Management Discussion & Analysis

Overview

In the fiscal year ended March 31, 2019, the global economy was relatively lacking in vigor overall due to the economic slowdown in emerging countries and resource-rich countries, along with other factors, despite the ongoing modest growth centered on the U.S., where the real economy remains strong. In addition, there continues to be uncertainty about future prospects for the real economy as a downturn in corporate earnings stemming from U.S.-China trade friction is beginning to emerge and there is still a chance of a U.K. split from the EU without an agreement, even though the deadline for the split from the EU has been delayed. As a result, there is a continued need for these developments-with the potential to drag down the global economy-to be watched sufficiently closely.

The Japanese economy has been recovering modestly, due to a modest increase in capital investment, an improvement in corporate earnings and other factors. Although overall modest growth is expected to continue, it is necessary to continue to watch foreign exchange rates since the economic policies of the U.S. and other countries or other factors may trigger a yen appreciation.

Amid such an operating environment, the Group's orders received in the fiscal year ended March 31, 2019, decreased overall from the previous fiscal year due to a decrease in the Rolling Stock segment and the Aerospace Systems segment, despite an increase in the Ship & Offshore Structure segment and other segments. Net sales increased overall from with the previous fiscal year due to increases in the Motorcycle & Engine segment, the Precision Machinery & Robot and other segments, despite decreases in the Rolling Stock segment and other segments. Operating income increased overall due to the improvement in the Ship & Offshore Structure segment and increases in the Energy System & Plant Engineering segment and other factors. Recurring profit decreased due to the payments for the in-service issue of commercial jet aircraft engines and other factors despite the increase in operating income. Net income attributable to the owners of the parent decreased as a result of the decrease in recurring profit and other factors.

As a result, the Group's consolidated orders received decreased ¥22.0 billion from the previous fiscal year to ¥1,585.9 billion, consolidated net sales increased ¥20.5 billion year on year to ¥1,594.7 billion, consolidated operating income increased ¥8.0 billion to ¥64.0 billion, consolidated recurring profit fell ¥5.3 billion to ¥37.8 billion, and net income attributable to the owners of the parent decreased ¥1.4 billion to ¥27.4 billion. ROIC* was 4.5%, while ROE was 5.8%.

** Before-tax ROIC = EBIT (income before income taxes + interest expense) / invested capital (interest-bearing debt + shareholders' equity)*

Business Segments

The following sections supply additional details on the consolidated performance of each business segment*. Please note that operating income or loss includes intersegment transactions.

** The Company reviewed the method of business segment classification from the fiscal year ended March 31, 2019 and changed its reportable segments from the previous Ship & Offshore Structure, Rolling Stock, Aerospace, Gas Turbine & Machinery, Plant & Infrastructure, Motorcycle & Engine, Precision Machinery and Other Operations to Aerospace Systems, Energy System & Plant Engineering, Precision Machinery & Robot, Ship & Offshore Structure, Rolling Stock, Motorcycle & Engine and Other Operations.*

Consolidated segment information for the fiscal year ended March 31, 2018 has been prepared using the revised segment classification method.

Aerospace Systems

Concerning the business environment surrounding the Aerospace Systems segment, there is a certain level of demand from the Ministry of Defense in Japan despite an otherwise tight defense budget, while demand for commercial aircraft airframes and jet engines is increasing in conjunction with the rise in the number of air passengers.

Although demand for the component parts for commercial aircraft jet engines increased, consolidated orders decreased ¥67.2 billion year on year to ¥431.6 billion due to a decrease in demand for component parts for the Ministry of Defense and commercial aircraft.

Consolidated net sales decreased ¥5.5 billion year on year to ¥463.9 billion due to a decrease in demand for component parts for the Ministry of Defense and commercial aircraft, despite an increase in demand for component parts for commercial aircraft jet engines. Nevertheless, consolidated operating income increased ¥1.7 billion year on year to ¥32.6 billion due to improvement in the profitability of component parts for commercial aircraft.

