**	7,974	**412,793**
Effect of exchange rate changes on cash and cash equivalents	**2,032**	5,787	**17,214**
Net increase (decrease) in cash and cash equivalents	**50,831**	(16,376)	**430,587**
Cash and cash equivalents at beginning of year	**176,274**	189,781	**1,493,215**
Increase in cash and cash equivalents resulting from inclusion of consolidated subsidiaries	**480**	2,869	**4,064**
Cash and cash equivalents at end of year (Note 13)	**¥ 227,585**	¥ 176,274	**$ 1,927,866**

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, 2007 and 2006

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, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards 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.

b) Principles of consolidation

The accompanying consolidated financial statements for the years ended March 31, 2007 and 2006 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 Valuation, translation adjustments and others.

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 Valuation, translation adjustments and others, 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) Reserve for losses on construction contracts

Reserve 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 reserve for losses on construction contracts at March 31, 2007 and 2006) 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 reserve 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.

Also effective the year ended March 31, 2007, MHI has revised the defined interest rate of the retirement pension plan. The effect of the revision was the increase of retirement allowance in the amount of ¥2,033 million (US$17,217 thousand) and all the amount was recorded as "Prior service cost due to change in defined interest rate of employee retirement annuity" of extraordinary expense.

m) Reserve for treatment of PCB waste

Reserve for treatment of PCB (Poly Chlorinated Biphenyl) waste has been provided based on estimated costs of the treatment for PCB products or equipments as well as their collection and transportation fees.

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$42,355 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.

s) Others (Changing accounting policy)

• Accounting standard for presentation of net assets in the balance sheet

Effective the year ended March 31, 2007, MHI and Subsidiaries have adopted "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Accounting Standards Board of Japan (ASBJ) Statement No. 5, which was issued by ASBJ at December 9, 2005) and "Guidance on Accounting Standard for Presentation of Net Assets in the Balance Sheet" (ASBJ Guidance No. 8, which was issued by ASBJ at December 9, 2005).

At the end of this fiscal year, the total amount that corresponds to hitherto known "Stockholders' equity (category of the past years)" was ¥1,427,364 million (US$12,091 thousand).

• Accounting standard for directors' bonus

Effective the year ended March 31, 2007, MHI and Subsidiaries have adopted "Accounting Standard for Directors' Bonus" (ASBJ Statement No. 4, which was issued by ASBJ at November 29, 2005). The effect of this adoption was to decrease Operating income, Ordinary income and Income before income tax and minority interests by ¥253 million (US$ 2,146 thousand), respectively.

• Accounting standard for share-based payment

Effective the year ended March 31, 2007, MHI and Subsidiaries have adopted "Accounting Standard for Share-based Payment" (ASBJ Statement No. 8, which was issued by ASBJ at December 27, 2005) and "Guidance on Accounting Standard for Share-based Payment" (ASBJ Guidance No. 11, which was issued by ASBJ at May 31, 2006).

The effect of this adoption was to decrease Operating income, Ordinary income and Income before income tax and minority interests by ¥294 million (US$2,488 thousand) respectively.

• Accounting standard for business combinations and divestitures

Effective the year ended March 31, 2007, MHI and Subsidiaries have adopted "Accounting Standard for Business Combination" (issued by the Business Accounting Council at October 31, 2003), "Accounting Standard for Business Divestitures" (ASBJ Statement No. 7, which was issued by ASBJ at December 27, 2005) and "Guidance on Accounting Standard for Business Combinations and Accounting Standard for Business Divestitures" (ASBJ Guidance No. 10, which was issued by ASBJ at December 22, 2006).

