MITSUBISHI HEAVY INDUSTRIES, LTD.

ANNUAL REPORT 2005

For the Year Ended March 31, 2005

OUR VISION:
MHI, A PREMIER GLOBAL ORGANIZATION

- **Live up to the trust of customers with outstanding technology**
- **Help people worldwide lead safe and fulfilling lives**
- **Aim for sustainable growth**

CONTENTS

FORWARD-LOOKING STATEMENTS

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

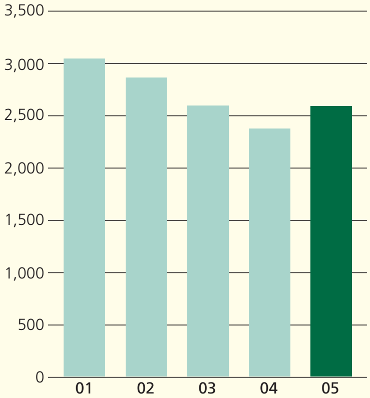
FINANCIAL HIGHLIGHTS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2005 and 2004

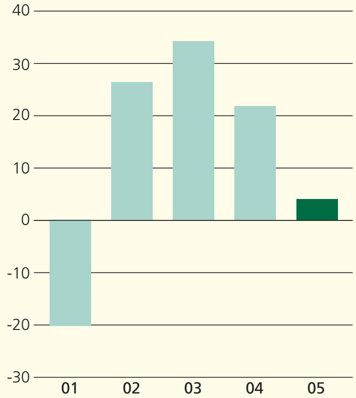
	In millions of yen except per share amounts		In thousands of U.S. dollars except per share amounts	Percent change
	2005	2004	**2005**	
Orders received	**¥2,722,867**	¥2,662,844	**$25,354,940**	2.3%
Net sales	**2,590,733**	2,373,441	**24,124,530**	9.2
Operating income	**14,773**	66,631	**137,560**	(77.8)
Net income	**4,050**	21,787	**37,711**	(81.4)
Research and development costs	**124,023**	99,515	**1,154,879**	24.6
Capital expenditures	**112,296**	109,832	**1,045,685**	2.2
Depreciation and amortization	**99,183**	99,816	**923,582**	(0.6)
Per share of common stock:				
Net income — basic	**¥ 1.20**	¥ 6.46	**$ 0.011**	(81.4)%
Cash dividends	**4.00**	6.00	**0.037**	(33.3)
Total assets	**¥3,831,144**	¥3,715,359	**$35,675,057**	3.1%
Stockholders' equity	**1,309,977**	1,324,498	**12,198,317**	(1.1)
Short-term borrowings and long-term debt	**1,172,896**	1,101,269	**10,921,837**	6.5

Notes: 1. U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥107.39 = U.S.$1, the exchange rate prevailing at March 31, 2005.
2. The accompanying consolidated financial statements for the years ended March 31, 2005 and 2004 have been compiled in accordance with accounting principles and practices generally accepted in Japan.

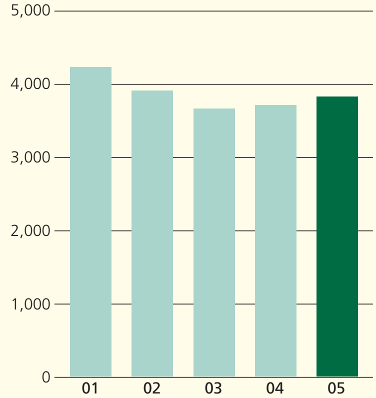
NET SALES
(In billions of yen)



NET INCOME (LOSS)
(In billions of yen)



TOTAL ASSETS
(In billions of yen)



A MESSAGE FROM THE MANAGEMENT

Operating Environment and Performance

During the fiscal year ended March 31, 2005, the long-term decline in public-sector spending continued and there were signs of a slowdown in capital investment, which has supported recovery in the Japanese economy. Furthermore, while exports were generally healthy, China's tight monetary policies, higher interest rates in the U.S. and rapidly rising crude oil prices led to some signs of a slowdown in the global economy. Consequently, in the second half of the year, export growth slowed somewhat and the economy appeared to be headed for a downturn.

In this operating environment, Mitsubishi Heavy Industries, Ltd. (MHI) and its consolidated subsidiaries (MHI Group) posted a year-on-year increase in the value of orders received of approximately 2.3%, to ¥2,722.9 billion (US$25,355 million). This reflected a sustained high level of orders in the Shipbuilding & Ocean Development division, despite a decline compared to the previous year when there was a succession of large-scale orders. Additionally, the Machinery & Steel Structures division, which won overseas orders for large-scale chemical plants, and the Mass and Medium-Lot Manufactured Machinery division, which benefited from strong exports and overseas production of small and medium-sized diesel engines and forklifts, recorded higher year-on-year orders. Moreover, the Power Systems division recorded higher orders after signing a number of contracts for gas turbine combined cycle power plants, and the Aerospace division also reported a slight increase over the previous fiscal year.

Takashi Nishioka, *Chairman: Left*
Kazuo Tsukuda, *President: Right*

Net sales grew approximately 9.2% to ¥2,590.7 billion (US$24,125 million), thanks to significant increases in sales in the Power Systems, Shipbuilding & Ocean Development and Mass and Medium-Lot Manufactured Machinery divisions that more than compensated for lower sales in the Machinery & Steel Structures division, where there was a decline in sales generated by bridge construction, chemical plants and other products.

During the year, MHI Group aggressively invested in R&D to develop new products and businesses, while also working to strengthen the operating structure. This included actions to boost production efficiency and upgrade product quality and reliability, and to improve profitability. Unfortunately, these efforts failed to counter the rapid rise in materials prices and other factors that squeezed profits, resulting in a decline in operating income of ¥51.9 billion to ¥14.8 billion (US$138 million), and a drop in ordinary income of ¥17.2 billion to ¥12.5 billion (US$117 million). After recording extraordinary expense, including losses related to the application of asset-impairment accounting for impairment of fixed assets, and extraordinary income from gains on sales of investment securities and property, plant and equipment, carried out from the perspective of enhancing asset efficiency, MHI Group recorded income before income taxes and minority interests of ¥16.4 billion (US$153 million) and net income of ¥4.1 billion (US$38 million).

Dividend Reduced

MHI decided not to pay an interim dividend during the year under review. In light of recent operating performance, the decision was also taken to reduce the year-end dividend for the March 2005 fiscal year by ¥2.0 to ¥4.0 per share.

Although MHI Group worked hard to drive a recovery in earnings this year, in the Shipbuilding & Ocean Development division, orders received when the yen was weaker were recorded as sales during the year under review, leading to deterioration in profitability. In other divisions, because the time from order to delivery is often two or three years, there were many cases where it was difficult for Group to reflect the escalating cost of materials and resources in the sales price, resulting in lower profitability; an unexpected rise in both the cost of maintaining the reliability of products already delivered to customers and outsourcing costs due to efforts to increase output also impacted on profitability. Group is also making significant investments in R&D to develop products that will support operations in the future. These and other factors resulted in a disappointing performance for the year under review. MHI also deeply regrets that it had to make the decision to reduce the dividend to shareholders this year.

2004 Business Plan Development

Despite these challenging business conditions, MHI Group continued to implement the core policy of its 2004 Business Plan (a four-year management plan beginning April 1, 2004)—making our businesses more competitive, supported by efforts to reinforce business functions, with the goal of boosting orders and realizing a recovery in earnings. Below are some of the steps we took during the year.

As part of efforts to make our businesses more competitive, the aerospace business signed a memorandum of agreement with the Boeing Company to participate in the development and production of Boeing's next-generation commercial transport aircraft, the Boeing 787. In a related move, construction began on a manufacturing facility at the Nagoya Aerospace Systems Works that will be dedicated to the production of wing sections made of composite material. The use of composite material wings in large commercial transport aircraft will be a world first. The aerospace business also concluded a contract with Rolls-Royce plc to participate in the joint development of the TRENT 1000, a new jet engine for the Boeing 787. In another move, the 7th H-ⅡA Launch Vehicle achieved a problem-free lift-off in February 2005, marking the first successful launch for the H-ⅡA in 15 months and boosting confidence in its reliability. The power systems business, meanwhile, worked to win new orders, particularly in Asia and Central and South America, by tapping into strong demand in these regions. The result was a raft of new orders for gas turbine combined cycle power plants in Thailand, South Korea, China, Mexico, New Zealand and other countries. The Machinery & Steel Structures business, leveraging its track record, won a contract for a large-scale fertilizer plant in Oman. Finally, in order to keep pace with business growth, the Mass and Medium-lot Manufactured Machinery business began adding manufacturing capacity for small engines for industrial use and small turbochargers at the general machinery

2004 Business Plan*

* A four-year management plan beginning April 1, 2004

and special vehicle headquarters' main factory in Sagamihara City, Kanagawa.

MHI Group also reinforced its industrial machinery business by setting up three integrated development, manufacturing, sales and service companies in April 2005 for food packaging machinery, injection molding machinery and commercial washing machines. The aim was to create faster decision-making processes and enhance responsiveness to market and customer needs to give Group the ability to compete with specialist manufacturers.

Meanwhile, in April 2004, as part of efforts to reinforce business functions, we realigned sales companies in the mass and medium-lot manufactured machinery business along product rather than regional lines, enabling them to respond more rapidly to customer needs. Additionally, in our overseas business, we established local companies in Singapore, South Korea, Brazil and India between December 2004 and March this year in order to create the framework for more regionally focused marketing activities and reinforce procurement capabilities. These moves to strengthen the MHI Group's overseas activities enabled us to sustain the high level of export orders achieved in the previous fiscal year of close to ¥1,000 billion on a nonconsolidated basis. Furthermore, we established a New Business Development Fund in order to accelerate the creation of businesses by making strategically targeted investments in new products and fields. In the fund's first year, we have decided to focus on medical equipment (3D radiation treatment systems), semiconductor manufacturing equipment and home-use robots. MHI is currently exhibiting some of its "wakamaru" home-use robots at the 2005 World Exposition in Aichi as part of aggressive PR activities for these products.

■ Consolidated Performance Targets

(In billions of yen)	2005 (Actual)	2008 (2004 Business Plan)
Orders Received	¥2,722.9	¥3,100.0
Net Sales	2,590.7	3,000.0
Operating Income	14.8	160.0
Short-term Borrowings and Long-term Debt	1,172.9	1,250.0

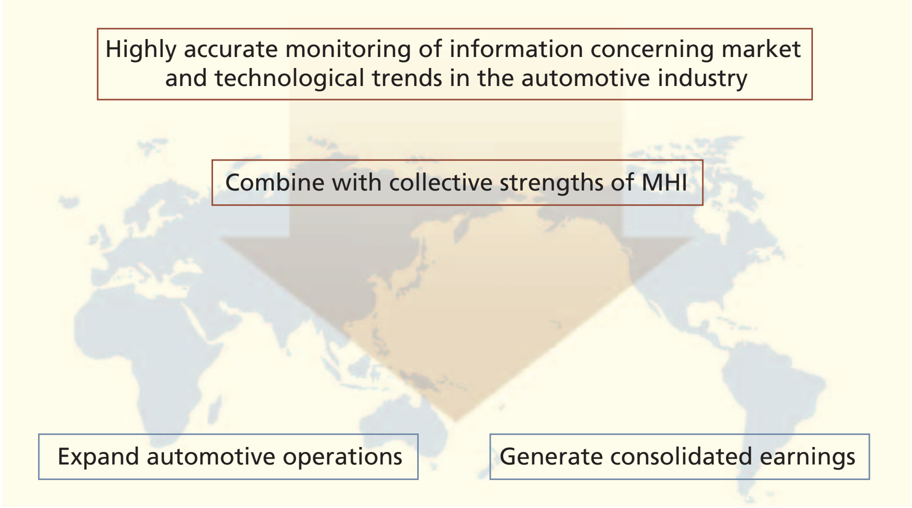
Support for the Revitalization of Mitsubishi Motors Corporation

Next, we would like to report on our support for the revitalization of Mitsubishi Motors Corporation (MMC). In June 2004, MHI accepted and completed the payment for MMC stock of ¥40 billion, offered through a private placement. The decision to inject additional capital into MMC was based on management's judgment that a robust recovery in the operations of MMC, through the implementation of its Business Revitalization Plan announced in May 2004, would support the sustainability and development of MHI's own operations. Subsequently, however, MMC was subject to severe public criticism regarding its past approach to product recall issues. MMC was then faced with an extremely difficult business situation of weaker sales and declining trust in the company.

Under these circumstances, MMC announced its Mitsubishi Motors Revitalization Plan in January 2005 incorporating additional measures. MHI accepted and completed payment for additional MMC stock of ¥50 billion in a subsequent private placement in March 2005. This decision to increase investment in MMC was based on three key considerations—that this second plan is both highly rational and feasible; that we can expect to further develop our own automotive-related businesses by more accurately reading automaker needs for cars that promise stable global demand; and that by supporting MMC's revitalization we are fulfilling our corporate social responsibility.

With MHI Group's ratio of voting rights in MMC exceeding 15% during the year ending March 31, 2006, our policy will be to make MMC an equity-method affiliate once more. In this way, we hope to play our part in winning back public trust in MMC and further increasing the feasibility of the Mitsubishi Motors Revitalization Plan. We believe that this will drive forward the development and expansion of our own automotive-related businesses.

Participation in Management of MMC



Issues to Be Addressed

There are a number of concerns for the Japanese economy in the months ahead, including high crude oil prices, rising materials prices, weaker growth in corporate profits and, as a result, softer capital investment. Public-sector capital investment is also expected to continue falling as a whole. Growth in the global economy, mainly in China and the rest of Asia, is projected to gradually decline, leading to an expected moderate decrease in the pace of export growth. Consequently, uncertainty about the direction of the economy is expected to continue.