Energy System & Plant Engineering

Regarding the business environment surrounding the Energy System & Plant Engineering segment, in addition to the recovery in resource development and oil and natural gas related investment overseas, there is still demand for energy infrastructure maintenance in Asia and demand for distributed power sources is increasing due to stronger interest in investment in the environment and energy conservation, among other factors. In Japan, there is ongoing demand for replacing aging facilities for refuse incineration plants and industrial machinery. Meanwhile, in the energy and environmental field, although there is large potential demand for distributed power sources in Japan, investment plans are slightly delayed in light of the liberalization of electricity.

Year on year consolidated orders received increased ¥39.8 billion to ¥263.5 billion due to the orders received from a Combined Cycle Power Plant (CCPP) and a LNG tank for the Japanese market among other factors. Consolidated net sales increased ¥1.4 billion year on year to ¥253.0 billion due to an increase in construction work volume in the Energy System segment and other factors, despite the decline in construction work volume on refuse incineration plants for the Japanese market and chemical plants for overseas markets. Consolidated operating income was ¥11.6 billion, a ¥3.9 billion increase from the previous year, due to the improvement in profitability in the Energy System segment and the other factors.

Precision Machinery & Robot

With respect to the business environment surrounding the Precision Machinery & Robot segment, in the construction machinery market, excavator sales competition in the Chinese market is becoming increasingly intense, and there are growing concerns and a sense of uncertainty about the future prospects of the China market, particularly among foreign construction machinery manufacturers that are losing market share in the Chinese market (especially for small- and medium-sized excavators). However, demand still exceeds its production capacity, so the Company is working to increase production. The Company will continue to monitor the situation in the Chinese market. In the robot market, the current situation is deteriorating due to the postponement of capital investment and the putting off of investment by semiconductor manufacturers in the Chinese market due to the U.S.-China trade friction, creating the expectation that the overseas market will remain unstable for a while. Still, semiconductor investment is expected to resume in the second half of the fiscal year, and demand is expected to recover. In the domestic market, demand is expected to steadily expand in the industrial sector as a whole, including in human-robot coexistence field.

Year on year in this segment, consolidated orders received increased ¥15.3 billion to ¥225.2 billion due to an increase in hydraulic components for construction machinery, despite a decrease in robots in the semiconductors field. Consolidated net sales was ¥222.0 billion, a ¥23.0 billion increase from the fiscal year ended March 31, 2018 due to an increase in hydraulic components for construction machinery, despite a decrease in industrial robots for semiconductors. Consolidated operating income was ¥21.3 billion, roughly the same level as in the previous fiscal year, due to an increase in SG&A expenses, including expenses increasing production as well as R&D costs, along with other factors, despite the increase in net sales.

Ship & Offshore Structure

With respect to the business environment surrounding the Ship & Offshore Structure segment, while new-build vessel prices are recovering after bottoming out and demand for gas-fueled vessels has been increasing in conjunction with the tightening of environmental regulations, competition remained intense due to factors including the pushing back of demand for LNG carriers because of the delay in LNG development projects and the continuation of policies by the South Korean government to support their domestic shipbuilding industries. In the year ended March 31, 2019, consolidated orders received were ¥81.1 billion, a ¥76.4 billion increase from the previous fiscal year when the Company terminated a ship building contract for an offshore service vessel after receiving an order for a submarine for the

Ministry of Defense. Consolidated net sales fell by ¥16.6 billion year on year to ¥78.9 billion, due to a change in the sales mix between LNG carriers and LPG carriers and other factors. Consolidated operating income was ¥1.0 billion, a ¥4.9 billion improvement from the previous fiscal year due to improvement in shipbuilding cost and other factors, despite a decrease in sales.

Rolling Stock

With respect to the business environment surrounding the Rolling Stock segment, there continues to be stable demand in Japan for the replacement of aging railcars. In North America, demand for new and replacement railcars has been increasing in the New York area, which is its core market, and the other areas. Meanwhile, in Asia, demand in emerging markets is increasing with the Japanese government's efforts to promote infrastructure related exports.