2. U.S. DOLLAR AMOUNTS

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

As the amounts shown in U.S. dollars are for convenience only, the rate of ¥118.05=US$1 prevailing at March 31, 2007 has been used for the purpose of the presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

3. SECURITIES

a) Other securities with market value, which were included in securities (current assets) and investment securities (investments and advances) at March 31, 2007 and 2006, consisted of the following:

	In millions of yen			In thousands of U.S. dollars		
	2007			2007		
cost	Acquisition amount	Carrying gain (loss)	Unrealized cost	Acquisition amount	Carrying gain (loss)	Unrealized
i) Carrying amounts over acquisition costs:						
Equity securities	**¥130,329**	**¥483,532**	**¥353,203**	**$1,104,018**	**$4,095,994**	**$2,991,976**
Government bonds	**243**	**307**	**64**	**2,056**	**2,598**	**542**
Others	**111**	**130**	**19**	**943**	**1,103**	**160**
Subtotal	**¥130,683**	**¥483,969**	**¥353,286**	**$1,107,017**	**$4,099,695**	**$2,992,678**
ii) Acquisition costs over carrying amounts:						
Equity securities	**¥ 1,624**	**¥ 1,116**	**¥ (508)**	**$ 13,753**	**$ 9,454**	**$ (4,299)**
Others	**1,891**	**1,870**	**(21)**	**16,022**	**15,844**	**(178)**
Subtotal	**3,515**	**2,986**	**(529)**	**29,775**	**25,298**	**(4,477)**
Total (i + ii)	**¥134,198**	**¥486,955**	**¥352,757**	**$1,136,792**	**$4,124,993**	**$2,988,201**

	In millions of yen		
	2006		
	Acquisition cost	Carrying amount	Unrealized gain (loss)
i) Carrying amounts over acquisition costs:			
Equity securities	¥123,061	¥443,390	¥320,329
Government bonds	242	319	77
Others	1,194	1,199	5
Subtotal	¥124,497	¥444,908	¥320,411
ii) Acquisition costs over carrying amounts:			
Equity securities	¥ 801	¥ 335	¥ (466)
Total (i + ii)	¥125,298	¥445,243	¥319,945

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, impairment losses amounted to ¥ 33 million (US$280 thousand) for the year ended March 31, 2007. And for the year ended March 31, 2006, there was no impairment losses.

b) Sales amounts of other securities and related gains and losses for the years ended March 31, 2007 and

2006 were as follows:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	2007
Sales amounts	¥10,981	¥2,603	$93,023
Gains	8,885	1,576	75,268
Losses	(2)	(10)	(19)

c) Other securities without market value, which were included in securities (current assets) and investment securities (investments and advances) at March 31, 2007 and 2006, mainly consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	2007
Equity securities - unlisted	¥19,894	¥26,219	$168,520

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, 2007 and 2006 amounted to ¥5,137 million (US$43,517 thousand) and ¥52 million, respectively, with respect to other securities without market value.

d) The contractual maturities of other securities at March 31, 2007 and 2006 were as follows:

	In millions of yen			In thousands of U.S. dollars		
	2007			2007		
	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	¥1,909	¥ –	¥ –	$16,174	$ –	$ –
Loan trusts	702	–	–	5,942	–	–
Bonds:						
Government bonds	306	508	–	2,595	4,309	–
Others	659	629	95	5,582	5,326	806
Total	¥3,576	¥1,137	¥95	$30,293	$9,635	$806

	In millions of yen		
	2006		
	Due within one year	Due after one year through five years	Due after five years
Certificate of deposit	¥1,209	¥ –	¥–
Loan trusts	60	114	–
Bonds:			
Government bonds	250	579	–
Total	¥1,519	¥693	¥–

4. INVENTORIES

Inventories at March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	2007
Finished products	¥ 147,567	¥132,209	$1,250,035
Work in process	796,450	764,182	6,746,723
Raw materials	104,569	75,118	885,801
Total	¥1,048,586	¥971,509	$8,882,559

5. 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, 2007 and 2006.