In this difficult business environment, the greatest and most urgent challenge for the MHI Group will be how to boost earnings as quickly as possible. Every MHI Group director and employee is aware of the seriousness of the situation. We have initiated emergency activities that cut across the company, led by senior management, to improve profitability. Our actions include paring back costs and enhancing productivity. Through these activities, MHI Group will increase the quality and cost-competitiveness of all its product lines, create and establish new businesses and products, such as the Boeing 787 commercial transport aircraft, speed up efforts to make individual businesses more competitive and work company-wide to reinforce business functions.

Specific steps to make MHI Group's businesses more competitive will focus on the following: the Shipbuilding & Ocean Development business will seek to secure a stable supply of steel and actively work to increase productivity in order to minimize the impact of exchange rate fluctuations and tight supplies and rising prices of steel. The business will also continue to leverage its superior technologies to increase the tonnage value of its products. The Power Systems business will continue to strengthen engineering, procurement and construction (EPC) capabilities and work to procure materials at more competitive prices in order to boost margins of mainstay gas turbine combined cycle power plants and other products. This will go hand in hand with steps to use resources more efficiently at the design and production stages to enhance cost-competitiveness. The Machinery & Steel Structures business will target large-scale orders for chemical plants by leveraging its experience and track record in methanol, fertilizer and other plants, and strive to expand its overseas business by working to secure orders for new transport systems and other products, particularly in Asia and the U.S. Initiatives such as shortening production processes and strengthening risk management will also be implemented in the interests of reducing costs. The aerospace business, meanwhile, will steadily push forward the development of wings made of composite material for the Boeing 787 and combustor modules, core components for the TRENT 1000 jet engine, also for the Boeing 787. These are expected to be an important business going forward.

The Mass and Medium-lot Manufactured Machinery business will seek to realize the benefits of increased production capacity in small and medium-sized diesel engines used in power generation and other industrial applications, and automotive turbochargers to meet growing demand for these products in the U.S., Europe and China. In machine tools, the business will strategically channel resources into the automotive and other fields where demand is projected to rise steadily, while further strengthening the development and manufacturing framework for these products.

Enhancing MHI Group's manufacturing capabilities through company-wide efforts will be key to reinforcing business functions. Here our approach will be manifold: such as effectively using the New Business Development Fund to create new products and businesses, and reinforcing manufacturing capabilities in the wider sense by looking at areas such as order processing, product development, design, and after-sales services, in addition to reforming manufacturing itself. This will include boosting quality and reliability in conjunction with further efforts to strengthen customer satisfaction initatives.

Amid intensifying global competition, MHI must ensure that its business keeps evolving and that it fulfills its corporate social responsibility to customers, shareholders, employees and society. To achieve this, MHI must be capable of taking swift and proper decisions and executive actions, and importantly, ensure internal systems realize sound management by monitoring the suitability of these decisions and actions. With this in mind, MHI has decided to reform its corporate governance structure in June 2005 to increase the soundness and transparency of company management, as well as improve efficiency and responsiveness. Specifically, we will increase the number of outside directors, reduce the number of directors on the board and their term of office, and introduce an executive officer system. These moves will reinforce the oversight function of the Board of Directors and clearly separate the roles of directors and executive officers. Following these changes, directors will be responsible for making key management decisions and overseeing overall management of MHI, while executive officers will be responsible for the day-to-day running of the company.

Although the MHI Group is currently facing extremely challenging business conditions, by steadily implementing the above measures, we believe we can increase MHI Group's earnings and take the company forward. Your support, as ever, will be vital to our endeavors.

July 2005

T. Nishioka K. Tsukuda

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

MHI AT A GLANCE

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

SHIPBUILDING & OCEAN DEVELOPMENT	Through its Shipbuilding & Ocean Development division, MHI plays an extensive role on the world's oceans with the development and construction of a wide range of large vessels and ocean structures that satisfy diverse customer needs. Underpinned by more than a century of tradition and years of technological expertise, MHI is actively working to develop new products that raise the bar on economy, reliability and safety.
POWER SYSTEMS	Based on independent research efforts that strike a balance between solving energy supply issues and protecting the environment, MHI's Power Systems division develops energy conservation measures, petroleum substitutes and new forms of energy to help solve some of the common problems faced by mankind today. MHI is also widely involved in the nuclear power field as one of the world's leading manufacturers of nuclear power plants.
MACHINERY & STEEL STRUCTURES	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.
AEROSPACE	This division uses research and development programs underpinned by state-of-the-art technologies to prepare for the advent of the next Space Age. In aerospace products, MHI is working to expand its business into new areas through participation in projects for Japan's Defense Agency and the development of new commercial aircraft. And in space systems, MHI helps to drive forward Japan's space program as a systems integrator in launch vehicle development.
MASS AND MEDIUM-LOT MANUFACTURED MACHINERY	In the general machinery and special vehicles business, MHI develops and manufactures products such as engines and forklift trucks for the logistics field. The air-conditioning and refrigeration systems business boasts an extensive lineup of air-conditioning products, while the industrial machinery business manufactures extrusion machinery, used in the production of plastic products, beverage filling and packaging machines and other industrial equipment. This division also includes the paper and printing machinery business, which meets a diverse range of customer needs in Japan and overseas as a specialist player in the paper-related equipment field. Through its machine tools business, this division also supplies the "mother machines" of industry.

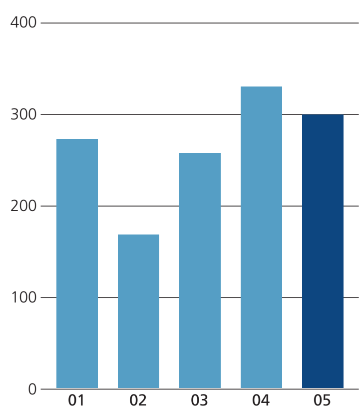
Note: MHI's operations also include an Others business division, not shown above.

REVIEW OF OPERATIONS

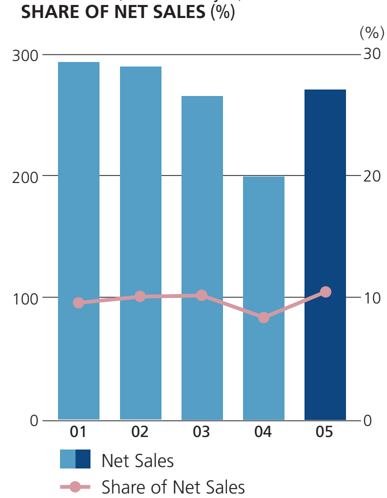
SHIPBUILDING & OCEAN DEVELOPMENT

Car Ferry "HAMANASU"

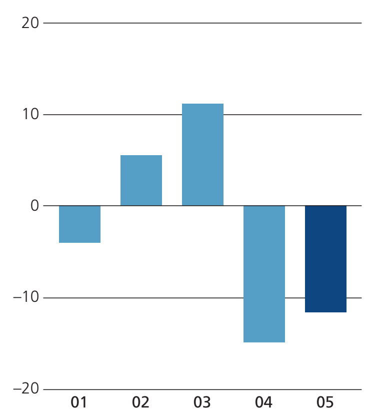
ORDERS RECEIVED
(In billions of yen)



NET SALES (In billions of yen)
SHARE OF NET SALES (%)



OPERATING INCOME (LOSS)
(In billions of yen)



Products

Crude oil carriers, Container ships, Cruise ships, Car ferries, LPG carriers, LNG carriers and various other ships, Defense vessels, Offshore structures

LNG Carrier "PUTERI FIRUS SATU"

Patrol Vessel "ASO"

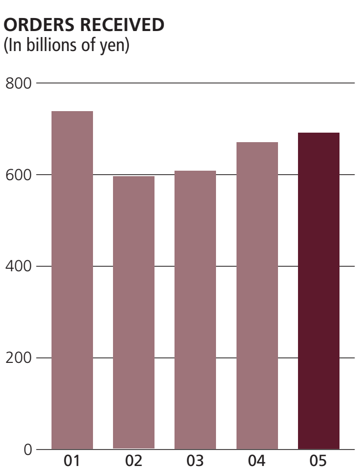
During the year, new order activity in the marine transport market was buoyant, as demand for new shipbuilding remained high. In this environment, the division actively sought to win new orders, particularly for high-value-added vessels, a market segment where MHI is strong. These efforts paid off with orders received for a total of 23 new vessels (all figures in this section exclude vessels of less than 100 gross tons). By vessel type, MHI secured contracts for four mega container carriers capable of carrying 8,100 TEU containers—the first time MHI has won an order for this kind of vessel—eight LNG carriers, two LPG carriers, six pure car and truck carriers, one submarine for the Japan Defense Agency and other vessels. However, reflecting the lack of large-scale orders compared to a year earlier, the total value of new orders declined to ¥299.4 billion (US$2,788 million). As of March 31, 2005, MHI had outstanding orders for 60 vessels totaling approximately 3.98 million gross tons.

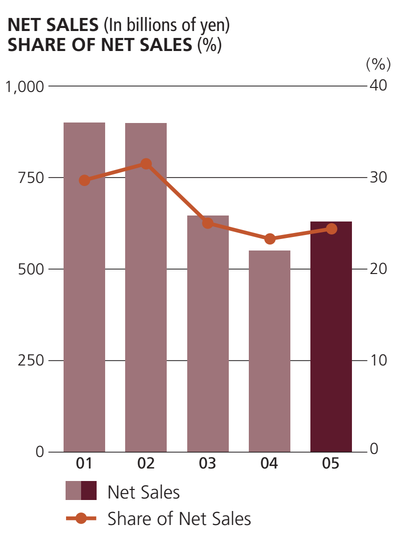
Net sales were higher at ¥271.6 billion (US$2,529 million) on the back of an increase in vessel deliveries to export customers and other factors.

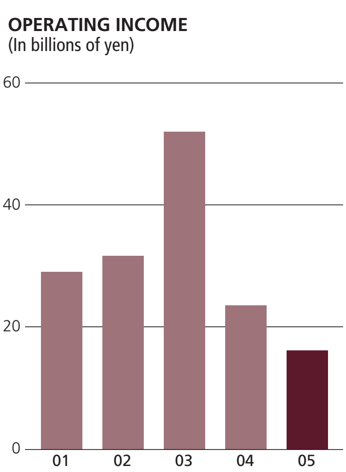
REVIEW OF OPERATIONS

POWER SYSTEMS

Maizuru No.1 Thermal Power Station of The Kansai Electric Power Co., Inc.







Products

Boilers, Steam turbines, Gas turbines, Diesel engines, Water turbines, Wind turbines, Nuclear power equipment, Nuclear fuel, Denitrification equipment, Marine machinery

UEC-Eco Marine Diesel Engine

Work to Replace Reactor Core Internals (Reactor No.1, Ikata Nuclear Power Station, Shikoku Electric Power Co., Inc.)

Active global sales activities, centered on markets in Asia and Central and South America with strong demand, helped this division to win new contracts for gas turbine combined cycle power plants and other power systems in Thailand, Korea, China, Mexico and New Zealand. Orders for the upgrade, refurbishment and repair of existing power plants and for wind turbines to the U.S. also grew. Other highlights included an order to supply replacement steam generators for nuclear power plants in the U.S. In Japan, although orders were weak for the upgrade, refurbishment and repair of existing power plants, as electric utilities reduced budgets for facility maintenance, orders increased due in part to the closure of contracts for new power plants. As a result, the total value of new orders in this division increased year on year to ¥691.4 billion (US$6,438 million).

Net sales were higher at ¥629.7 billion (US$5,863 million) owing to an increase in construction orders for thermal power plants and other factors.

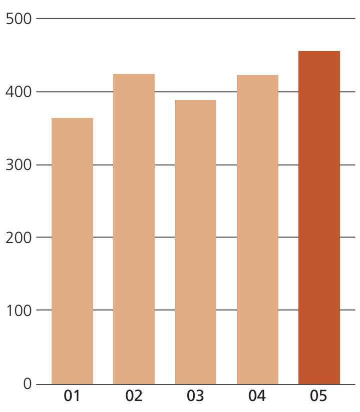
REVIEW OF OPERATIONS

MACHINERY & STEEL STRUCTURES

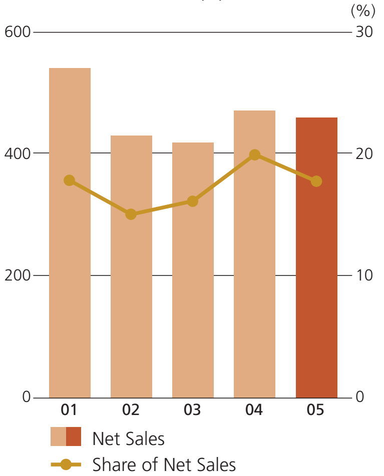
Container Handling Quayside Crane

Electronic Toll Collection in Vehicle Unit

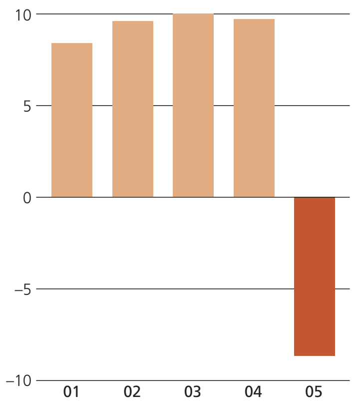
ORDERS RECEIVED
(In billions of yen)



NET SALES (In billions of yen)
SHARE OF NET SALES (%)



OPERATING INCOME
(In billions of yen)



Products

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, Desalination plants, Iron and steel manufacturing machinery, Blowers, Packing machinery, Bridges, Hydraulic gates, Cranes, Stacks, Parking systems, Tanks, Entertainment facilities, Sports and leisure-related facilities, Various other steel structures

Tunnel Excavation Machinery

Innovative Transport System "Crystal Mover"

In the machinery business, new orders declined in the domestic market for waste treatment facilities and flue-gas desulfurization systems, which the division secured major orders for in the previous year. However, this drop was more than offset by new contracts for large-scale test equipment in the automotive industry, where capital investment is currently strong, and a number of overseas orders, including a large fertilizer plant in Oman and an Automated People Mover in Dubai. Consequently, the value of new orders secured in this business exceeded the level in the previous fiscal year.