For the year, consolidated orders received were ¥136.0 billion, a ¥121.0 decline from the fiscal year ended March 31, 2018, when orders were received for new generation subway cars from the New York City Transit Authority, despite the fact that an order for commuter train cars was received from the Port Authority of New York and New Jersey along with other factors. Consolidated net sales decreased ¥17.0 billion year on year to ¥124.6 billion due to a decrease in sales for overseas markets in the U.S., Asia and other countries, and other factors. Consolidated operating income decreased ¥1.3 billion year on year to ¥13.7 billion of operating loss due to deterioration in profitability in orders for the U.S. since the previous year.

Motorcycle & Engine

Regarding the business environment surrounding the Motorcycle & Engine segment, the modest growth in motorcycle markets mainly in Europe is continuing, and the decline in demand for motorcycles in emerging countries is signaling a bottoming out. With respect to utility vehicles, the market continues to grow stably mainly in North America, and the general-purpose engine market is also growing steadily. Overall, consolidated net sales increased in this segment ¥25.1 billion year on year to ¥356.8 billion due to an increase in sales of motorcycles and vehicles for developed countries. Consolidated operating income deteriorated ¥0.8 billion year on year to ¥14.3 billion despite the increase in sales because increasing prices of steel and other materials in the U.S., the impact of weakness in the currencies of emerging countries and other factors.

Other Operations

Consolidated net sales increased ¥10.0 billion year on year to ¥95.1 billion. However, consolidated net operating income decreased ¥0.4 billion year on year to ¥2.5 billion.

Consolidated Financial Position

(1) Assets

Total assets at March 31, 2019 were ¥1,838.8 billion, a ¥53.8 billion increase from March 31, 2018. Current assets increased ¥20.5 billion from March 31, 2018 to ¥1,136.3 billion due to an increase in inventory assets and other factors. Fixed assets increased ¥33.2 billion year on year to ¥702.5 billion due to an increase in holdings of property, plant and equipment because of capital investment and other factors.

(2) Liabilities

Overall liabilities increased ¥42.9 billion from March 31, 2018 to ¥1,346.5 billion due to a rise in net defined benefit liabilities, the posting of the provision for the in-service issue of commercial jet aircraft engines and other factors. Interest bearing liabilities decreased ¥7.2 billion year on year to ¥439.4 billion.

(3) Net assets

Consolidated net assets increased ¥10.8 billion year on year to ¥492.2 billion due to factors including the increase from the posting of net income attributable to the owners of the parent and despite the decline due to dividend payments and other factors.

Cash Flows

(1) Cash flows from operating activities

Operating activities provided net cash of ¥109.7 billion, a ¥53.7 billion increase from the previous fiscal year. It is due mainly to a decrease in trade receivable. Major sources of operating cash flow included income before income taxes of ¥37.8 billion, depreciation and amortization of ¥59.0 billion, and trade receivable of ¥58.9 billion. Major uses of operating cash flow included expenditure of ¥65.3 billion due to an increase in inventory assets.

(2) Cash flows from investing activities
Investing activities used net cash of ¥85.3 billion, which is ¥4.7 billion more than in the previous fiscal year, mainly due to the requisition of property, plant and equipment as well as intangible assets.

(3) Cash flows from financing activities
Financing activities used ¥19.7 billion, which is ¥57.5 billion more than in the previous fiscal year when financing activities provided net cash of ¥37.7 billion. This was due mainly to the payment of dividends.

Given these changes in cash flows, cash and cash equivalents at end of year settled at ¥68.3 billion, up ¥3.9 billion from the beginning of the year.

Management of Liquidity Risk

To manage liquidity risk comprehensively, the Finance Department formulates and renews financial plans in a timely fashion based on reports from each business segment. In addition, measures are taken to diversify sources of financing, adjust the balance of long- and short-term financing with consideration for financial conditions and secure commitment lines (credit limit of ¥54.0 billion, immediate activation possible) and commercial paper (issuance limit of ¥150.0 billion).

Management Indicators

As target management indicators, the Company has adopted Earnings (Operating income, Recurring profit, Profit attributable to owners of parent) and Return on Invested Capital [ROIC = EBIT (Income before income taxes + Interest expense) / Invested Capital (Interest-bearing debt + Shareholders' equity)] as indicators for measuring capital efficiency.

