

## Message from the President

During fiscal year 2001, conditions remained difficult in the Japanese economy, as seen in a broad drop in capital investment in the private sector, continuing stagnation in consumer spending and public spending, and a decline in exports due to the slowdown in the U.S. economy, among other factors.

Due to these negative factors, domestic demand for iron and steel products decreased substantially in the construction and manufacturing sectors, and market price conditions also deteriorated. In exports, tonnage increased but prices fell.

Kawasaki Steel's production for the year totaled 12.29 million tons of crude steel and 11.67 million tons of steel products, which were respective increases of 1.2% and 1.5% in comparison with fiscal year 2000.

Summarizing the company's sales results in its core steel business, in spite of a decrease in domestic tonnage, particularly in shipments to the construction and automotive industries, export tonnage increased thanks to tie-ups with foreign rolling mills in South Korea and other countries, and on balance, the total tonnage of shipments increased. However, declining prices had a serious impact on sales revenues, resulting in a decline of 4.4% from the previous fiscal year. As additional factors, revenues decreased due to the spin-off of the company's LSI business, and sales also declined in the chemical and engineering businesses. As a result, total sales for the year fell by 8.5% from the previous year, to ¥712.6 billion.

To cope with these difficult circumstances, the company expanded its profit improvement activities, such as streamlining costs and paring down asset levels, in 2001 as the final fiscal year of its 2nd Mid-Term Business Plan.

However, these efforts were not sufficient to offset the drop in steel prices, and operating profit for the period was limited to ¥1.34 billion. Figuring in extraordinary profit and loss items, which included profits on the sale of assets, profit on the creation of a retirement benefit trust, and other extraordinary profit items, and extraordinary losses such as write-down of investments in securities, expenses on special retirement payments, and other extraordinary loss items, the company was obliged to record a net loss of ¥10.7 billion for the year.

In making a decision on the year-end dividend, the company gave careful consideration to these conditions, the outlook for a continuing difficult management environment, and the effect of the dividend payment on business fundamentals. As a result, the annual shareholders' meeting approved omission of the year-end dividend for the period. Management deeply regrets that this measure was necessary and requests the

generous understanding of all our shareholders.

Regarding the consolidated results for the year, thanks to efforts to improve the management efficiency of the Kawasaki Steel Group as a whole, the group recorded consolidated sales of ¥1,215.9 billion and a consolidated ordinary profit of ¥24.3 billion. However, the group's consolidated results were also affected by the loss recorded by Kawasaki Steel itself, which reduced the consolidated result for FY 2001 to a net profit of ¥6.8 billion for the year.

Among major management policies during the year, the most important task was the planned consolidation of all operations with NKK Corporation ("NKK"). As a result of energetic and concrete consultation and study by the two companies since April of last year, an agreement was reached on such basic items as the name of the new company, ratio of stock exchange, business formation, and representative directors. The Basic Agreement for Consolidation was signed in December of 2001, and the Agreement for Consolidation was concluded in May of the present year. It may be noted that the Japan Fair Trade Commission has ruled that the consolidation poses no problems from the viewpoint of Japan's Antimonopoly Law.

Kawasaki Steel also continued to implement various other policies, centering on the construction of strategic global cooperative relationships and business reorganization within the Kawasaki Steel Group. In the steel business, the company concluded a tie-up agreement with AK Steel Corporation in the United States for the construction of a strategic cooperative relationship in the field of steel materials for automotive applications, and in April of this year, also entered into a comprehensive three-company cooperation agreement for carbon flat steel focused on automotive steel products and on R&D in this area, with NKK and a German company, Thyssen Krupp Steel AG. Also in April of this year, Kawasaki Steel and the Canadian company Stelco Inc. signed a comprehensive cooperation agreement, mainly for the Canadian market, covering automotive steel sheets, special bar steel for automotive use, large diameter steel pipe, and other items.

In its chemical business, Kawasaki Steel transferred its engineering plastic compounding business to a subsidiary of the U.S. company, General Electric Company, and in its LSI business, it established Kawasaki Microelectronics Inc. by spinning off its LSI business division. In a transaction involving another group company, the leasing and installment purchase business of Kawasaki Enterprises, Inc. was transferred to Tokyo Leasing Co., Ltd.

Among other important business developments, in the environmental business, the

Mizushima Industrial Complex Business Group, of which Kawasaki Steel is a leading member, made a successful bid for the construction and operation of a recycling type waste treatment facility in Kurashiki City, where waste will be treated using the Kawatetsu Thermoselect gasification and melting process. In its solar grade silicon material business, the company began commercial production of ingots for use in silicon wafers for solar cells at a facility on the grounds of its Mizushima Works.