The steel structures business experienced a drop in orders for crane & material handling systems and tunneling equipment, which the division had secured major orders for in the previous fiscal year, in domestic and overseas markets characterized by sustained and intense price competition. Despite this, the business increased the value of new orders secured thanks to new large-scale contracts for bridge construction projects in Japan, an LNG tank order in Mexico and other overseas orders.

Consequently, the total value of new orders in the division as a whole increased to ¥455.6 billion (US$4,242 million).

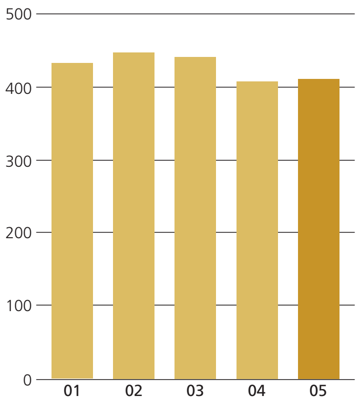
Net sales were lower at ¥459.4 billion (US$4,278 million), reflecting lower sales from bridge construction projects, chemical plants and other products.

REVIEW OF OPERATIONS

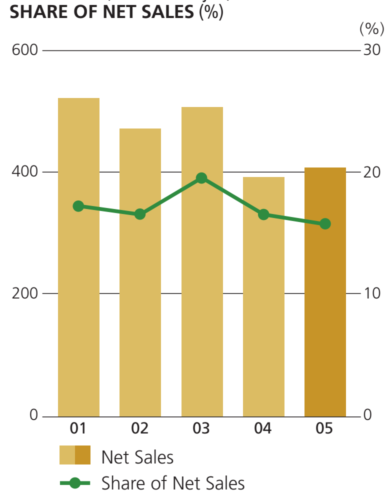
AEROSPACE

Boeing 777 Transport Aircraft

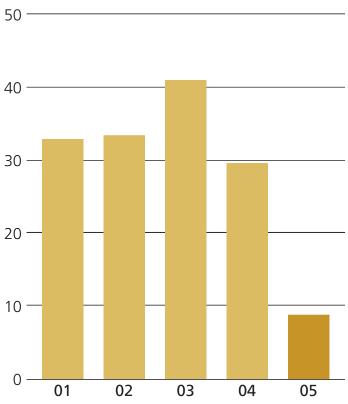
ORDERS RECEIVED
(In billions of yen)



NET SALES (In billions of yen)
SHARE OF NET SALES (%)



OPERATING INCOME
(In billions of yen)



Products

Fighters and other aircraft, Helicopters, Aero engines, Missiles, Torpedoes, Fleet engines, Space systems

F-2 Support Fighter

SH-60J Anti-submarine Helicopter

Orders in space systems declined year on year due to falling orders for the H-IIA Launch Vehicle. However, orders in defense-related products grew due to a new contract to upgrade ground equipment for the Patriot surface-to-air missile, related to the deployment of the Ballistic Missile Defense (BMD) system, which more than offset lower orders for F-2 support fighters. In commercial aircraft products, orders for aft fuselage and other components used in the Boeing 767 commercial transport aircraft, and wings and other components for the Global Express business jet declined, but new orders for wings for the Boeing 787 commercial transport aircraft helped to lift orders higher overall compared to the previous year.

As a result, the total value of new aerospace orders increased year on year to ¥411.1 billion (US$3,828 million).

Net sales were higher at ¥408.0 billion (US$3,799 million) due to an increase in the number of deliveries of commercial transport aircraft and other factors.

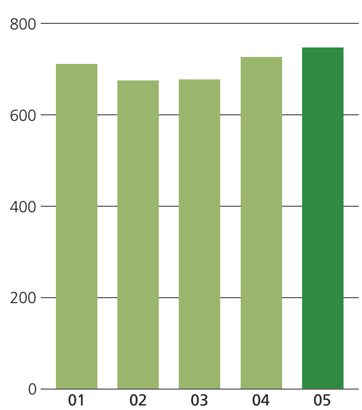
REVIEW OF OPERATIONS

MASS AND MEDIUM-LOT MANUFACTURED MACHINERY

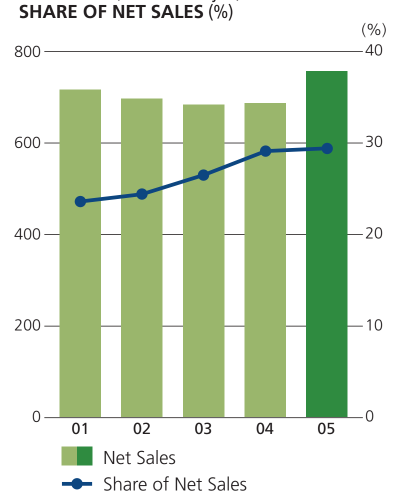
Truck and Trailer Refrigeration Unit

Mitsubishi Forklift Truck "GRENDIA"

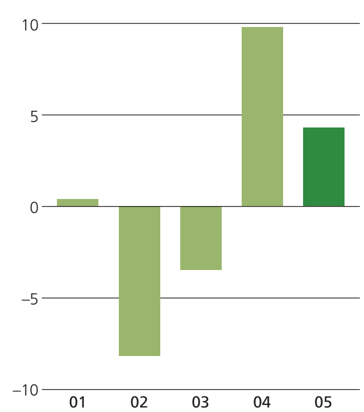
ORDERS RECEIVED
(In billions of yen)



NET SALES (In billions of yen)
SHARE OF NET SALES (%)



OPERATING INCOME (LOSS)
(In billions of yen)



Products

Forklift trucks, Construction machinery, Earthmoving and grading machinery, Medium and small-sized engines, Turbochargers, Special vehicles, Air-conditioners (commercial use, residential), Automotive thermal systems, Chilling systems, Plastic processing machinery, Food machinery, Industrial robots, Transmissions, Pulp and paper making machinery, Box-making machinery, Printing machinery, Machine tools

Mitsubishi EVOL Box-making Machine

Mitsubishi Gear Grinding Machine

In the general machinery and special vehicles business, orders for small and medium-sized diesel engines and forklift trucks were healthy on the back of strong demand supported by economic recovery in Japan and overseas, and high-paced growth in Asia, particularly China. Together with rising orders for turbochargers in Europe, this led to an increase in both the value of new orders secured and net sales, to ¥347.4 billion (US$3,235 million) and ¥363.0 billion (US$3,380 million), respectively.

In the air-conditioning and refrigeration systems business, orders for residential use air-conditioners and commercial use air-conditioners in Europe rose and higher orders were recorded for centrifugal liquid chillers in Japan. However, sales of residential use air-conditioners in Japan declined, and sales of automotive thermal systems were weaker both in Japan and overseas. This led to a decline in the value of new orders secured to ¥180.6 billion (US$1,682 million), while net sales were on a par with the previous year at ¥178.7 billion (US$1,664 million).

In the industrial machinery business in Japan, orders grew for newspaper offset presses, as the division tapped into new demand driven by capital investment related to the shift to full-page color printing by newspaper publishing companies. Also in Japan, the machine tools business, which launched new products, including gear cutting machines, saw orders increase, mainly from the automotive industry, where capital investment is currently strong, while new large-scale domestic orders for pulp and paper machinery were also secured. Overseas, although sales of sheet-fed offset presses were strong, exports of extrusion machinery and pulp and paper machinery to China declined. As a result, the value of orders secured dipped slightly year on year to ¥219.9 billion (US$2,048 million). Net sales rose to ¥216.2 billion (US$2,013 million), reflecting stronger sales of printing machinery, machine tools and other products in Japan.

TOPICS

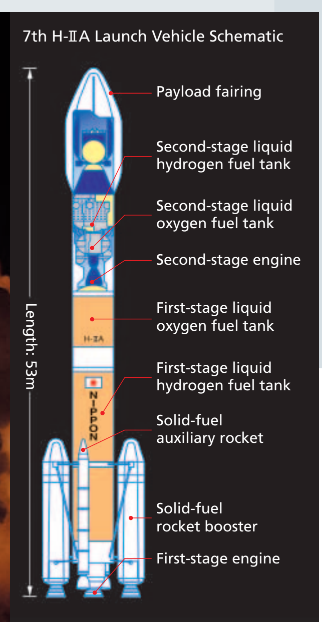
Problem-free Lift-off for the 7th H-ⅡA Launch Vehicle

On February 26, 2005 at 18:25 JST, the domestically built 7th H-ⅡA Launch Vehicle successfully lifted off from the Tanegashima Space Center. MHI is a key partner in the development and manufacture of this rocket. The H-IIA payload, the Multi-functional Transport Satellite-1 Replacement (MTSAT-1R), was safely delivered to geostationary orbit. Standing at 53 meters, equivalent to the height of a 17-storey building, the standard H-ⅡA Launch Vehicle is capable of carrying satellites weighing up to 6 tons. The H-IIA incorporates a liquid-propellant rocket engine with a reignition capability and other unique, world-class technologies highly rated overseas. MHI aims to take a more active role in the launch service business in 2007 by taking orders itself for commercial satellite launches using the H-IIA.

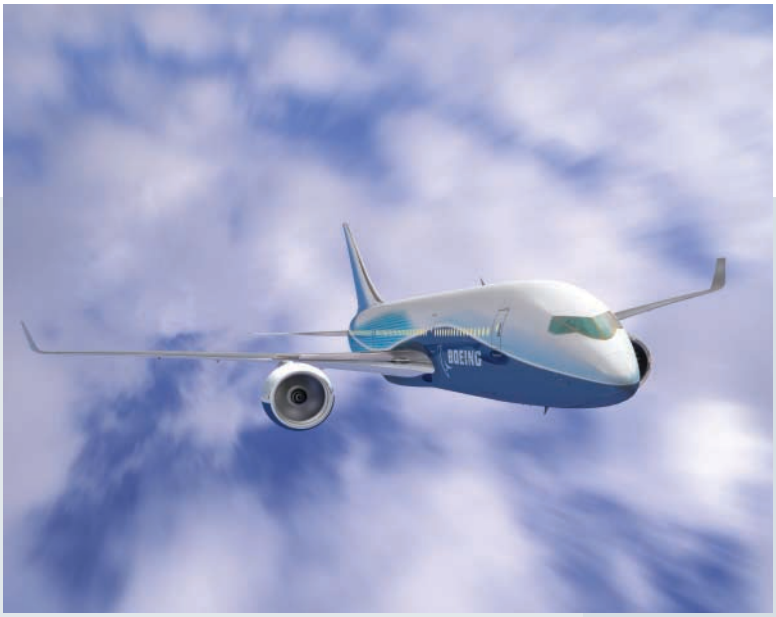
MHI to Help Boeing Develop the 787

In October 2004, MHI signed a memorandum of agreement with Boeing of the U.S. to take part in the development and volume production of Boeing's next-generation passenger aircraft, the 787. The aircraft, designed to carry 200–300 passengers, is scheduled to perform its maiden flight in 2007, and to enter service the following year.

MHI is responsible for developing the 787's wing boxes, which will be fabricated using a new, light and strong composite material made from a



7th H-ⅡA Launch Vehicle



Boeing 787

combination of carbon fiber and resin—a world first for the wing of a commercial aircraft. The wings are naturally one of the most important parts of any aircraft, and Boeing's decision to select an outside contractor to develop and manufacture these components is a first for the company. MHI believes that the high regard in which its fabrication and design capabilities are held undoubtedly led to its participation in the project.

In a related development, in January 2005, MHI began construction of a new factory dedicated to the production of these composite main wing sections. Fabrication is due to start at the end of the year.

MHI Develops Japan's First 100% Low-Floor LRV

MHI has developed a 100% low-floor LRV*, the first made in Japan, in partnership with The Kinki Sharyo Co., Ltd. and Toyo Electric Manufacturing Co., Ltd. Called the Green Mover max, the streetcar was delivered to Hiroshima Electric Railway Co., Ltd. and entered service in March 2005. Because the vehicle uses independent wheels that connect to the bogie without axles, MHI and its partners have been able to create a floor that is close to street level and entirely flat, allowing passengers such as the elderly and physically challenged to board, alight and move around more freely. Thanks to resilient wheels, the development of a new system that converts braking energy into electrical power and other innovations, noise, vibration and power consumption have all been reduced, resulting in a vehicle for public transport that is both eco- and user-friendly.

* Light Rail Vehicle

Ultra-Low-Floor LRV

CORPORATE SOCIAL RESPONSIBILITY

CSR: At the Heart of Management

MHI's corporate philosophy is to contribute to society through its business activities. Based on this thinking, we formulated a new vision for the company in 2003: MHI, a Premier Global Organization. This vision expresses our desire to continue driving the development of the company by living up to the trust of customers with outstanding technology, and helping people worldwide lead safe and fulfilling lives. In realizing this vision, we are working to achieve our mission of enhancing MHI's corporate value for all the company's stakeholders—shareholders, customers, employees and society. Based on this vision and mission, we hope to play a part in building a brighter future for people around the world.