a) Significant components of deferred tax assets and liabilities at March 31, 2007 and 2006, 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
	2007	2006	**2007**
Deferred tax assets:			
Reserve for retirement allowance	**¥ 113,097**	¥ 115,118	**$ 958,042**
Accrued expenses for product warranty	**26,120**	25,181	**221,266**
Accrued expenses for construction contracts	**21,646**	13,200	**183,363**
Tax loss carryforwards	**–**	17,653	**–**
Others	**78,019**	57,038	**660,895**
Subtotal	**238,882**	228,190	**2,023,566**
Valuation allowance	**(25,700)**	(17,733)	**(217,700)**
Total gross deferred tax assets	**213,182**	210,457	**1,805,866**
Deferred tax liabilities:			
Net unrealized gains on investment securities	**(143,073)**	(129,768)	**(1,211,969)**
Gains on contribution of investment securities to trust for retirement allowance	**(69,346)**	(66,213)	**(587,429)**
Reserve for reduction in costs of fixed assets	**(17,055)**	(14,348)	**(144,474)**
Reserve for accelerated depreciation	**(4,074)**	(5,595)	**(34,514)**
Others	**(6,207)**	(4,154)	**(52,579)**
Total gross deferred tax liabilities	**(239,755)**	(220,078)	**(2,030,965)**
Net deferred tax assets (liabilities)	**¥ (26,573)**	¥ (9,621)	**$ (225,099)**

Note: 1. "Others" of Deferred tax assets at March 31, 2007 includes "Tax loss carryforwards" amounts to ¥8,386 million (US$71,038 thousand).
2. Net deferred tax assets (liabilities) at March 31, 2007 and 2006 are reflected in the consolidated balance sheets as follows:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Deferred income taxes in current assets	**¥ 87,742**	¥ 75,978	**$ 743,264**
Deferred income taxes in investments and advances	**6,309**	10,159	**53,445**
Other current liabilities	**(6)**	(67)	**(55)**
Deferred income taxes in long-term liabilities	**¥(120,618)**	¥(95,691)	**$(1,021,753)**

b) Reconciliation of the statutory effective income tax rate and the income tax rate as a percentage of income before income taxes and minority interest for the year ended March 31, 2007 is as follows:

	2007
Japanese statutory effective income tax rate	40.5%
Adjustment:	
Items excluded from expenses	1.9
Items excluded from gross income	(0.4)
Equity in earnings of unconsolidated subsidiaries and affiliates	(4.2)
Valuation allowance	9.5
Others	(4.0)
Income tax rate as a percentage of income before income taxes and minority interests	43.3%

Note: 3. 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 for the year ended March 31, 2006, was less than 5% of statutory effective income tax rate. Therefore, reconciliation of these rate for the year ended March 31, 2006 is not shown.

6. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

a) Short-term borrowings at March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Loans, principally from banks, with weighted-average interest rate of 1.5% at March 31, 2007 and 1.1% at March 31, 2006:			
Secured	**¥ 4,760**	¥ 7,376	**$ 40,322**
Unsecured	**285,652**	300,396	**2,419,754**
Total	**¥290,412**	¥307,772	**$2,460,076**

b) Long-term debt at March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Loans, principally from banks and insurance companies, due 2007 to 2023 with weighted-average interest rate of 1.6% at March 31, 2007 and due 2006 to 2022 with weighted-average interest rate of 1.4% at March 31, 2006:			
Secured	**¥ 23,072**	¥ 19,679	**$ 195,445**
Unsecured	**698,884**	639,802	**5,920,237**
Export loans, principally from main contractors, due 2007 to 2018 with weighted-average interest rate of 2.6% at March 31, 2007 and due 2006 to 2018 with weighted-average interest rate of 2.7% at March 31, 2006:			
Unsecured	**11,916**	17,801	**100,942**
Unsecured bonds:			
2.525% bonds due 2008	**50,000**	50,000	**423,549**
2.15% bonds due 2008	**40,000**	40,000	**338,839**
0.63% bonds due 2010	**20,000**	20,000	**169,420**
1.03% bonds due 2013	**30,000**	30,000	**254,130**
0.365% bonds due 2010	**20,000**	20,000	**169,420**
0.70% bonds due 2013	**50,000**	50,000	**423,549**
1.45% bonds due 2011	**10,000**	–	**84,710**
2.04% bonds due 2016	**20,000**	–	**169,420**
Unsecured bonds issued by Subsidiaries:			
0.62% bonds, due 2007 to 2010 in 2007 and due 2006 to 2010 in 2006	**950**	1,250	**8,047**
8.39% bonds due 2007	**2,382**	2,361	**20,180**
6.45% bonds due 2011	**5,956**	–	**50,449**
Subtotal	**983,160**	890,893	**8,328,337**
Less current portion due within one year	**(116,546)**	(101,917)	**(987,256)**
Total	**¥ 866,614**	¥ 788,976	**$7,341,081**