The Company's Group-wide businesses are segmented and subdivided into Business Units (hereinafter referred to as "BUs"), and ROIC management is applied to each and every BU. Those BUs not clearing the ROIC hurdle rate (minimum required level) are required to take practical actions for clearing the hurdle rate early. On the other hand, those BUs already clearing the ROIC hurdle rate are encouraged to achieve the ROIC level for the top market leader and, while taking initiatives to enhance Economic Value Added (EVA), improve the enterprise value of the entire group.

With the improvement of these management indicators, the Company also seeks to improve its Return on Equity (ROE = Profit attributable to owners of parent / Shareholders' equity).

Dividends

As a basic management policy, the Company aims to increase corporate value by consistently generating profit exceeding the cost of invested capital. In line with this policy, the Company believes that one priority for management is to engage in cutting-edge research and development as well as innovative capital investment required to achieve future growth and thereby return profits to shareholders by enhancing shareholder value over the long term.

In order to maintain a good balance between enhancing shareholder value and returning profits to shareholders through dividends, the Company has set a medium- to long-term consolidated payout ratio standard of 30% corresponding to the consolidated profit attributable to the owners of the parent and in light of both the outlook for future earnings and a comprehensive examination of its financial condition, including its free cash flow, D/E ratio (debt-to-equity ratio) and other factors.

The Company has a basic policy of distributing surplus retained earnings as dividends twice a year, once after the fiscal second quarter and once after the fiscal year-end. Interim dividends are authorized by the Board of Directors, while year-end dividends are authorized at the general meetings of shareholders.

Consolidated Balance Sheets

KAWASAKI HEAVY INDUSTRIES, LTD. AND CONSOLIDATED SUBSIDIARIES
At March 31, 2019 and 2018

Assets

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2019	2018	**2019**
Current assets			
Cash and deposits (Note 23)	**¥ 74,311**	¥ 70,632	**$ 669,408**
Notes and accounts receivable–trade	**427,665**	470,110	**3,852,491**
Merchandise and finished goods	**68,176**	62,385	**614,143**
Work in process (Notes 4 and 9)	**405,087**	326,459	**3,649,104**
Raw materials and supplies	**119,558**	115,893	**1,077,002**
Other	**45,333**	72,542	**408,369**
Allowance for doubtful accounts	**(3,792)**	(2,247)	**(34,159)**
Total current assets	**1,136,340**	1,115,776	**10,236,375**
Non-current assets			
Property, plant and equipment (Note 8)			
Buildings and structures, net	**194,939**	186,623	**1,756,049**
Machinery, equipment and vehicles, net	**148,620**	144,399	**1,338,798**
Land	**62,705**	62,694	**564,859**
Leased assets, net	**2,148**	2,199	**19,350**
Construction in progress	**18,227**	25,724	**164,192**
Other, net	**59,028**	58,155	**531,736**
Total property, plant and equipment	**485,669**	479,797	**4,375,002**
Intangible assets	**16,797**	16,178	**151,311**
Investments and other assets			
Investment securities (Notes 5, 6 and 8)	**14,501**	14,798	**130,628**
Retirement benefit asset (Note 10)	**93**	88	**838**
Deferred tax assets (Note 22)	**70,179**	69,632	**632,186**
Other (Notes 7 and 8)	**116,696**	92,441	**1,051,221**
Allowance for doubtful accounts	**(1,422)**	(3,685)	**(12,810)**
Total investments and other assets	**200,048**	173,276	**1,802,072**
Total non-current assets	**702,514**	669,252	**6,328,385**
Total assets	**¥1,838,855**	¥1,785,028	**$16,564,769**