The company will also participate in the Soga Special District Development Plan, which was established by Chiba City and includes part of the East Plant of Chiba Works. Under this plan, Kawasaki Steel is to begin a land readjustment development and park construction based on mutual cooperation among Kawasaki Steel itself, Chiba City, and Urban Development Corporation.

As to the outlook for the Japanese economy, no sign of a recovery in domestic consumer spending or private capital investment can be seen at present, and although the economic downturn appears to have bottomed out in Asia, the direction of the foreign business climate remains unclear. Considering these facts, there is little room for optimism regarding the near term. Where conditions in the steel business are concerned, a decline in domestic demand is foreseen against the background of poor economic conditions. It also appears that conditions in export markets will be difficult, with fears of intensifying competition in Asia due to trade problems with the United States.

To survive in a climate characterized by increasingly fierce competition on a global scale, Kawasaki Steel has agreed with NKK to create a new business group called the JFE Group, and will consolidate and reorganize all of its business operations with NKK as part of this agreement. In September of this year, Kawasaki Steel will become a member of a holding company called JFE Holdings, Inc., which will be established jointly with NKK by a stock-for-stock exchange. This move has already been approved by the annual shareholders' meeting. Next, with April 2003 as a target date, the two companies and their affiliates under JFE Holdings will be reorganized into several new companies by business segment. These will include JFE Steel Corporation, JFE Engineering Corporation, JFE Urban Development Corporation, and JFE R&D Corporation. The above-mentioned Kawasaki Microelectronics Inc. is also expected to become a member of this group.

The goals of the JFE Group is to realize a strong management base, advanced technical capabilities, and the highest levels of competitiveness, with the aim of becoming a group of excellent companies for the 21st century, and to achieve higher

efficiency and profitability in keeping with a global corporate group by creating an innovative business culture which will continue to meet the challenges of a changing business environment.

JFE Steel Corporation, which will be responsible for the group's iron and steel business, will strive to strengthen its responsiveness to increasingly advanced customer needs and achieve thoroughgoing control of profitability by product line in order to maximize profitability. To realize the highest level of competitiveness at an early date by unifying the management of nearby steel works and ensure a harmonious merger of the two companies, the four steel works currently operated by the companies (KSC's Chiba and NKK's Keihin in eastern Japan, KSC's Mizushima and NKK's Fukuyama in western Japan) will be reorganized into two steel works called East Works and West Works. JFE Steel Corporation will therefore have two major steel works and Chita Works, which is specializing in production of pipes and tubes.

JFE Engineering Corporation will adopt a consolidated division system comprising divisions and functional group companies in order to respond flexibly to changes in the business environment, promote common business strategies with group companies, and maximize profits on a consolidated basis.

In the urban development business and LSI business, the optimum management system will be created based on features of these businesses which are different from those in the steel business and engineering business.

Both JFE Steel Corporation and JFE Engineering Corporation will have R&D functions so as to realize closely linked operation among product/technology development, manufacturing, and sales and marketing. The newly established JFE R&D Corporation will focus on research and development for common basic technologies and development of projects with growth potential to effectively realize the synergistic effects of the entire group.

The JFE Group will ultimately reorganize and restructure all subsidiaries and affiliates of KSC and NKK. However, as a first step, the JFE Group plans to merge subsidiaries operating similar business in the area of construction material and containers in April 2003.

Kawasaki Steel's management policy until reorganization by business segment can be completed is to unify its existing sales, technical research, and production divisions with the aim of securing a stable profit, and to promote reliable product and technology development which meets the needs of its respective customers. Moreover, with international competition becoming more and more intense, the company is endeavoring

to strengthen the strategic cooperative relationships which it has established with foreign companies to date.

In the Kawasaki Steel Group, the division of functions within the group has been clarified and a system has been constructed to maximize the performance of the group as a whole, with the aim of ensuring stronger consolidated financial results. At the same time, we are also synchronizing our strategies with NKK in all business fields so as to maximize the synergistic effects of consolidation at an early date. These moves include the creation of a stronger integrated management system.

We should also mention Kawasaki Steel's continuing commitment to environmental protection. We are implementing effective measures to preserve the environment, and at the same time, we are promoting corporate activities which will win the wider understanding and sympathy of society by fulfilling the social responsibilities demanded of Kawasaki Steel as a business.

Although the economic environment surrounding Kawasaki Steel is extremely severe, we are actively engaged in a number of important tasks for the future, beginning with the consolidation of operations, and we will continue to conduct the company's management in a way that responds to the expectations of our shareholders. We request your continuing understanding and support in the future, as in the past.

June 26, 2002

Fumio Sudo  
President