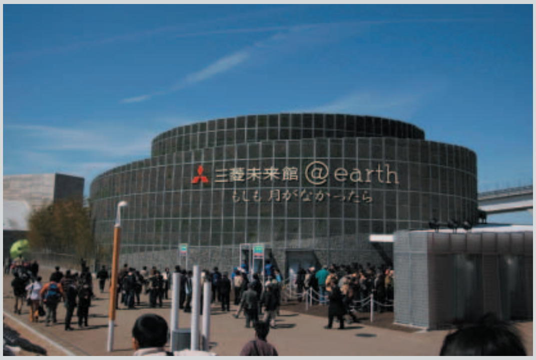
For more details on our CSR activities, please view the MHI Social and Environmental Report on our website.
(URL: http://www.mhi.co.jp/ekankyohozen/main.html)

CSR Topics: MHI Takes Part in EXPO 2005 Aichi, Japan

As part of its CSR activities, MHI is participating in the 2005 World Exposition, which is located on a site east of Nagoya, Aichi Prefecture, and runs from March 25 to September 25, 2005. Based on the overarching theme "Nature's Wisdom," the EXPO seeks to bring together different people from around the world to talk and think about how to create new cultures, civilizations and a social model for the 21st century.

As a member of the Mitsubishi Group, MHI has exhibited in the Mitsubishi Pavilion at every international exposition held in Japan since the Osaka World Exposition 1970. The theme of the Mitsubishi Pavilion at EXPO 2005 Aichi is "The Wonder of Our Lives on Earth—A Glimpse of the Miracle," and gives visitors a view from space of the remarkable balance between human activity and the natural environment. The pavilion is designed to communicate our stance on the environment and present our point of view on environmental issues for the 21st century. In parallel, we hope the exhibition will raise awareness of the Mitsubishi Group's new brand image.

MHI is supporting the exposition through technical assistance for five pavilions, including the construction of the main attraction at the Mitsubishi Pavilion, the IFX Theatre. With this realistic video space, visitors can experience what the earth would be like without a moon, or gain an understanding of how abundant the global environment is today. The IFX Theatre's highly realistic imagery has already attracted tremendous interest among visitors to the exposition.



Mitsubishi Pavilion

CORPORATE GOVERNANCE

1. Fundamental Policy

MHI is taking 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. The Group is also working to make management more transparent by disclosing information rapidly and accurately to shareholders and other external stakeholders.

2. Corporate Governance Initiatives

(1) Corporate Governance Framework

The Board of Directors makes important management decisions and oversees the execution of business operations. The Board of Auditors monitors the execution of duties of the members of the Board of Directors. For some time, MHI has sought to strengthen management oversight functions through the appointment of outside directors and corporate auditors. Currently, of the 17 directors, two are from outside MHI, while three of the five corporate auditors are external appointments. Additionally, MHI has established a Management Committee to provide a forum for discussing important matters related to executive actions. This allows for a more collegiate 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 also overhauled its corporate governance system in June 2005 to improve the soundness and transparency of management and increase speed and flexibility in decision-making and policy execution. The main components of this reform included streamlining the Board of Directors while increasing the number of outside directors, shortening the tenure of directors, and implementing an executive officer system. These modifications are aimed at enhancing the oversight functions of the Board of Directors and clearly delineating the roles and responsibilities of directors, who are responsible for general oversight of the Company's operations and making important business decisions, and executive officers, who are responsible for the day-to-day business and affairs of the Company.

(2) Enhancing Internal Control Systems

To ensure that business operations are appropriately and effectively carried out, MHI has implemented the following measures under the themes of compliance, risk management, and monitoring, which are essential to the establishment of internal control systems.

1. Strengthening and upgrading compliance activities

MHI carries out compliance activities on a broad scale that encompasses not only all relevant laws and regulations but also societal norms and business ethics. Strict compliance activities are carried out throughout the entire organization. Specific measures included the establishment of a Compliance Committee, chaired by the managing director in charge of the General Affairs Department, in May 2001. Since then, MHI has established the Mitsubishi Heavy Industries Compliance Policy, set up a dedicated contact point for accepting reports from employees and other individuals, and implemented various programs, including periodic compliance training. All of these measures are aimed at increasing employee awareness about the importance of compliance.

To accurately understand the level of compliance awareness among employees, MHI carries out a Compliance Awareness Survey and has established other mechanisms for periodically checking the effectiveness of measures aimed at strengthening compliance.

Based on the results of these surveys and evaluations, MHI decided to implement additional measures to promote compliance across the Company. Consequently, from the year under review, MHI has increased the frequency of compliance training to two times per year, and required every manager in the Company from the section chief grade upward, including directors, to sign cautionary compliance contracts.

2. Strengthening the risk management system

MHI conducts periodic risk assessments based on the recognition that processes to accurately manage the various business risks it faces are indispensable to its survival as a firm. These assessments include the detection and assessment of risks in each department responsible for executing business operations, and the formulation of necessary measures to prevent and mitigate these risks. Internal auditing is also conducted to check the appropriateness of these measures. In this way, underpinned by consistent application of the Plan Do Check Action (PDCA) cycle, MHI is able to conduct appropriate risk management.

MHI has also constructed a Crisis Management Data System to quickly and accurately deal with emerging risks and to ensure risk information is passed to senior management as rapidly as possible. The Group's risk management system is headed by the managing director in charge of the General Affairs Department, who is responsible for company-wide crisis management, and is supported by individuals in each business unit responsible for crisis management in their respective operating fields. MHI also activates a Countermeasures Headquarters in the event of an emergency.

3. Monitoring

MHI checks the effectiveness of internal control systems through internal audits. Specifically, the heads of each department responsible for business execution set their own auditing themes and carry out periodic checks. The Internal Auditing and Control Department sets essential company-wide auditing parameters and participates in the audits of related business units, thereby creating a mechanism for preserving objectivity. This department also conducts special audits based on specific themes as necessary.

Auditors, in addition to monitoring the execution of internal checks, share information on specific internal issues with the Internal Auditing and Control Department. By strengthening cooperation between auditors and departments in charge of compliance, the Company's overall internal auditing system is enhanced. In order to further reinforce monitoring of divisions responsible for business execution, MHI established an Internal Audit Office on July 1, 2005 as a dedicated internal audit organization.

(3) Auditing System

The Board of 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, auditors attend other key meetings, including meetings of the managing directors and the business planning committee, in addition to meetings of the Board of Directors. This allows auditors to more effectively monitor the execution of director duties by accurately assessing the status of business execution, conducting spot checks and compliance with relevant laws and regulations, and monitoring activities involving the operation and enhancement of internal control systems. To support the activities of auditors, MHI established a six-person Auditing Office to ensure that auditing activities are carried out smoothly.

In addition, corporate auditors periodically exchange information with accounting auditors and cooperate closely in other ways, including the receipt of audit reports and the support of accounting audits implemented as needed.

(4) Accounting Audits

MHI's corporate auditor is Ernst & Young ShinNihon. The names and years of continual auditing experience of the firm's certified public accountants (engagement partners and management partners) that audit the Company's financial statements are listed below.

(Years of continual auditing experience)
Mineo Toyama (24 years)
Kouichi Hirao (1 year)
Masayuki Ueda (6 years)
Katsuhiko Hizawa (3 years)

In addition to the above, the auditing team includes seven CPAs, three assistant CPAs, and one other staff member.

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

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

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

4. Director and Auditor Remuneration

Remuneration paid to directors and corporate auditors in the year under review was as follows.

Directors	¥573 million
Corporate auditors	¥ 52 million
Total	¥625 million

Note: In addition to the above, directors with concurrent positions as advisors received a total of ¥201 million for these services. In accordance with resolutions passed at the 79th annual general meeting of shareholders held on June 25, 2004, directors and corporate auditors were paid bonuses of ¥436 million and ¥47 million, respectively.

5. Audit Fees

Fees paid to independent auditors during the year under review were as follows.

Fees related to audit certification ¥49 million

Note: The above amount represents fees paid to Ernst & Young ShinNihon for audit certification pursuant to the Law for Special Exceptions to the Commercial Code Concerning Audit and the Securities and Exchange Law. The total amount paid to Shin Nihon & Co. for audit certification by the Company and its consolidated subsidiaries was ¥147 million.

Indictment Related to Alleged Violations of Antimonopoly Law in Steel Bridge Construction

On June 15, 2005, MHI was indicted for alleged violations of Japan's Antimonopoly Law (improper trading) related to steel bridge construction orders from the Ministry of Land, Infrastructure and Transport. MHI regards this situation and the related ban on participating in government tenders as extremely serious.

Over the years, MHI has continually emphasized the importance of compliance, and in particular, expressly instructed employees to avoid actions that could be construed as bid rigging in relation to Japan's Antimonopoly Law. However, to ensure that this kind of incident never occurs again, we will further strengthen the auditing functions of the Internal Audit Department and establish an Order Compliance Committee, which will draw on the advice of both internal and external experts to improve checks on order process and individual projects. Other initiatives to prevent reoccurrence will include an overhaul of the personnel structure in sales divisions and enhanced staff education and training.

FINANCIAL SECTION

CONTENTS

CONSOLIDATED SIX-YEAR SUMMARY

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

	In millions of yen except per share amounts						In thousands of U.S. dollars except per share amounts
	2005	2004	2003	2002	2001	2000	**2005**
Net sales	**¥2,590,733**	¥2,373,441	¥2,593,894	¥2,863,985	¥3,045,024	¥2,875,039	**$24,124,530**
Operating income (loss)	**14,773**	66,631	115,308	78,655	74,889	(23,797)	**137,560**
Interest expense – net of interest income	**(5,590)**	(6,333)	(8,394)	(9,407)	(7,708)	(7,607)	**(52,046)**
Income (loss) before income taxes and minority interests	**16,399**	50,124	66,162	48,028	(5,121)	(217,672)	**152,704**
Net income (loss)	**4,050**	21,787	34,331	26,447	(20,351)	(137,006)	**37,711**
Per share of common stock:							
Net income (loss) — basic	**¥1.20**	¥6.46	¥10.14	¥7.84	¥(6.03)	¥(40.62)	**$0.011**
Net income — diluted	**–**	–	–	7.82	–	–	**–**
Cash dividends	**4.00**	6.00	6.00	4.00	4.00	2.50	**0.037**
Total assets	**¥3,831,144**	¥3,715,359	¥3,666,866	¥3,915,276	¥4,236,634	¥4,636,739	**$35,675,057**
Stockholders' equity	**1,309,977**	1,324,498	1,270,968	1,282,727	1,278,242	1,245,064	**12,198,317**
Current assets	**2,465,645**	2,402,987	2,389,358	2,598,526	2,891,271	3,474,015	**22,959,728**
Current liabilities	**1,567,987**	1,519,467	1,721,515	1,881,226	1,965,808	2,319,456	**14,600,868**
Short-term borrowings and long-term debt	**1,172,896**	1,101,269	1,122,923	1,049,998	1,090,696	1,205,301	**10,921,837**

Note: U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥107.39=U.S.$1, the exchange rate prevailing at March 31, 2005.

SEGMENT INFORMATION

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
Years ended March 31, 2005 and 2004

	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	**2005**	2004	**2005**	**2005**	2004	**2005**
Shipbuilding & Ocean Development	**¥ 271,578**	¥ 200,096	**$ 2,528,892**	**¥(11,735)**	¥(14,985)	**$(109,274)**
Power Systems	**629,665**	549,895	**5,863,354**	**16,089**	23,476	**149,813**
Machinery & Steel Structures	**459,366**	471,505	**4,277,545**	**(8,702)**	9,668	**(81,029)**
Aerospace	**407,956**	392,242	**3,798,828**	**8,751**	29,585	**81,487**
Mass and Medium-Lot Manufactured Machinery	**757,857**	687,627	**7,057,056**	**4,315**	9,850	**40,181**
Others	**111,006**	115,892	**1,033,675**	**6,055**	9,037	**56,382**
Subtotal	**2,637,428**	2,417,257	**24,559,350**	**14,773**	66,631	**137,560**
Eliminations or Corporate	**(46,695)**	(43,816)	**(434,820)**	**–**	–	**–**
Total	**¥2,590,733**	¥2,373,441	**$24,124,530**	**¥ 14,773**	¥ 66,631	**$ 137,560**

	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	**2005**	2004	**2005**	**2005**	2004	**2005**
Shipbuilding & Ocean Development	**¥ 205,424**	¥ 260,480	**$ 1,912,875**	**¥ 6,220**	¥ 5,912	**$ 57,918**
Power Systems	**754,185**	750,856	**7,022,857**	**22,220**	22,708	**206,913**
Machinery & Steel Structures	**584,315**	524,870	**5,441,053**	**9,646**	9,563	**89,824**
Aerospace	**634,543**	626,728	**5,908,773**	**17,485**	17,187	**162,820**
Mass and Medium-Lot Manufactured Machinery	**754,960**	708,680	**7,030,079**	**25,329**	25,585	**235,858**
Others	**211,521**	253,270	**1,969,658**	**18,283**	18,861	**170,249**
Subtotal	**3,144,948**	3,124,884	**29,285,295**	**99,183**	99,816	**923,582**
Eliminations or Corporate	**686,196**	590,475	**6,389,762**	**–**	–	**–**
Total	**¥3,831,144**	¥3,715,359	**$35,675,057**	**¥99,183**	¥99,816	**$923,582**

	Impairment Losses on Fixed Assets			Capital Expenditures		
	In millions of yen		In thousands of U.S. dollars	In millions of yen		In thousands of U.S. dollars
INDUSTRY SEGMENT	**2005**	2004	**2005**	**2005**	2004	**2005**
Shipbuilding & Ocean Development	**¥ 39**	¥ –	**$ 360**	**¥ 5,292**	¥ 5,651	**$ 49,280**
Power Systems	**113**	–	**1,054**	**18,722**	20,541	**174,339**
Machinery & Steel Structures	**262**	–	**2,439**	**8,808**	10,192	**82,018**
Aerospace	**72**	–	**675**	**25,687**	17,905	**239,189**
Mass and Medium-Lot Manufactured Machinery	**66**	–	**613**	**28,714**	30,379	**267,379**
Others	**5,556**	–	**51,734**	**25,073**	25,164	**233,480**
Subtotal	**6,108**	–	**56,875**	**112,296**	109,832	**1,045,685**
Eliminations or Corporate	**–**	–	**–**	**–**	–	**–**
Total	**¥6,108**	¥ –	**$56,875**	**¥112,296**	¥109,832	**$1,045,685**

	In millions of yen		In thousands of U.S. dollars
Overseas Sales	**2005**	2004	**2005**
Overseas Sales	**¥1,049,368**	¥892,659	**$9,771,558**
Ratio to Total Net Sales	**40.5%**	37.6%	

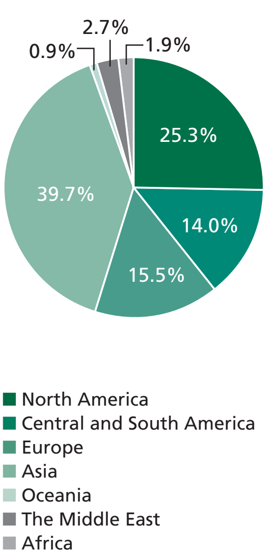
Notes: 1. U.S. dollar amounts in this annual report are translated from yen, for convenience only, at the rate of ¥107.39=US$1, the exchange rate prevailing at March 31, 2005.