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

Liabilities and Net Assets

	Millions of yen 2019	Millions of yen 2018	Thousands of U.S. dollars (Note 1) 2019
Current liabilities			
Notes and accounts payable–trade (Note 8)	**¥ 247,191**	¥ 245,398	**$ 2,226,745**
Electronically recorded obligations–operating	**123,083**	117,772	**1,108,756**
Short-term loans payable (Note 8)	**100,023**	108,978	**901,027**
Current portion of bonds (Note 8)	**10,000**	20,000	**90,082**
Lease obligations (Note 8)	**319**	283	**2,874**
Income taxes payable (Note 22)	**10,390**	6,042	**93,595**
Provision for bonuses	**21,168**	19,903	**190,686**
Provision for construction warranties	**13,096**	13,000	**117,971**
Provision for loss on construction contracts (Note 9)	**27,609**	18,258	**248,707**
Advances received	**181,419**	194,306	**1,634,258**
Other	**129,978**	125,454	**1,170,867**
Total current liabilities	**864,280**	869,398	**7,785,605**
Non-current liabilities			
Bonds payable (Note 8)	**140,000**	130,000	**1,261,148**
Long-term loans payable (Note 8)	**187,568**	185,685	**1,689,650**
Lease obligations (Note 8)	**1,513**	1,697	**13,629**
Deferred tax liabilities (Note 22)	**593**	9,187	**5,342**
Retirement benefit liability (Note 10)	**97,602**	86,836	**879,218**
Provision for the in-service issues of commercial aircraft jet engines (Note 11)	**11,468**	–	**103,306**
Other	**43,566**	20,837	**392,451**
Total non-current liabilities	**482,313**	434,244	**4,344,771**
Total liabilities	**1,346,593**	1,303,642	**12,130,376**
Net assets (Note 13):			
Shareholders' equity:			
Common stock:			
Authorized–336,000,000 shares			
Issued–167,080,532 shares in 2019			
–167,080,532 shares in 2018	**104,484**	104,484	**941,213**
Capital surplus	**54,542**	54,573	**491,325**
Retained earnings	**324,606**	308,010	**2,924,115**
Treasury stock–33,049 shares in 2019			
–25,910 shares in 2018	**(130)**	(124)	**(1,171)**
Total shareholders' equity	**483,502**	466,944	**4,355,481**
Accumulated other comprehensive income			
Valuation difference on available-for-sale securities	**2,682**	3,526	**24,160**
Deferred gains or losses on hedges	**(227)**	403	**(2,045)**
Foreign currency translation adjustment	**(4,556)**	719	**(41,041)**
Remeasurements of defined benefit plans	**(5,014)**	(5,532)	**(45,167)**
Total accumulated other comprehensive income	**(7,115)**	(883)	**(64,093)**
Non-controlling interests	**15,874**	15,324	**142,996**
Total net assets	**492,261**	481,386	**4,434,384**
Total liabilities and net assets	**¥1,838,855**	¥1,785,028	**$16,564,769**

Consolidated Statements of Income

KAWASAKI HEAVY INDUSTRIES, LTD. AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 2019 and 2018

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2019	2018	**2019**
Net sales	**¥1,594,743**	¥1,574,242	**$14,365,760**
Cost of sales (Note 14)	**(1,326,668)**	(1,319,715)	**(11,950,887)**
Gross profit	**268,075**	254,527	**2,414,873**
Selling, general and administrative expenses			
Salaries and allowances	**(54,952)**	(52,502)	**(495,018)**
Research and development expenses (Note 15)	**(48,734)**	(45,434)	**(439,005)**
Other	**(100,364)**	(100,665)	**(904,099)**
Total selling, general and administrative expenses	**(204,052)**	(198,602)	**(1,838,141)**
Operating profit	**64,023**	55,925	**576,732**
Non-operating income			
Interest income	**909**	720	**8,188**
Dividend income	**294**	291	**2,648**
Gain on sales of securities	**862**	46	**7,765**
Share of profit of entities accounted for using equity method	**1,574**	4,492	**14,179**
Other	**3,056**	3,580	**27,529**
Total non-operating income	**6,696**	9,131	**60,319**
Non-operating expenses			
Interest expenses	**(3,427)**	(2,794)	**(30,871)**
Foreign exchange losses	**(4,721)**	(7,017)	**(42,528)**
Payments for the in-service issues of commercial aircraft jet engines (Note 16)	**(14,851)**	–	**(133,781)**
Payments for contract adjustments for commercial aircraft jet engines (Note 17)	**–**	(2,505)	**–**
Other	**(9,857)**	(9,513)	**(88,794)**
Total non-operating expenses	**(32,858)**	(21,830)	**(295,991)**
Ordinary profit	**37,861**	43,225	**341,059**
Extraordinary income			
Gain on sales of non-current assets (Note 18)	**–**	2,606	**–**
Total extraordinary income	**–**	2,606	**–**
Extraordinary losses			
Loss from termination of a shipbuilding contract for an offshore service vessel (Note 19)	**–**	(12,833)	**–**
Total extraordinary losses	**–**	(12,833)	**–**
Profit before income taxes (Note 22)	**37,861**	32,999	**341,059**
Income taxes—current	**(16,704)**	(11,634)	**(150,473)**
Income taxes—deferred	**8,681**	9,982	**78,200**
Total income taxes	**(8,022)**	(1,652)	**(72,264)**
Profit	**29,838**	31,347	**268,787**
Profit attributable to non-controlling interests	**2,385**	2,431	**21,485**
Profit attributable to owners of parent	**¥ 27,453**	¥ 28,915	**$ 247,302**