c) A summary of assets pledged as collateral for short-term borrowings and long-term debt at March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Property, plant and equipment	**¥16,358**	¥13,912	**$138,572**
Trade receivables:			
Notes	**4,892**	5,520	**41,437**
Accounts	**13,886**	15,267	**117,630**
Short-term loans included in prepaid expenses and other current assets	**1,747**	2,730	**14,799**
Total	**¥36,883**	¥37,429	**$312,438**

d) The aggregate annual maturities of long-term debt at March 31, 2007 were as follows:

Year ending March 31	In millions of yen	In thousands of U.S. dollars
2008	¥116,546	$ 987,256
2009	119,882	1,015,521
2010	119,935	1,015,966
2011	97,000	821,685
2012	118,410	1,003,054
Thereafter	411,387	3,484,855
Total	¥983,160	$8,328,337

7. 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, 2007 and 2006 were as follows:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Benefit obligations	**¥(746,215)**	¥(748,358)	**$(6,321,177)**
Fair value of plan assets	**636,229**	678,264	**5,389,484**
Unfunded benefit obligations	**(109,986)**	(70,094)	**(931,693)**
Unrecognized actuarial losses (gains)	**37,108**	(13,818)	**314,342**
Unrecognized prior service costs (benefits)	**(613)**	(605)	**(5,189)**
Net benefit liability recognized on the consolidated balance sheets	**(73,491)**	(84,517)	**(622,540)**
Prepaid pension expense	**25,007**	24,193	**211,832**
Reserve for retirement allowance	**¥ (98,498)**	¥(108,710)	**$ (834,372)**

b) The components of net periodic retirement benefit expenses for the years ended March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Service cost	**¥ 28,810**	¥ 28,217	**$ 244,053**
Interest cost	**14,997**	15,128	**127,037**
Expected return on plan assets	**(15,277)**	(13,666)	**(129,411)**
Amortization of actuarial losses (gains)	**5,605**	17,791	**47,476**
Amortization of prior service costs (benefits)*	**1,995**	(83)	**16,901**
Total	**¥ 36,130**	¥ 47,387	**$ 306,056**

* Amortization of prior service costs for the year ended March 31, 2007 included the costs generated by change in expected rate on plan assets.

c) The principal assumptions used in determining the information above at March 31, 2007 and 2006 were as follows:

	2007	2006
Discount rate	**2.0%**	2.0%
Expected rate of return on plan assets	**3.5%**	4.0%
Amortization period for prior service costs	**Expensed as incurred or 10 to 11 years**	Expensed as incurred or 10 to 11 years
Amortization period for actuarial gains and losses	**11 to 20 years**	11 to 20 years

8. GAINS ON SALES OF FIXED ASSETS

Gains on sales of fixed assets for the year ended March 31, 2007 and 2006 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2007	**2007**
Land	**¥9,711**	**$82,257**
Others	**53**	**452**
Total	**¥9,764**	**$82,709**

	In millions of yen
	2006
Land	¥14,316
Others	(640)
Total	¥13,676

9. BUSINESS IMPROVEMENT AND RESTRUCTURING CHARGES

Business improvement and restructuring charges arising from Mass and Medium-Lot Manufactured Machinery business, Machinery and Steel Structures business and Power Systems business for the year ended March 31, 2007 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2007	**2007**
Losses on disposal of fixed assets	**¥ 3,663**	**$31,029**
Losses on disposal of inventories	**3,607**	**30,554**
Others	**3,473**	**29,417**
Total	**¥10,743**	**$91,000**

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

	In millions of yen
	2006
Maintenance charges of products	¥2,824
Losses on disposal of inventories	1,366
Losses on disposal of fixed assets	226
Others	1,143
Total	¥5,559

10. LOSSES ON REVALUATION OF INVESTMENT SECURITIES

Losses on revaluation of investment securities for the year ended March 31, 2007 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2007	**2007**
Devaluation of securities	**¥5,170**	**$43,796**
Devaluation of golf club membership	**57**	**485**
Total	**¥5,227**	**$44,281**

11. CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

a) By adopting new accounting standard “Accounting standard for presentation of Net assets in the Balance sheet,” following 3 account titles have been included in the Net assets since the year ended March 31, 2007.