2. The accompanying consolidated financial statements for the years ended March 31, 2005 and 2004 have been compiled in accordance with accounting principles 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
	2005	2004	2005	2005	2004	2005
Japan	¥2,416,826	¥2,221,309	$22,505,129	¥ 9,148	¥61,691	$ 85,188
North America	166,332	168,895	1,548,856	2,726	1,465	25,385
Asia	59,045	50,374	549,820	1,709	1,428	15,908
Europe	84,311	72,370	785,091	474	1,298	4,414
Others	7,467	6,208	69,533	716	749	6,665
Subtotal	2,733,981	2,519,156	25,458,429	14,773	66,631	137,560
Eliminations or Corporate	(143,248)	(145,715)	(1,333,899)	–	–	–
Total	¥2,590,733	¥2,373,441	$24,124,530	¥14,773	¥66,631	$137,560

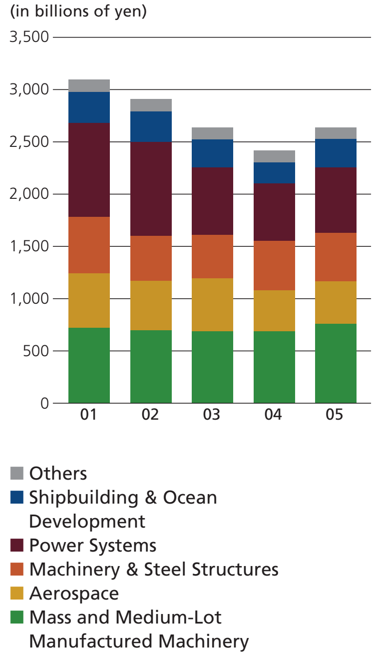
GEOGRAPHIC DISTRIBUTION	Total Assets		
	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Japan	¥2,902,734	¥2,892,331	$27,029,836
North America	131,162	138,887	1,221,364
Asia	37,359	31,814	347,883
Europe	64,546	54,042	601,039
Others	9,147	7,810	85,173
Subtotal	3,144,948	3,124,884	29,285,295
Eliminations or Corporate	686,196	590,475	6,389,762
Total	¥3,831,144	¥3,715,359	$35,675,057

COMPOSITION OF OVERSEAS NET SALES BY GEOGRAPHIC DISTRIBUTION



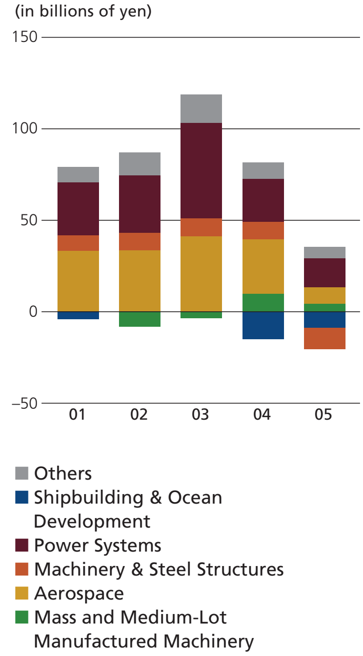
NET SALES BY INDUSTRY SEGMENT

(in billions of yen)



OPERATING INCOME (LOSS) BY INDUSTRY SEGMENT

(in billions of yen)



MANAGEMENT'S DISCUSSION AND ANALYSIS

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

Analysis of Operating Results

In the year ended March 31, 2005, consolidated net sales of Mitsubishi Heavy Industries, Ltd. (MHI) and its consolidated subsidiaries (MHI Group) increased 9.2%, or ¥217,292 million vis-á-vis the previous year, to ¥2,590,733 million (US$24,124,530 thousand). This was mainly the result of substantial sales growth in the Power Systems, Shipbuilding & Ocean Development and Mass and Medium-Lot Manufactured Machinery divisions. Sales were lower in the Machinery & Steel Structures division, mostly because of a downturn in bridges, chemical plants and other products.

Operating income fell ¥51,858 million, or 77.8%, to ¥14,773 million (US$137,560 thousand) despite the increase in sales. Earnings were held down by high research and development expenditures associated with new products and new businesses, a steep rise in the cost of materials, an appreciation of the yen against the U.S. dollar, and other items.

Net non-operating expenses were ¥2,234 million (US$20,799 thousand), ¥34,624 million less than in the previous year. This was mainly due to an improvement of ¥19,258 million in foreign exchange gains and losses, and an increase in equity in earnings of unconsolidated subsidiaries and affiliates. Ordinary income was down ¥17,234 million, or 57.9%, to ¥12,539 million (US$116,761 thousand).

Extraordinary income items were gains of ¥15,745 million (US$146,618 thousand) on sales of investment securities and ¥10,357 million (US$96,442 thousand) on sales of fixed assets. Extraordinary expenses were ¥22,242 million (US$207,117 thousand), which were mainly composed of provision of reserve for product warranties and losses on impairment for fixed assets resulting from the adoption of the new accounting standard.

Income before income taxes and minority interests decreased ¥33,725 million, or 67.3%, to ¥16,399 million (US$152,704 thousand), and net income fell ¥17,737 million, or 81.4%, to ¥4,050 million (US$37,711 thousand).

Key Factors Affecting Operating Results

Key factors which affect the management of MHI Group include external factors such as market trends, foreign exchange rate fluctuations and changes in material costs, and internal factors such as risks associated with various overseas business contracts, accidents and disasters, etc.

Market trends

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

Exchange rate fluctuation

Foreign exchange rate fluctuation can significantly affect MHI Group's competitiveness and operating results. In order to minimize exchange rate risk, MHI Group is increasing its liabilities denominated in foreign currencies by expanding the procurement of overseas materials, promoting a 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 primarily reflecting the increase in the demand from China in recent years, are driving up the cost of steel and other raw materials. There is also a concern about the increasing difficulty of securing a steady supply of certain materials. In response, MHI Group is working harder to reduce costs by promoting design standardization, increasing its utilization of common components, employing standardized parts, signing comprehensive procurement contracts, and expanding its overseas production activities. MHI Group is also passing the price rises of materials on to customers. In order to secure the supply of materials, MHI Group is strengthening relationships with its business partners, promoting an even greater level of information sharing, and moving even more rapidly to secure the materials essential to its business activities.

Overseas business contracts

MHI Group is exposed to a number of risks associated with the business contracts, which it concludes in overseas markets. These include the quality and delivery dates of locally procured materials and the skill levels and specific labor practices of the local staff, as well as the risks inherent in its contractual obligations such as performance guarantees and the payment of late delivery penalties. In order to mitigate these risks, all contracts undergo a rigorous internal assessment process prior to their formal conclusion. In addition to the business headquarters and the divisions 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, as well as other prudent steps.

Accidents and Disasters

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

Source of Funds and Liquidity

Cash flow analysis

Operating activities provided net cash of ¥107,066 million (US$996,980 thousand), ¥27,174 million less than in the previous year. The impact on cash flows of the decline in income before income taxes and minority interests was greater than that of increased revenue associated with growth in orders and sales.

Investing activities used net cash of ¥163,322 million (US$1,520,830 thousand), ¥67,943 million more than the previous year. The increase was mainly due to the payment of ¥90,000 million (US$838,062 thousand) for the purchase of newly issued shares of Mitsubishi Motors Corporation.

Financing activities provided net cash of ¥57,933 million (US$539,467 thousand) as debt was increased to meet requirements for funds.

Primary funding requirements

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

MHI Group foresees growth in working capital requirements in the coming years because of expected growth in sales. In addition, MHI Group is planning on making substantial capital investment in the following areas: gas turbines and other power systems; the Boeing 787 and other commercial aircraft; and small and mid-size engines for power generation and industrial use. This is expected to result in greater demand for funds for capital investment.

Breakdown of short-term borrowings and long-term debt and their uses

Short-term borrowings and long-term debt as of March 31, 2005 are as follows.

MHI Group is involved in numerous projects with comparatively long construction schedules. MHI Group also owns a number of manufacturing facilities, which employ large-scale equipment and machinery. Consequently, MHI Group must secure a stable level of working capital and funds for capital investments. Taking into account these factors and future interest rate projections, MHI Group's funding procurements for the current year resulted in short-term borrow-

	In millions of yen			In thousands of U.S. dollars		
	Total	Due within one year	Due after one year	Total	Due within one year	Due after one year
Short-term borrowings	**¥298,269**	**¥298,269**	**¥ –**	**$2,777,436**	**$2,777,436**	**$ –**
Long-term loans	**600,316**	**51,672**	**548,644**	**5,590,056**	**481,165**	**5,108,891**
Export loans	**27,551**	**6,742**	**20,809**	**256,547**	**62,778**	**193,769**
Bonds	**246,760**	**33,426**	**213,334**	**2,297,798**	**311,261**	**1,986,537**

ings and long-term debt of ¥390,109 million (US$3,632,640 thousand) due within one year, and of ¥782,787 million (US$7,289,197 thousand) due after one year.

Short-term borrowings and long-term debt are utilized as working capital and for capital investment. MHI Group plans to use these funds mainly in key areas such as gas turbines and other power systems, the Boeing 787 and other commercial aircraft, and for investments to raise productivity of small and medium-sized engines for power generation, industrial use and other applications.

Financial Policy

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

In appropriately determining the amounts and methods of procuring long-term funds through long-term loans, bonds and other means, MHI Group takes into account the funding requirements of its business plans on effect at that time, interest-rate trends and various other factors as well as the amount of and repayment schedule for its existing debt. At the same time, MHI Group is working to improve asset efficiency by reducing trade receivables and inventories and by raising the utilization rate of its property, plant and equipment. Steps to utilize excess funds effectively within MHI Group are aimed at reducing the levels of short-term borrowings and long-term debt.

MHI repurchased 13,408,000 shares of its treasury stock on the open market during the current year, with a value of ¥3,762 million (US$35,037 thousand). Repurchases of treasury stock are expected to continue based on the financial position of MHI 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, 2005 and 2004

	In millions of yen		In thousands of U.S. dollars (Note 3)
ASSETS	**2005**	2004	**2005**
Current assets:			
Cash and deposits (Notes 7 and 15)	**¥ 211,912**	¥ 209,806	**$ 1,973,288**
Trade receivables (Note 7):			
Notes	**47,857**	44,241	**445,634**
Accounts	**1,001,036**	951,065	**9,321,503**
Allowance for doubtful receivables	**(6,613)**	(6,709)	**(61,575)**
Securities (Notes 4 and 7)	**2,572**	1,759	**23,948**
Inventories (Note 5)	**958,513**	975,977	**8,925,534**
Advances to suppliers	**56,405**	35,832	**525,239**
Deferred income taxes (Note 6)	**65,501**	59,819	**609,936**
Prepaid expenses and other current assets (Note 7)	**128,462**	131,197	**1,196,221**
Total current assets	**2,465,645**	2,402,987	**22,959,728**
Property, plant and equipment (Note 7):			
Land	**138,290**	139,342	**1,287,736**
Buildings and structures	**672,250**	660,094	**6,259,889**
Machinery and equipment	**1,382,966**	1,368,540	**12,877,979**
Construction in progress	**25,440**	25,421	**236,896**
	2,218,946	2,193,397	**20,662,500**
Less accumulated depreciation	**(1,482,446)**	(1,450,165)	**(13,804,319)**
Net property, plant and equipment	**736,500**	743,232	**6,858,181**
Intangible assets	**33,727**	33,728	**314,060**
Investments and advances:			
Investments in unconsolidated subsidiaries and affiliates accounted for by the equity method	**95,591**	89,987	**890,129**
Long-term loans and advances	**62,320**	81,032	**580,314**
Investment securities (Note 4)	**444,353**	373,748	**4,137,746**
Deferred income taxes (Note 6)	**9,745**	22,797	**90,747**
Allowance for doubtful accounts	**(51,712)**	(61,993)	**(481,535)**
Net investments and advances	**560,297**	505,571	**5,217,401**
Other assets	**34,975**	29,841	**325,687**
Total assets	**¥ 3,831,144**	¥ 3,715,359	**$ 35,675,057**