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

Consolidated Statements of Comprehensive Income

KAWASAKI HEAVY INDUSTRIES, LTD. AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 2019 and 2018

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2019	2018	**2019**
Profit	**¥29,838**	¥31,347	**$268,787**
Other comprehensive income (loss):			
Net unrealized gains (losses) on securities	**(864)**	338	**(7,783)**
Deferred gains (losses) on hedges	**(675)**	1,616	**(6,081)**
Foreign currency translation adjustments	**(796)**	(1,085)	**(7,171)**
Remeasurements of defined benefit plans	**549**	5,170	**4,946**
Share of other comprehensive income of entities accounted for using equity method	**(4,867)**	2,296	**(43,843)**
Total other comprehensive income (loss) (Note 20)	**(6,654)**	8,336	**(59,941)**
Comprehensive income	**23,183**	39,683	**208,837**
Comprehensive income attributable to:			
Owners of the parent company	**21,220**	37,015	**191,154**
Non-controlling interests	**¥ 1,962**	¥ 2,668	**$ 17,674**

	Yen		U.S. dollars (Note 1)
	2019	2018	**2019**
Per share amounts (Notes 21 and 24)			
Net income per share—basic	**¥ 164.3**	¥ 173.1	**$ 1.48**
Cash dividends	**65.0**	5.0	**0.59**

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

Consolidated Statements of Changes in Net Assets

KAWASAKI HEAVY INDUSTRIES, LTD. AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 2019 and 2018

	Number of shares of common stock (Thousands)	Common stock
Balance at March 31, 2017	167,080	¥104,484
Net income for the year	–	–
Treasury stock purchased, net	–	–
Cash dividends	–	–
Loss on sales of treasury stock	–	–
Capital increase of consolidated subsidiaries	–	–
Other	–	–
Balance at March 31, 2018	167,080	¥104,484
Net income for the year	–	–
Treasury stock purchased, net	–	–
Cash dividends	–	–
Loss on sales of treasury stock	–	–
Transfer of loss on sales of treasury stock	–	–
Capital increase of consolidated subsidiaries	–	–
Other	–	–
Balance at March 31, 2019	**167,080**	**¥104,484**

	Common stock
Balance at March 31, 2018	$941,213
Net income for the year	–
Treasury stock purchased, net	–
Cash dividends	–
Loss on sales of treasury stock	–
Transfer of loss on sales of treasury stock	–
Capital increase of consolidated subsidiaries	–
Other	–
Balance at March 31, 2019	**$941,213**