(1) Minority interests: In previous years, this account title was separated from “Stockholders’ equity.”

(2) Share Subscription Rights: This is a new account title according to recognition of the cost of share based payment.

(3) Deferred gains or losses on hedges: In previous years, this account title was recorded as liabilities or assets.

This adoption of new accounting standard is described in section s) of note 1 “Summary of Significant Accounting Policies.”

b) Retained earnings

The new Corporate Law of Japan (the “Law”), which superseded most of the provisions of the Commercial Code of Japan, went into effect at May 1, 2006. The Law provides that an amount equal to 10% of the amount to be disbursed as distributions of capital surplus (other than the capital reserve) and retained earnings (other than the legal reserve) be transferred to the capital reserve and the legal reserve, respectively, until the sum of the capital reserve and the legal reserve equals 25% of the capital stock account. Such distributions can be made at any time by resolution of the shareholders, or by the Board of Directors if certain conditions are met.

c) Total number of the shares issued and treasury stock at March 31, 2007 and 2006 is as follows

	Type of shares	At March 31, 2006	Increase by March 31, 2007	Decrease by March 31, 2007	At March 31, 2007
Total number of the shares issued	Common stock	3,373,647,813	–	–	3,373,647,813
Treasury stock	Common stock	18,301,162	210,398	647,590	17,863,970

(1) Reason for increase of treasury stock

Repurchasing of shares that were less than the minimum trading unit	169,148
Number of shares that belongs to MHI and Subsidiaries as treasury stock, which has been held by certain affiliate. (That company was converted to affiliated company accounted for by the equity method in the year ended March 31, 2007)	41,250
Total	210,398

(2) Reason for decrease of treasury stock

Disposal resulting from the exercise of share purchase warrants, which were issued for the purpose of providing stock options	628,000
Disposal resulting from purchase request from shareholders who have some shares that were less than the minimum trading unit	19,590
Total	647,590

d) Cash dividends

(1) Cash dividends paid

Resolution	Type of shares	Record date	Effective date	Cash dividends per share in yen	Cash dividends per share in dollars	Total cash dividends paid in millions of yen	Total cash dividends paid in thousands of dollars
June 28, 2006 Ordinary General Meeting of Shareholders	Common stock	March 31, 2006	June 29, 2006	¥4	$0.0339	¥13,421	$113,693
October 31, 2006 Board of Directors	Common stock	September 30, 2006	December 5, 2006	3	0.0254	10,067	85,275
Total						¥23,488	$198,968

(2) Dividends of which record date is within this fiscal year but the effective date is within next fiscal year

Resolution	Type of shares	Record date	Effective date	Cash dividends per share in yen	Cash dividends per share in dollars	Total cash dividends paid in millions of yen	Total cash dividends paid in thousands of dollars
June 27, 2007 Ordinary General Meeting of Shareholders	Common stock	March 31, 2007	June 28, 2007	¥3	$0.0254	¥10,068	$85,282

12. SHARE-BASED COMPENSATION PLANS

MHI has the following share-based compensation plans for directors and corporate executive officers. During the year ended March 31, 2007, ¥294 million (US$2,488 thousand) of the compensation expense was recognized as Selling, general and administrative expenses.