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

LIABILITIES AND STOCKHOLDERS' EQUITY	In millions of yen 2005	In millions of yen 2004	In thousands of U.S. dollars (Note 3) 2005
Current liabilities:			
Trade payables:			
Notes	¥ 14,970	¥ 21,197	$ 139,396
Accounts	634,174	609,773	5,905,340
Short-term borrowings (Note 7)	298,269	300,211	2,777,436
Current portion of long-term debt (Note 7)	91,840	103,066	855,204
Advance payments received on contracts	363,448	327,301	3,384,373
Accrued expenses	65,819	70,163	612,900
Accrued income taxes	6,023	6,725	56,087
Reserve for product warranties	11,913	–	110,932
Allowance for losses on construction contracts	6,401	649	59,605
Other current liabilities (Note 6)	75,130	80,382	699,595
Total current liabilities	1,567,987	1,519,467	14,600,868
Long-term liabilities:			
Long-term debt (Note 7)	782,787	697,992	7,289,197
Deferred income taxes (Note 6)	17,465	21,584	162,628
Reserve for retirement allowance (Note 8)	109,798	114,610	1,022,423
Other long-term liabilities	27,919	22,991	259,980
Total long-term liabilities	937,969	857,177	8,734,228
Total liabilities	2,505,956	2,376,644	23,335,096
Minority interests	15,211	14,217	141,644
Stockholders' equity (Notes 13 and 14):			
Common stock, without par value:			
Authorized—6,000,000,000 shares			
Issued:			
2005—3,373,647,813 shares	265,609		2,473,310
2004—3,373,647,813 shares		265,609	
Capital surplus	203,855	203,854	1,898,267
Retained earnings	741,234	747,872	6,902,268
Net unrealized gains on investment securities	110,460	114,245	1,028,589
Foreign currency translation adjustments	(6,007)	(5,722)	(55,940)
Treasury stock, at cost:			
2005–18,481,426 shares	(5,174)		(48,177)
2004–4,917,104 shares		(1,360)	
Total stockholders' equity	1,309,977	1,324,498	12,198,317
Total liabilities and stockholders' equity	¥3,831,144	¥3,715,359	$35,675,057

CONSOLIDATED STATEMENTS OF INCOME

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2005 and 2004

	In millions of yen		In thousands of U.S. dollars (Note 3)
	2005	2004	2005
Net sales	¥2,590,733	¥2,373,441	$24,124,530
Cost of sales	2,300,895	2,041,245	21,425,598
Gross profit	289,838	332,196	2,698,932
Selling, general and administrative expenses	275,065	265,565	2,561,372
Operating income	14,773	66,631	137,560
Non-operating income (expense):			
Interest and dividend income	9,907	10,461	92,254
Equity in earnings of unconsolidated subsidiaries and affiliates	10,004	6,104	93,155
Foreign exchange gains	1,632	–	15,193
Other income	4,229	5,759	39,382
Interest expense	(15,497)	(16,794)	(144,300)
Losses on disposal of fixed assets	(4,933)	(7,055)	(45,934)
Foreign exchange losses	–	(17,626)	–
Other expenses	(7,576)	(17,707)	(70,549)
	(2,234)	(36,858)	(20,799)
Ordinary income	12,539	29,773	116,761
Extraordinary income (expense):			
Gains on sales of investment securities	15,745	–	146,618
Gains on sales of fixed assets (Note 9)	10,357	5,733	96,442
Prior service cost due to change in defined interest rate of employee retirement annuity	–	35,845	–
Provision of reserve for product warranties (Note 1)	(10,889)	–	(101,397)
Losses on impairment for fixed assets (Note 10)	(6,108)	–	(56,875)
Losses on damage from natural disasters	(3,466)	–	(32,281)
Business improvement and restructuring charges (Note 11)	(1,779)	(20,208)	(16,564)
Losses on revaluation of investment securities (Note 12)	–	(1,019)	–
	3,860	20,351	35,943
Income before income taxes and minority interests	16,399	50,124	152,704
Income taxes (Note 6)			
Current	3,540	6,764	32,964
Deferred	7,927	20,946	73,813
Minority interests	882	627	8,216
Net income	¥ 4,050	¥ 21,787	$ 37,711

	In yen		In U.S. dollars (Note 3)
Per share of common stock:	2005	2004	2005
Net income (Note 1)	¥1.20	¥6.46	$0.011
Cash dividends	4.00	6.00	0.037

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2005 and 2004

	In millions of yen		In thousands of U.S. dollars (Note 3)
	2005	2004	2005
Common stock:			
Balance at beginning of year	¥ 265,609	¥ 265,609	$ 2,473,310
Balance at end of year	265,609	265,609	2,473,310
Capital surplus:			
Balance at beginning of year	203,854	203,853	1,898,262
Gains on sales of treasury stock (Note 13)	1	1	5
Balance at end of year	203,855	203,854	1,898,267
Retained earnings:			
Balance at beginning of year	747,872	745,288	6,964,077
Net income	4,050	21,787	37,711
Cash dividends (Note 13)	(10,107)	(20,239)	(94,110)
Bonuses to directors and statutory auditors	–	(120)	–
(Decrease) increase resulting from inclusion of consolidated subsidiaries and companies accounted for by the equity method	(99)	1,156	(919)
Decrease resulting from exclusion of affiliates accounted for by the equity method	(482)	–	(4,491)
Balance at end of year	741,234	747,872	6,902,268
Net unrealized gains on investment securities:			
Balance at beginning of year	114,245	59,984	1,063,836
Change during the year	(3,785)	54,261	(35,247)
Balance at end of year (Note 13)	110,460	114,245	1,028,589
Foreign currency translation adjustments:			
Balance at beginning of year	(5,722)	(3,621)	(53,286)
Change during the year	(285)	(2,101)	(2,654)
Balance at end of year	(6,007)	(5,722)	(55,940)
Treasury stock:			
Balance at beginning of year	(1,360)	(145)	(12,668)
Change during the year	(3,814)	(1,215)	(35,509)
Balance at end of year	(5,174)	(1,360)	(48,177)
Total balance at end of year	¥1,309,977	¥1,324,498	$12,198,317

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Mitsubishi Heavy Industries, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 2005 and 2004

	In millions of yen		In thousands of U.S. dollars (Note 3)
	2005	2004	2005
Cash flows from operating activities:			
Income before income taxes and minority interests	¥ 16,399	¥ 50,124	$ 152,704
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	99,183	99,816	923,582
Losses on impairment for fixed assets	6,108	–	56,875
Decrease in reserve for retirement allowance	(4,803)	(1,684)	(44,722)
Interest and dividend income	(9,907)	(10,461)	(92,254)
Interest expense	15,497	16,794	144,300
Equity in earnings of unconsolidated subsidiaries and affiliates	(10,004)	(6,104)	(93,155)
Gains on sales of investment securities	(15,745)	–	(146,618)
Gains on sales of fixed assets	(10,357)	–	(96,442)
Prior service cost due to change in defined interest rate of employee retirement annuity	–	(35,845)	–
Provision of reserve for product warranties	10,889	–	101,397
Losses on damage from natural disasters	3,466	–	32,281
Business improvement and restructuring charges	1,779	20,208	16,564
(Increase) decrease in receivables	(53,198)	57,200	(495,370)
Decrease (increase) in inventories and advances to suppliers	53,102	(64,495)	494,478
Increase in other assets	(41,711)	(6,455)	(388,406)
Increase in payables	18,759	19,872	174,679
Increase in advance payments received on contracts	36,249	18,011	337,543
Increase (decrease) in other liabilities	10,917	(6,352)	101,658
Others	(8,119)	(5,963)	(75,600)
Subtotal	118,504	144,666	1,103,494
Interest and dividend received	9,690	11,592	90,227
Interest paid	(15,670)	(16,765)	(145,918)
Payments for income taxes	(5,458)	(5,253)	(50,823)
Net cash provided by operating activities	107,066	134,240	996,980
Cash flows from investing activities:			
Net decrease in time deposits	2,984	4,021	27,785
Proceeds from sales and redemption of marketable securities and investments	155	40	1,442
Purchases of property, plant, equipment and intangible assets	(108,234)	(114,061)	(1,007,855)
Proceeds from sales of property, plant, equipment and intangible assets	11,814	9,081	110,009
Purchases of investment securities	(91,267)	(2,587)	(849,860)
Proceeds from sales and redemption of investment securities	23,362	5,375	217,539
Disbursement of long-term loans	(3,784)	(2,637)	(35,232)
Collection of long-term loans	4,071	7,821	37,905
Others	(2,423)	(2,432)	(22,563)
Net cash used in investing activities	(163,322)	(95,379)	(1,520,830)
Cash flows from financing activities:			
Net decrease in short-term borrowings	(2,056)	(175,965)	(19,142)
Proceeds from long-term debt	181,077	251,541	1,686,165
Repayment of long-term debt	(106,533)	(69,535)	(992,023)
Proceeds from issuance of bonds	–	72,000	–
Payment for redemption of bonds	(300)	(100,150)	(2,794)
Dividends paid to stockholders	(10,110)	(20,162)	(94,142)
Dividends paid to minority stockholders of subsidiaries	(317)	(372)	(2,951)
Others	(3,828)	(1,760)	(35,646)
Net cash provided by (used in) financing activities	57,933	(44,403)	539,467
Effect of exchange rate changes on cash and cash equivalents	2,799	(3,190)	26,061
Net increase (decrease) in cash and cash equivalents	4,476	(8,732)	41,678
Cash and cash equivalents at beginning of year	184,767	190,456	1,720,522
Increase in cash and cash equivalents resulting from inclusion of consolidated subsidiaries	538	3,043	5,011
Cash and cash equivalents at end of year (Note 15)	¥ 189,781	¥ 184,767	$ 1,767,211

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, 2005 and 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presenting consolidated financial statements

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

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

b) Principles of consolidation

The accompanying consolidated financial statements for the years ended March 31, 2005 and 2004 include the accounts of MHI and Subsidiaries. All significant inter-company transactions and accounts have been eliminated. Investments in unconsolidated subsidiaries and affiliates, with certain minor exceptions, are accounted for by the equity method.

c) Foreign currency translation

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

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

d) Securities

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

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

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

e) Inventories

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

Finished products, raw materials and supplies are principally stated at cost determined by the moving average method, while some prospective products are stated at the lower of cost or market, the cost being determined by the moving average method.

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

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

f) Property, plant and equipment and depreciation

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

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

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

g) Intangible assets

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

Goodwill is amortized over expected years of investment recovery, on a case-by-case basis, but not longer than 20 years, using the straight-line method.

h) Leases

Non-cancelable lease transactions of MHI and 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

The allowance for doubtful receivables is provided at an amount sufficient to cover possible losses on the collection of receivables. The amount of the allowance is determined based on (1) an estimated amount for probable doubtful accounts based on a review of the collectibility of individual receivables, and (2) 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 in order to equip for the expenditures with respect to warranties for products after delivery, which is calculated based on the historical expense with consideration given to the estimated level of future warranty cost.

It had been recognized by MHI and Subsidiaries that product warranty costs are to be incurred in previous fiscal years. Because of the increase in such costs due to the growing outstanding number of certain delivered build-to-order products which have a nature similar to that of mass-produced products, however, as from the year ended March 31, 2005, reserve for product warranties is provided under a new accounting policy that the future warranty cost for such a product should in terms of timing correspond to revenue recognition of the product, thereby enforcing a period matching of revenue-cost and contributing to a better product profitability management. The new policy is supported by a study based on recent cases on the relationship between actual warranty costs incurred and operation history of products, which made possible the rational estimates of future warranty costs.

¥11,913 million (US$110,932 thousand) was reserved at the end of this fiscal year, and ¥10,889 million (US$101,397 thousand) to be reserved at the beginning of April 2004 was provided as reserve for product warranties within extraordinary expense. The effect of this change was to decrease operating income and ordinary income by ¥1,024 million (US$9,535 thousand) and to decrease income before income taxes and minority interests by ¥11,913 million (US$110,932 thousand).

k) Allowance for losses on construction contracts

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

If the costs of partially completed construction contracts (of the construction contracts covered by the allowance for losses on construction contracts at March 31, 2005 and 2004) exceed their respective contract revenues at the end of year, the excess of such costs is recognized as a loss on revaluation of partially completed construction contracts and, accordingly, is not included in the allowance for losses on construction contracts.

l) Reserve for retirement allowance

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

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

m) Revenue recognition

A sale of product is in principle recognized upon acceptance by customer. But revenue from a long-term contract, i.e., a contract with period 2 years or longer, and with amount over ¥5,000 million (US$46,559 thousand), is recognized on the basis of the percentage-of-completion method.

Until the year ended March 31, 2004 the percentage-of-completion method had been generally applied to a contract with amount over ¥10,000 million (US$93,119 thousand), with the exception of contracts won by Aerospace division or those whose works had started before March 31, 2001 where such threshold amount being ¥5,000 million (US$46,559 thousand) and ¥15,000 million (US$139,678 thousand), respectively. Under the circumstances where the proportion of long-term contracts in overall contracts by MHI and Subsidiaries is expected to remain high in the future, and in order to ensure more properly accounted profit and loss over years, the threshold amount for new long-term contracts was revised to ¥5,000 million from the year ended March 31, 2005.