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

Millions of yen

Shareholders' equity				Accumulated other comprehensive income						
Capital surplus	Retained earnings	Treasury stock	Total shareholders' equity	Net unrealized gains (losses) on securities, net of tax	Deferred gains (losses) on hedges	Foreign currency translation adjustments	Accumulated adjustments for retirement benefits	Total accumulated other comprehensive income	Non-controlling interests	Total net assets
¥54,393	¥287,448	¥ (96)	¥446,230	¥3,232	¥(1,182)	¥ (341)	¥(10,692)	¥(8,983)	¥14,080	¥451,327
–	28,915	–	28,915	–	–	–	–	–	–	28,915
–	–	(28)	(28)	–	–	–	–	–	–	(28)
–	(8,352)	–	(8,352)	–	–	–	–	–	–	(8,352)
(0)	–	0	0	–	–	–	–	–	–	0
179	–	–	179	–	–	–	–	–	–	179
–	–	–	–	293	1,585	1,060	5,160	8,099	1,244	9,344
¥54,573	¥308,010	¥(124)	¥466,944	¥3,526	¥ 403	¥ 719	¥ (5,532)	¥ (883)	¥15,324	¥481,386
–	**27,453**	**–**	**27,453**	**–**	**–**	**–**	**–**	**–**	**–**	**27,453**
–	**–**	**(7)**	**(7)**	**–**	**–**	**–**	**–**	**–**	**–**	**(7)**
–	**(10,858)**	**–**	**(10,858)**	**–**	**–**	**–**	**–**	**–**	**–**	**(10,858)**
(0)	**–**	**1**	**1**	**–**	**–**	**–**	**–**	**–**	**–**	**1**
0	**(0)**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
(30)	**–**	**–**	**(30)**	**–**	**–**	**–**	**–**	**–**	**–**	**(30)**
–	**–**	**–**	**–**	**(843)**	**(630)**	**(5,275)**	**517**	**(6,232)**	**549**	**(5,683)**
¥54,542	**¥324,606**	**¥(130)**	**¥483,502**	**¥2,682**	**¥ (227)**	**¥(4,556)**	**¥ (5,014)**	**¥(7,115)**	**¥15,874**	**¥492,261**

Thousands of U.S. dollars

Shareholders' equity				Accumulated other comprehensive income						
Capital surplus	Retained earnings	Treasury stock	Total shareholders' equity	Net unrealized gains (losses) on securities, net of tax	Deferred gains (losses) on hedges	Foreign currency translation adjustments	Accumulated adjustments for retirement benefits	Total accumulated other comprehensive income	Non-controlling interests	Total net assets
$491,604	$2,774,615	$(1,117)	$4,206,324	$31,763	$ 3,630	$ 6,477	$(49,833)	$ (7,954)	$138,042	$4,336,420
–	**247,302**	**–**	**247,302**	**–**	**–**	**–**	**–**	**–**	**–**	**247,302**
–	**–**	**(63)**	**(63)**	**–**	**–**	**–**	**–**	**–**	**–**	**(63)**
–	**(97,811)**	**–**	**(97,811)**	**–**	**–**	**–**	**–**	**–**	**–**	**(97,811)**
(0)	**–**	**9**	**9**	**–**	**–**	**–**	**–**	**–**	**–**	**9**
0	**(0)**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
(270)	**–**	**–**	**(270)**	**–**	**–**	**–**	**–**	**–**	**–**	**(270)**
–	**–**	**–**	**–**	**(7,594)**	**(5,675)**	**(47,518)**	**4,657**	**(56,139)**	**4,946**	**(51,194)**
$491,325	**$2,924,115**	**$(1,171)**	**$4,355,481**	**$24,160**	**$(2,045)**	**$(41,041)**	**$(45,167)**	**$(64,093)**	**$142,996**	**$4,434,384**

Consolidated Statements of Cash Flows

KAWASAKI HEAVY INDUSTRIES, LTD. AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 2019 and 2018