a) Conditions for issue of stock options

	Stock options granted in 2003	Stock options granted in 2004	Stock options granted in 2005	Stock options granted in 2006
Grantee (Number of individuals)	Directors (29)	Directors (27)	Directors & Executive officers (26)	Directors & Executive officers (25)
Number of shares	535,000	500,000	502,000	663,000
Type of share	Common stock	Common stock	Common stock	Common stock
Date of grant	August 11, 2003	August 11, 2004	August 11, 2005	August 17, 2006
Exercise period (from)	June 27, 2005	June 26, 2006	June 29, 2007	August 18, 2006
(to)	June 26, 2009	June 25, 2010	June 28, 2011	June 28, 2036

b) Activities of stock options in the year ended March 31, 2007

	Number of shares			
	Stock options granted in 2003	Stock options granted in 2004	Stock options granted in 2005	Stock options granted in 2006
Unexercised at March 31, 2006 . . .	287,000	500,000	502,000	–
Granted	–	–	–	663,000
Vested	–	–	–	663,000
Exercised	241,000	387,000	–	–
Expired	–	–	–	–
Unexercised at March 31, 2007 . . .	46,000	113,000	502,000	663,000

c) Price per share

	In yen			
	Stock options granted in 2003	Stock options granted in 2004	Stock options granted in 2005	Stock options granted in 2006
Weighted-average exercise price . . .	¥315	¥289	¥294	¥1
Weighted-average market share price when the stock acquisition rights were exercised in the year ended March 31, 2007	563	634	–	–
Fair value on the date of grant . . .	–	–	–	443

	In U.S. dollars			
	Stock options granted in 2003	Stock options granted in 2004	Stock options granted in 2005	Stock options granted in 2006
Weighted-average exercise price . . .	$2.67	$2.45	$2.49	$0.01
Weighted-average market share price when the stock acquisition rights were exercised in the year ended March 31, 2007	4.77	5.37	–	–
Fair value on the date of grant . . .	–	–	–	3.75

d) Estimate method of fair value of stock options

The fair value of stock options granted in 2006 was estimated using the Black-Scholes option-pricing model with the following assumptions.

		Stock options granted in 2006
Expected volatility	Note 1	33.142%
Expected life (of option)	Note 2	15 years
Expected dividends	Note 3	¥4 (US$0.034) per share
Risk-free interest rate	Note 4	2.073%

Note: 1. Estimated based on the actual share price for 15 years (from August 17, 1991 to August 17, 2006)
2. Calculated on the assumption that stock acquisition rights were excised at the middle point of exercise period (from August 18, 2006 to June 28, 2036)
3. Actual cash dividends in the year ended March 31, 2006
4. Yield of Japanese government bond with the same years to maturity as the above expected life of option

e) Estimate method of number of vested stock acquisition rights

MHI share-based compensation plans have given the vested stock acquisition rights at the same time when the rights was granted, therefore all the stock acquisition rights were recognized as vested.

13. CASH AND CASH EQUIVALENTS

Cash and cash equivalents at March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Cash and deposits	**¥244,234**	¥195,186	**$2,068,898**
Time deposits with maturities over three months	**(18,549)**	(20,112)	**(157,127)**
Short-term investments with maturities within three months included in securities	**1,900**	1,200	**16,095**
Total	**¥227,585**	¥176,274	**$1,927,866**

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
	2007	2006	**2007**
Equivalent of acquisition cost:			
Tools and equipment	**¥4,797**	¥6,282	**$40,638**
Others	**1,915**	1,645	**16,223**
Total	**¥6,712**	¥7,927	**$56,861**
Equivalent of accumulated depreciation:			
Tools and equipment	**¥2,501**	¥3,767	**$21,190**
Others	**1,094**	847	**9,270**
Total	**¥3,595**	¥4,614	**$30,460**
Equivalent of balance at the balance sheet date:			
Tools and equipment	**¥2,296**	¥2,515	**$19,448**
Others	**821**	798	**6,953**
Total	**¥3,117**	¥3,313	**$26,401**

ii) The equivalent of undue lease payments (including interest portion) at March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Within one year	**¥1,065**	¥1,372	**$ 9,020**
Thereafter	**2,052**	1,941	**17,381**
Total	**¥3,117**	¥3,313	**$26,401**

Note: Impairment losses distributed to leases had not been at March 31, 2007 and 2006.