The effect of this change was to increase net sales by ¥10,613 million (US$98,825 thousand), and operating income, ordinary income and income before income taxes and minority interests by ¥1,373 million (US$12,787 thousand) for the year ended March 31, 2005.

n) 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.

o) 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.

p) 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 convertible bonds were converted on the dates of each issue, appropriately adjusted for subsequent redemption.

q) Impairment of fixed assets

Effective April 1, 2004, MHI and Subsidiaries adopted a new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003) as they have become adoptable from the fiscal year beginning on April 1, 2003.

As the result of this adoption for the year ended March 31, 2005, with impairment loss of ¥6,108 million (US$56,875 thousand) being prepared in the extraordinary expense section, income before income taxes and minority interests decreased by the same amount from the income derived otherwise.

Accumulated losses on impairment for fixed assets were deducted directly from the amount of each fixed asset.

2. DIFFERENCES WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

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

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

a) Scope of consolidation

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

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

b) Inventories

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

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

c) Reserve for retirement allowance

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

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

d) Leases

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

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

e) Revenue recognition and expected losses on construction contracts

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

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

f) Goodwill

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

Goodwill, included in intangible assets, has been amortized as indicated in section g) of Note 1 "Summary of Significant Accounting Policies". Even if IFRS No. 3 had been applied, the difference would not have been material.

g) Stock options

Under IFRS No. 2, share-based payment transactions should be recognized in the financial statements.

MHI has two stock option plans, but no options are granted at price below the market price on the day of the grant. Even if IFRS No. 2 had been applied, the difference would not have been material.

h) Discontinuing operations

MHI and Subsidiaries have not had such occurrences as should be accounted for under IFRS No. 5 during the years ended March 31, 2005 and 2004.

3. U.S. DOLLAR AMOUNTS

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

As the amounts shown in U.S. dollars are for convenience only, the rate of ¥107.39=US$1 prevailing at March 31, 2005 has been used for the purpose of the presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

4. SECURITIES

a) Other securities with market value, which were included in securities (current assets) and investment securities (investments and advances) at March 31, 2005 and 2004, consisted of the following:

	In millions of yen			In thousands of U.S. dollars		
	2005			2005		
	Acquisition cost	Carrying amount	Unrealized gain (loss)	Acquisition cost	Carrying amount	Unrealized gain (loss)
i) Carrying amounts over acquisition costs:						
Equity securities	¥170,505	¥354,503	¥183,998	$1,587,715	$3,301,078	$1,713,363
Government bonds	242	334	92	2,259	3,116	857
Others	794	842	48	7,395	7,837	442
Subtotal	¥171,541	¥355,679	¥184,138	$1,597,369	$3,312,031	$1,714,662
ii) Acquisition costs over carrying amounts:						
Equity securities	¥ 1,733	¥ 1,217	¥ (516)	$ 16,133	$ 11,330	$ (4,803)
Total (i+ii)	¥173,274	¥356,896	¥183,622	$1,613,502	$3,323,361	$1,709,859

	In millions of yen		
	2004		
	Acquisition cost	Carrying amount	Unrealized gain (loss)
i) Carrying amounts over acquisition costs:			
Equity securities	¥141,572	¥333,962	¥192,390
Government bonds	242	346	104
Others	730	767	37
Subtotal	¥142,544	¥335,075	¥192,531
ii) Acquisition costs over carrying amounts:			
Equity securities	¥ 1,291	¥ 589	¥ (702)
Total (i+ ii)	¥143,835	¥335,664	¥191,829

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.

The amount of impairment losses for the years ended March 31, 2005 and 2004 amounted to ¥1,265 million (US$11,775 thousand) and ¥66 million, respectively, with respect to other securities with market value.

b) Sales amounts of other securities and related gains and losses for the years ended March 31, 2005 and 2004 were as follows:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Sales amounts	¥425,957	¥4,771	$3,966,453
Gains	15,666	1,278	145,876
Losses	(5)	(76)	(49)

c) Other securities without market value, which were included in securities (current assets) and investment securities (investments and advances) at March 31, 2005 and 2004, mainly consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Equity securities—unlisted	¥81,481	¥31,312	$758,736

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, 2005 and 2004 amounted to ¥89 million (US$832 thousand) and ¥726 million, respectively, with respect to other securities without market value.

d) The contractual maturities of other securities at March 31, 2005 and 2004 were as follows:

	In millions of yen			In thousands of U.S. dollars		
	2005			2005		
	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	**¥1,384**	**¥ –**	**¥–**	**$12,886**	**$ –**	**$–**
Loan trusts	**124**	**174**	**–**	**1,156**	**1,616**	**–**
Bonds:						
Government bonds	**–**	**594**	**0**	**–**	**5,535**	**2**
Corporate bonds	**367**	**600**	**–**	**3,412**	**5,586**	**–**
Foreign bonds	**697**	**–**	**–**	**6,494**	**–**	**–**
Total	**¥2,572**	**¥1,368**	**¥0**	**$23,948**	**$12,737**	**$2**

	In millions of yen		
	2004		
	Due within one year	Due after one year through five years	Due after five years
Certificate of deposit	¥1,229	¥ –	¥–
Loan trusts	145	298	–
Bonds:			
Government bonds	10	356	–
Corporate bonds	375	600	–
Foreign bonds	–	688	–
Total	¥1,759	¥1,942	¥–

5. INVENTORIES

Inventories at March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Finished products	**¥127,962**	¥127,471	**$1,191,566**
Work in process	**767,381**	797,132	**7,145,742**
Raw materials	**63,170**	51,374	**588,226**
Total	**¥958,513**	¥975,977	**$8,925,534**

6. INCOME TAXES

MHI and Subsidiaries are subject to corporation income tax, inhabitants' tax and enterprise tax, based on income, which in the aggregate resulted in the statutory effective tax rate of approximately 40.5% for the year ended March 31, 2005 and 42.0% for the year ended March 31, 2004.

a) Significant components of deferred tax assets and liabilities at March 31, 2005 and 2004, which arose as a result of the recognition of the tax effect mentioned in section n) of Note 1 "Summary of Significant Accounting Policies", were as follows:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	**2005**
Deferred tax assets:			
Reserve for retirement allowance	**¥ 106,727**	¥ 100,610	**$ 993,828**
Tax loss carryforwards	**34,065**	38,703	**317,208**
Accrued expenses for product warranty	**24,461**	20,331	**227,774**
Allowance for doubtful receivables	**13,336**	16,100	**124,187**
Accrued expenses for construction contracts	**11,650**	15,557	**108,487**
Others	**43,132**	32,386	**401,636**
Subtotal	**233,371**	223,687	**2,173,120**
Valuation allowance	**(17,319)**	(3,936)	**(161,277)**
Total gross deferred tax assets	**216,052**	219,751	**2,011,843**
Deferred tax liabilities:			
Net unrealized gains on investment securities	**(73,786)**	(77,281)	**(687,081)**
Gains on contribution of investment securities to trust for retirement allowance	**(67,043)**	(68,560)	**(624,295)**
Reserve for reduction in costs of fixed assets	**(10,056)**	(6,794)	**(93,644)**
Reserve for accelerated depreciation	**(4,559)**	(3,021)	**(42,447)**
Others	**(2,855)**	(3,065)	**(26,586)**
Total gross deferred tax liabilities	**(158,299)**	(158,721)	**(1,474,053)**
Net deferred tax assets	**¥ 57,753**	¥ 61,030	**$ 537,790**

Note: Net deferred tax assets at March 31, 2005 and 2004 are reflected in the consolidated balance sheets as follows:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	**2005**
Deferred income taxes in current assets	**¥ 65,501**	¥ 59,819	**$ 609,936**
Deferred income taxes in investments and advances	**9,745**	22,797	**90,747**
Other current liabilities	**(28)**	(2)	**(265)**
Deferred income taxes in long-term liabilities	**(17,465)**	(21,584)	**(162,628)**

b) Reconciliation of the statutory effective income tax rate and the income tax rate as a percentage of income before income taxes and minority interests at March 31, 2005 and 2004 were as follows:

	2005	2004
Japanese statutory effective income tax rate	**40.5%**	42.0%
Adjustment:		
Equity in earnings of unconsolidated subsidiaries and affiliates	**(24.7)**	(5.1)
Items excluded from expenses	**9.9**	3.9
Items excluded from gross income	**(4.5)**	(0.9)
Valuation allowance	**46.9**	7.8
Unrealized profit in excess of taxable income	**–**	4.2
Others	**1.8**	3.4
Income tax rate as a percentage of income before income taxes and minority interests	**69.9%**	55.3%

7. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

a) Short-term borrowings at March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Loans, principally from banks, with weighted-average interest rate of 0.9% at March 31, 2005 and 0.8% at March 31, 2004:			
Secured	¥ 7,476	¥ 8,140	$ 69,615
Unsecured	290,793	292,071	2,707,821
Total	¥298,269	¥300,211	$2,777,436

b) Long-term debt at March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Loans, principally from banks and insurance companies, due 2005 to 2022 with weighted-average interest rate of 1.4% at March 31, 2005 and due 2004 to 2022 with weighted-average interest rate of 1.4% at March 31, 2004:			
Secured	¥ 22,387	¥ 29,714	$ 208,468
Unsecured	577,929	484,612	5,381,588
Export loans, principally from main contractors, due 2005 to 2018 with weighted-average interest rate of 2.9% at March 31, 2005 and due 2004 to 2018 with weighted-average interest rate of 3.4% at March 31, 2004:			
Unsecured	27,551	39,526	256,547
Unsecured bonds:			
2.525% bonds due 2008	50,000	50,000	465,593
1.83% bonds due 2005	30,000	30,000	279,356
2.15% bonds due 2008	40,000	40,000	372,474
0.63% bonds due 2010	20,000	20,000	186,237
1.03% bonds due 2013	30,000	30,000	279,356
0.365% bonds due 2010	20,000	20,000	186,237
0.70% bonds due 2013	50,000	50,000	465,593
Unsecured bonds issued by Subsidiaries:			
0.62% bonds, due 2005 to 2010 in 2005 and due 2004 to 2010 in 2004	1,550	1,850	14,433
8.29% bonds due 2005	3,126	3,214	29,111
8.39% bonds due 2007	2,084	2,142	19,408
Subtotal	874,627	801,058	8,144,401
Less current portion due within one year	(91,840)	(103,066)	(855,204)
Total	¥782,787	¥ 697,992	$7,289,197

c) A summary of assets pledged as collateral for short-term borrowings and long-term debt at March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Property, plant and equipment	¥14,960	¥17,451	$139,308
Trade receivables:			
Notes	6,406	7,670	59,651
Accounts	13,680	16,416	127,384
Short-term loans included in prepaid expenses and other current assets	3,801	4,479	35,399
Securities	565	585	5,259
Cash and deposits	30	30	280
Total	¥39,442	¥46,631	$367,281

d) The aggregate annual maturities of long-term debt at March 31, 2005 were as follows:

Year ending March 31	In millions of yen	In thousands of U.S. dollars
2006	¥ 91,840	$ 855,204
2007	99,393	925,534
2008	100,472	935,578
2009	103,634	965,019
2010	98,713	919,205
Thereafter	380,575	3,543,861
Total	¥874,627	$8,144,401

8. RETIREMENT BENEFITS

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

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

a) Benefit obligations and related information at March 31, 2005 and 2004 were as follows:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	**2005**
Benefit obligations	**¥(760,148)**	¥(758,412)	**$(7,078,387)**
Fair value of plan assets	**497,460**	494,264	**4,632,272**
Unfunded benefit obligations	**(262,688)**	(264,148)	**(2,446,115)**
Unrecognized actuarial losses	**175,536**	172,026	**1,634,564**
Unrecognized prior service costs (benefits)	**(155)**	(225)	**(1,438)**
Net benefit liability recognized on the consolidated balance sheets	**(87,307)**	(92,347)	**(812,989)**
Prepaid pension expense	**22,491**	22,263	**209,434**
Reserve for retirement allowance	**¥(109,798)**	¥(114,610)	**$(1,022,423)**

b) Benefit expenses for the years ended March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	**2005**
Service cost	**¥ 28,942**	¥ 27,557	**$ 269,505**
Interest cost	**15,205**	21,627	**141,590**
Expected return on plan assets	**(13,444)**	(10,148)	**(125,194)**
Amortization of actuarial losses	**16,568**	20,923	**154,280**
Amortization of prior service costs (benefits)	**(28)**	(35,844)	**(260)**
Net benefit expenses	**¥ 47,243**	¥ 24,115	**$ 439,921**

c) The principal assumptions used in determining the information above at March 31, 2005 and 2004 were as follows:

		2005	2004
Discount rate		**2.0%**	2.0%
Expected rate of return on plan assets		**4.0%**	4.0%
Amortization period for prior service costs	MHI	**Expensed as incurred**	Expensed as incurred
	Subsidiaries	**Expensed as incurred or 10 to 11 years**	Expensed as incurred or 10 to 11 years
Amortization period for actuarial gains and losses	MHI	**13 years**	13 years
	Subsidiaries	**11 to 20 years**	11 to 20 years

9. GAINS ON SALES OF FIXED ASSETS

Gains on sales of fixed assets for the year ended March 31, 2005 and 2004 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2005	**2005**
Land	**¥10,328**	**$96,170**
Others	**29**	**272**
Total	**¥10,357**	**$96,442**

	In millions of yen
	2004
Land	¥5,744
Others	(11)
Total	¥5,733

10. LOSSES ON IMPAIRMENT FOR FIXED ASSETS

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

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

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

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

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

e) Impairment losses
The amounts of impairment losses for the year ended March 31, 2005 was ¥6,108 million (US$56,875 thousand) and consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2005	**2005**
Land	**¥5,769**	**$53,718**
Buildings etc.	**339**	**3,157**
Total	**¥6,108**	**$56,875**

11. BUSINESS IMPROVEMENT AND RESTRUCTURING CHARGES

Business improvement and restructuring charges arising from Mass and Medium-Lot Manufactured Machinery business for the year ended March 31, 2005 and 2004 consisted of the following:

	In millions of yen	In thousands of U.S. dollars
	2005	**2005**
Losses on disposal of inventories	**¥ 391**	**$ 3,639**
Losses on disposal of fixed assets	**358**	**3,339**
Losses on special retirement benefit	**348**	**3,236**
Others	**682**	**6,350**
Total	**¥1,779**	**$16,564**

	In millions of yen
	2004
Losses on disposal and devaluation of inventories	¥ 7,150
Losses on maintenance charge of products	6,917
Losses on disposal of fixed assets	2,812
Relocation charges of facilities	1,165
Others	2,164
Total	¥20,208

12. LOSSES ON REVALUATION OF INVESTMENT SECURITIES

Losses on revaluation of investment securities for the year ended March 31, 2004 consisted of the following:

	In millions of yen
	2004
Devaluation of securities	¥ 767
Devaluation of golf club membership	252
Total	¥1,019

13. STOCKHOLDERS' EQUITY

a) Capital surplus

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

b) Retained earnings

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

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

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

c) Net unrealized gains on investment securities

The accounting policy of this account is described in section d) of Note 1 "Summary of Significant Accounting Policies". The unrealized gains at March 31, 2005 and 2004 were ¥184,859 million (US$1,721,378 thousand) and ¥192,863 million, respectively, and ¥110,460 million (US$1,028,589 thousand) and ¥114,245 million, net of tax effect, were accounted for as net unrealized gains on investment securities for the respective year ends.

d) Foreign currency translation adjustments

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

14. STOCK OPTION PLANS

MHI has two stock option plans, under which directors have been granted stock options to purchase MHI's common stock.

Under these stock option plans, options were granted with the strike price not less than market price at the date of grant, and one plan options are exercisable in a period from June 27, 2005 to June 26, 2009, and another plan options are exercisable in a period from June 26, 2006 to June 25, 2010.

Stock options outstanding at the balance sheet date consisted of the following:

	2005		2004		2005
	Stock options (shares)	Weighted-average exercised price (yen)	Stock options (shares)	Weighted-average exercised price (yen)	Weighted-average exercised price (U.S. dollars)
Outstanding at beginning of year	**535,000**	**¥315**	–	¥ –	**$2.93**
Granted	**500,000**	**289**	535,000	315	**2.69**
Outstanding at end of year	**1,035,000**	**¥302**	535,000	¥315	**$2.81**

15. CASH AND CASH EQUIVALENTS

Cash and cash equivalents at March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Cash and deposits	**¥211,912**	¥209,806	**$1,973,288**
Time deposits with maturities over three months	**(23,506)**	(26,320)	**(218,883)**
Short-term investments with maturities within three months included in securities	**1,375**	1,221	**12,806**
Short-term investments with maturities within three months included in prepaid expenses and other current assets	**–**	60	**–**
Total	**¥189,781**	¥184,767	**$1,767,211**

16. 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
	2005	2004	2005
Equivalent of acquisition cost:			
Tools and equipment	**¥ 8,237**	¥10,690	**$ 76,705**
Others	**2,565**	2,444	**23,883**
Total	**¥10,802**	¥13,134	**$100,588**
Equivalent of accumulated depreciation:			
Tools and equipment	**¥ 4,806**	¥ 6,097	**$ 44,757**
Others	**1,676**	1,550	**15,601**
Total	**¥ 6,482**	¥ 7,647	**$ 60,358**
Equivalent of balance at the balance sheet date:			
Tools and equipment	**¥ 3,431**	¥ 4,593	**$ 31,948**
Others	**889**	894	**8,282**
Total	**¥ 4,320**	¥ 5,487	**$ 40,230**

ii) The equivalent of undue lease payments (including interest portion) at March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Within one year	**¥1,762**	¥2,468	**$16,411**
Thereafter	**2,558**	3,019	**23,819**
Total	**¥4,320**	¥5,487	**$40,230**

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

iii) Lease payments (the equivalent of depreciation expenses)

Lease payments relating to finance lease transactions accounted for as operating leases in the accompanying consolidated financial statements for the years ended March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Lease payments	¥2,549	¥3,038	$23,736
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
	2005	2004	2005
Acquisition cost:			
Machinery and equipment	¥58,627	¥58,563	$545,925
Others	5,953	5,335	55,436
Total	¥64,580	¥63,898	$601,361
Accumulated depreciation:			
Machinery and equipment	¥26,814	¥25,136	$249,691
Others	2,143	2,220	19,950
Total	¥28,957	¥27,356	$269,641
Balance at the balance sheet date:			
Machinery and equipment	¥31,813	¥33,427	$296,234
Others	3,810	3,115	35,486
Total	¥35,623	¥36,542	$331,720

ii) Undue lease income (including interest portion), at March 31, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Within one year	¥13,622	¥14,230	$126,847
Thereafter	28,866	29,963	268,798
Total	¥42,488	¥44,193	$395,645

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, 2005 and 2004 consisted of the following:

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Lease income	¥14,836	¥15,441	$138,150
Depreciation expenses	10,257	10,086	95,508

17. DERIVATIVE FINANCIAL INSTRUMENTS

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

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

Summarized below are the notional amounts and the fair values of the derivative positions, except for those applied the hedge accounting, outstanding at March 31, 2005 and 2004:

	In millions of yen			In thousands of U.S. dollars		
	2005			2005		
	Notional amount	Fair value	Unrealized gain (loss)	Notional amount	Fair value	Unrealized gain (loss)
Forward foreign exchange contracts						
Sell:						
US$	**¥15,800**	**¥15,892**	**¥ (92)**	**$147,124**	**$147,979**	**$ (855)**
Euro	**19,079**	**19,225**	**(146)**	**177,662**	**179,019**	**(1,357)**
Others	**654**	**646**	**8**	**6,092**	**6,021**	**71**
Buy:						
US$	**382**	**366**	**(16)**	**3,562**	**3,408**	**(154)**
Total			**¥(246)**			**$(2,295)**

	In millions of yen		
	2004		
	Notional amount	Fair value	Unrealized gain (loss)
Forward foreign exchange contracts			
Sell:			
US$	¥198,382	¥190,732	¥7,650
Euro	8,505	8,133	372
Buy:			
US$	605	587	(18)
Total			¥8,004

18. CONTINGENT LIABILITIES

Contingent liabilities for guarantees to loans of others made in the ordinary course of business amounted to ¥145,017 million (US$1,350,373 thousand) and ¥151,342 million at March 31, 2005 and 2004, respectively.

19. REVISION OF THE TERM FOR THE PAYMENT OF EMPLOYEES' BONUSES

Certain domestic Subsidiaries have revised the terms for the payment of bonuses to employees for the year ended March 31, 2004, following MHI's revision made for the year ended March 31, 2003.

According to this revision, no accrual for employees' bonuses of these domestic Subsidiaries was provided for the year ended March 31, 2004.

The effect of this revision was to increase operating income, ordinary income and income before income taxes and minority interests by ¥13,538 million for the year ended March 31, 2004, compared with those calculated under the previous terms for the payment of bonuses to employees.

And this revision had no effects on the consolidated financial statements of the year ended March 31, 2005.

20. SUPPLEMENTARY INCOME INFORMATION

	In millions of yen		In thousands of U.S. dollars
	2005	2004	2005
Depreciation	**¥ 99,183**	¥99,816	**$ 923,582**
Research and development costs (including routine or periodic alterations to existing products)	**124,023**	99,515	**1,154,879**

21. SUBSEQUENT EVENTS

At an ordinary general meeting of the shareholders of MHI held on June 28, 2005, the following appropriations of retained earnings were approved:

	In millions of yen	In thousands of U.S. dollars
Cash dividends	**¥13,421**	**$124,974**
Reserve for reduction in costs of fixed assets	**5,224**	**48,650**
Reserve for accelerated depreciation	**3,255**	**30,307**
Total	**¥21,900**	**$203,931**

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. (the "Company") and consolidated subsidiaries as of March 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above, expressed in yen, present fairly, in all material respects, the consolidated financial position of the Company and consolidated subsidiaries at March 31, 2005 and 2004, 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.

Supplemental Information

As described in Note 1. j), effective April 1, 2004, the Company and its consolidated subsidiaries have adopted a new accounting policy for reserve for product warranties.
As described in Note 1.m), effective April 1, 2004, the Company and its consolidated subsidiaries changed the criteria for the use of the percentage-of-completion method.
As described in Note 1.q), effective April 1, 2004, the Company and its consolidated subsidiaries have adopted the new accounting standards for impairment fixed assets.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2005 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.

Ernst & Young ShinNihon

June 28, 2005

CORPORATE DATA

As of March 31, 2005

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

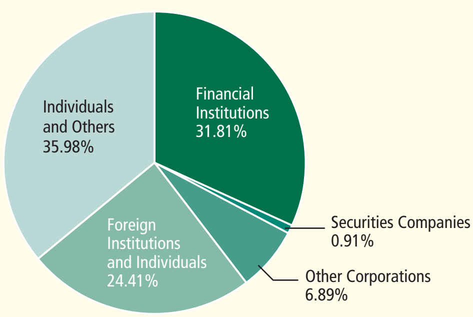
Total Number of Shares Authorized: 6,000,000,000

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

Number of Shareholders: 328,988

Number of Employees: 34,306

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

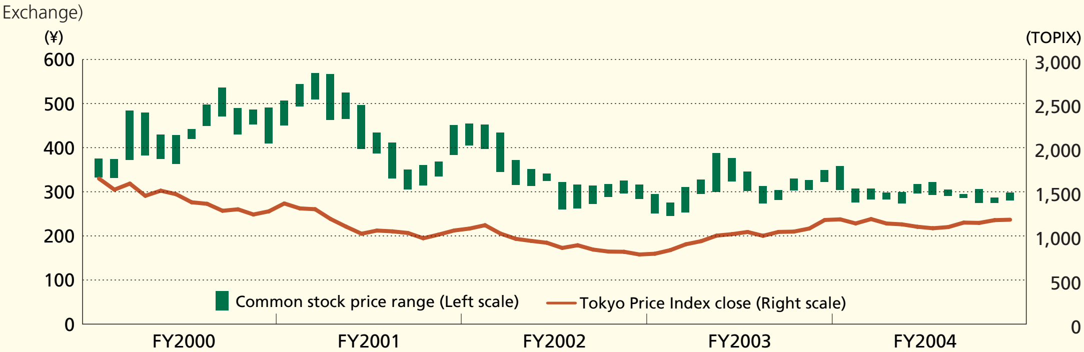
Transfer Agent: The Mitsubishi Trust and Banking Corporation 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8212, Japan

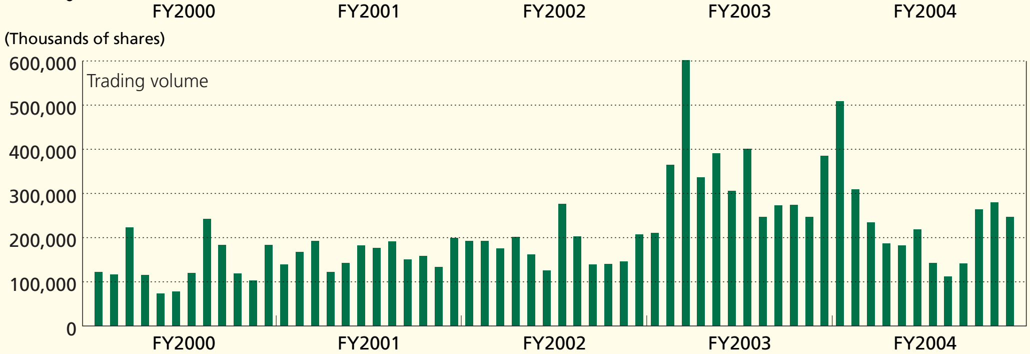
Certified Public Accountants: Ernst & Young ShinNihon
Hibiya Kokusai Bldg., 2-2-3, Uchisaiwai-cho, Chiyoda-ku, Tokyo, Japan 100-0011

Major Shareholders	Number of shares owned by major shareholders	% of total shares
Japan Trustee Services Bank, Ltd. (Holder in Trust)	163,604,000	4.85%
The Master Trust Bank of Japan, Ltd. (Holder in Trust)	137,162,000	4.07
The Master Trust Bank of Japan, Ltd. (Holder in Retirement Benefit Trust for The Bank of Tokyo-Mitsubishi, Ltd.)	125,666,000	3.72
Meiji Yasuda Life Insurance Company	88,000,741	2.37
Tokio Marine & Nichido Fire Insurance Co., Ltd.	63,000,000	1.87
State Street Bank and Trust Company 505103	60,562,425	1.80
The Master Trust Bank of Japan, Ltd. (Holder in Retirement Benefit Trust for The Mitsubishi Trust and Banking Corporation)	45,934,000	1.36
The Bank of New York. Treaty Jasdec Account	33,448,841	0.99
Mitsubishi Heavy Industries Employee Shareholding Association	32,278,579	0.96
BNP Paribas Securities (Japan), Ltd.	31,275,000	0.93

MONTHLY STOCK PRICE RANGE & TRADING VOLUME

(Tokyo Stock Exchange)





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Katsuhiko Yoshida
General Manager, General Machinery & Special Vehicle Headquarters

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Toyoshi Nakano
Senior Adviser, The Mitsubishi Trust and Banking Corporation
Kichisaburo Nomura
Executive Adviser, All Nippon Airways Co., Ltd.
Toshinori Tomita
Toyohiko Inaguma

(As of June 28, 2005)

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