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, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Lease payments	**¥1,518**	¥1,784	**$12,857**
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
	2007	2006	**2007**
Acquisition cost:			
Machinery and equipment	**¥58,332**	¥59,660	**$494,130**
Others	**8,941**	7,285	**75,737**
Total	**¥67,273**	¥66,945	**$569,867**
Accumulated depreciation:			
Machinery and equipment	**¥22,765**	¥25,920	**$192,839**
Others	**2,425**	2,446	**20,544**
Total	**¥25,190**	¥28,366	**$213,383**
Balance at the balance sheet date:			
Machinery and equipment	**¥35,567**	¥33,740	**$301,291**
Others	**6,516**	4,839	**55,193**
Total	**¥42,083**	¥38,579	**$356,484**

ii) Undue lease income (including interest portion), at March 31, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Within one year	**¥13,007**	¥13,374	**$110,182**
Thereafter	**29,521**	30,931	**250,074**
Total	**¥42,528**	¥44,305	**$360,256**

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, 2007 and 2006 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Lease income	**¥14,437**	¥14,710	**$122,299**
Depreciation expenses	**10,420**	11,360	**88,269**

15. DERIVATIVE FINANCIAL INSTRUMENTS

MHI and Subsidiaries utilize derivative financial instruments, which are comprised principally of forward foreign exchange contracts, foreign currency options, 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, 2007 and 2006:

	In millions of yen			In thousands of U.S. dollars		
	2007			**2007**		
	Notional amount	Fair value	Unrealized gain (loss)	Notional amount	Fair value	Unrealized gain (loss)
Forward foreign exchange contracts						
Sell:						
US$	**¥194,860**	**¥195,777**	**¥ (917)**	**$1,650,656**	**$1,658,420**	**$ (7,764)**
Euro	**33,359**	**35,131**	**(1,772)**	**282,587**	**297,597**	**(15,010)**
Others	**1,300**	**1,321**	**(21)**	**11,011**	**11,193**	**(182)**
Foreign currency options						
Buy:						
US$	**56,500**	**–**	**–**	**478,611**	**–**	**–**
Option cost	**1,727**	**1,631**	**(96)**	**14,633**	**13,817**	**(816)**
Total			**¥(2,806)**			**$(23,772)**

	In millions of yen		
	2006		
	Notional amount	Fair value	Unrealized gain (loss)
Forward foreign exchange contracts			
Sell:			
US$	¥72,386	¥74,171	¥(1,785)
Euro	26,543	26,981	(438)
Others	1,674	1,723	(49)
Total			¥(2,272)

16. CONTINGENT LIABILITIES

Contingent liabilities for guarantees to loans of others made in the ordinary course of business amounted to ¥129,452 million (US$1,096,583 thousand) and ¥128,732 million at March 31, 2007 and 2006, respectively.

17. SUPPLEMENTARY INCOME INFORMATION

	In millions of yen		In thousands of U.S. dollars
	2007	2006	**2007**
Depreciation	**¥106,720**	¥100,810	**$904,022**
Research and development costs (including routine or periodic alterations to existing products)	**106,358**	100,798	**900,961**

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

ERNST & YOUNG SHINNIHON

Certified Public Accountants
Hibiya Kokusai Bldg.
2-2-3, Uchisaiwai-cho
Chiyoda-ku, Tokyo, Japan 100-0011
C.P.O. Box 1196, Tokyo, Japan 100-8641

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, 2007 and 2006, and the related consolidated statements of income, changes in net assets, 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, 2007 and 2006, 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, 2007 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 27, 2007

Ernst & Young Shin Nihon

CORPORATE DATA

As of March 31, 2007

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

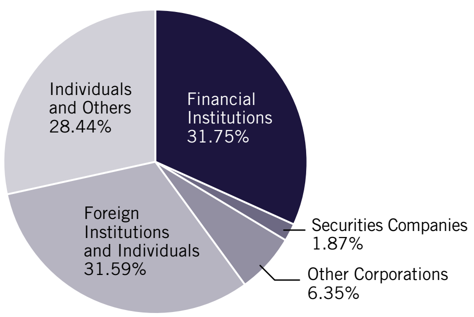
Total Number of Issuable Shares: 6,000,000,000

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

Number of Shareholders: 290,843

Number of Employees: 62,940

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

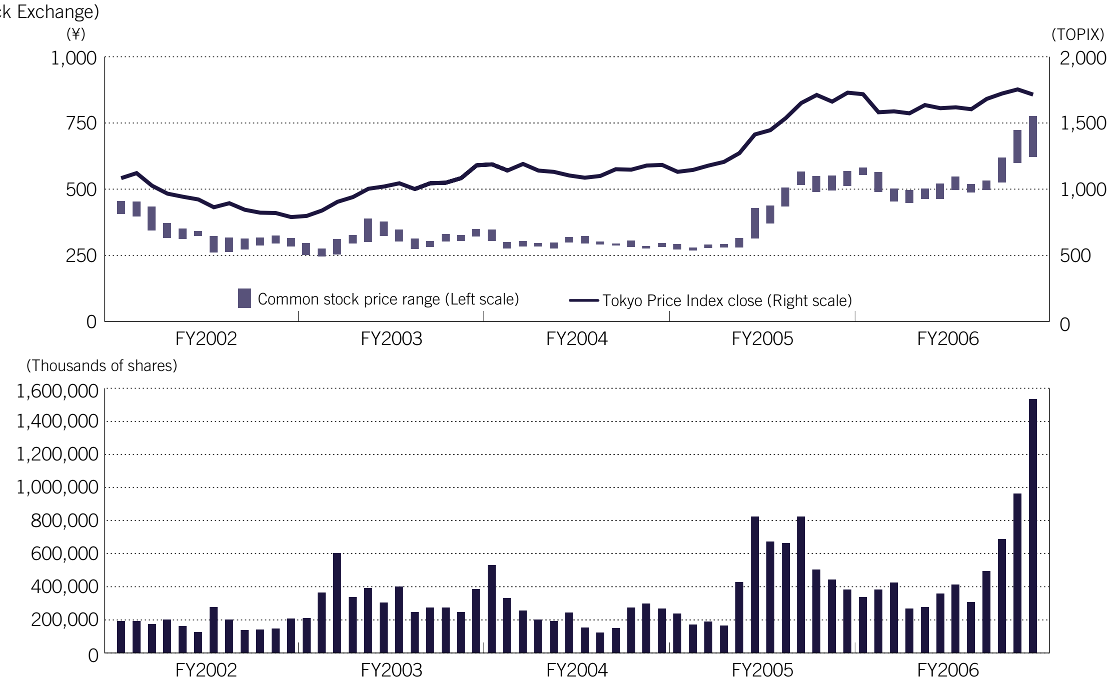
Manager of the Register of Shareholders:
Mitsubishi UFJ Trust and Banking Corporation 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8212, Japan

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
State Street Bank and Trust Company	239,028,413	7.1%
The Master Trust Bank of Japan, Ltd. (Holder in Trust)	153,401,000	4.5
Japan Trustee Services Bank, Ltd. (Holder in Trust)	126,071,900	3.7
The Nomura Trust and Banking Co., Ltd. (Holder in Retirement Benefit Trust for The Bank of Tokyo-Mitsubishi UFJ, Ltd.)	125,666,000	3.7
Meiji Yasuda Life Insurance Company	80,022,741	2.4
Tokio Marine & Nichido Fire Insurance Co., Ltd.	63,000,000	1.9
Japan Trustee Services Bank, Ltd. (Holder in Trust 4)	60,621,000	1.8
The Chase Manhattan Bank, N.A. London	53,798,184	1.6
State Street Bank and Trust Company 505103	50,778,625	1.5
The Nomura Trust and Banking Co., Ltd. (Holder in Retirement Benefit Trust for Mitsubishi UFJ Trust and Banking Corporation)	45,934,000	1.4

MONTHLY STOCK PRICE RANGE & TRADING VOLUME

(Tokyo Stock Exchange)



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Printed in Japan

K060-ANAL07E1-A-0, (8.0) 07-8, R