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2019	2018	**2019**
Cash flows from operating activities:			
Profit before income taxes	**¥ 37,861**	¥ 32,999	**$ 341,059**
Depreciation	**59,022**	56,137	**531,682**
Increase (decrease) in allowance for doubtful accounts	**(667)**	1,093	**(6,008)**
Increase (decrease) in provision for bonuses	**1,245**	(387)	**11,215**
Increase (decrease) in provision for construction warranties	**100**	814	**901**
Increase (decrease) in provision for loss on construction contracts	**9,336**	11,029	**84,101**
Increase (decrease) in retirement benefit liability	**11,982**	13,324	**107,936**
Increase (decrease) in provision for the in-service issues of commercial aircraft jet engines	**11,468**	–	**103,306**
Interest and dividend income	**(1,203)**	(1,011)	**(10,837)**
Interest expenses	**3,427**	2,794	**30,871**
Share of loss (profit) of entities accounted for using equity method	**(1,574)**	(4,492)	**(14,179)**
Loss (gain) on sales of non-current assets	**–**	(2,606)	**–**
Losses from the termination of a shipbuilding contract for an offshore service vessel	**–**	12,833	**–**
Decrease (increase) in notes and accounts receivable–trade	**58,985**	(35,516)	**531,349**
Decrease (increase) in inventories	**(65,383)**	(26,443)	**(588,983)**
Increase (decrease) in notes and accounts payable–trade	**6,829**	21,569	**61,517**
Decrease (increase) in advance payments	**1,202**	6,103	**10,828**
Increase (decrease) in advances received	**(14,013)**	(10,092)	**(126,232)**
Decrease (increase) in other current assets	**(1,557)**	(22,937)	**(14,026)**
Increase (decrease) in other current liabilities	**2,299**	8,644	**20,710**
Other, net	**1,192**	(789)	**10,738**
Subtotal	**120,553**	63,066	**1,085,965**
Interest and dividend income received	**3,859**	4,166	**34,763**
Interest expenses paid	**(3,439)**	(2,795)	**(30,979)**
Income taxes paid	**(11,211)**	(8,386)	**(100,991)**
Net cash provided by (used in) operating activities	**¥109,762**	¥ 56,050	**$ 988,758**

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2019	2018	**2019**
Cash flows from investing activities:			
Purchase of property, plant and equipment and intangible assets	**¥ (82,836)**	¥ (82,238)	**$ (746,203)**
Proceeds from sales of property, plant and equipment and intangible assets	**605**	6,452	**5,450**
Purchase of investment securities	**(1,025)**	(512)	**(9,233)**
Proceeds from sales of investment securities	**989**	342	**8,909**
Purchase of shares of subsidiaries and associates	**(3,818)**	(3,408)	**(34,393)**
Other, net	**741**	(1,226)	**6,675**
Net cash provided by (used in) investing activities	**¥ (85,344)**	¥ (80,590)	**$ (768,796)**
Cash flows from financing activities:			
Net increase (decrease) in short-term loans payable	**¥ (10,866)**	¥ 16,363	**$ (97,883)**
Proceeds from long-term loans payable	**34,772**	64,363	**313,233**
Repayments of long-term loans payable	**(30,709)**	(42,694)	**(276,633)**
Proceeds from issuance of bonds	**20,000**	20,000	**180,164**
Redemption of bonds	**(20,000)**	(10,000)	**(180,164)**
Cash dividends paid	**(10,868)**	(8,375)	**(97,901)**
Dividends paid to non-controlling interests	**(1,950)**	(1,433)	**(17,566)**
Other, net	**(149)**	(454)	**(1,342)**
Net cash provided by (used in) financing activities	**¥ (19,771)**	¥ 37,770	**$ (178,101)**
Effect of exchange rate change on cash and cash equivalents	**(696)**	410	**(6,270)**
Net increase (decrease) in cash and cash equivalents	**3,949**	13,640	**35,573**
Cash and cash equivalents at beginning of period	**64,362**	50,722	**579,786**
Cash and cash equivalents at end of period	**¥ 68,311**	¥ 64,362	**$ 615,359**
Supplemental information on cash flows:			
Cash and cash equivalents:			
Cash and deposits in the balance sheets	**¥ 74,311**	¥ 70,632	**$ 669,408**
Time deposits with maturities over three months	**(6,000)**	(6,269)	**(54,049)**
Total (Note 23)	**¥ 68,311**	¥ 64,362	**$ 615,359**

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

Notes to the Consolidated Financial Statements

KAWASAKI HEAVY INDUSTRIES, LTD. AND CONSOLIDATED SUBSIDIARIES

1.

Basis of presenting consolidated financial statements

The accompanying consolidated financial statements of Kawasaki Heavy Industries, Ltd. (the "Company") and its consolidated subsidiaries (together the "Companies") have been prepared from the financial statements filed with the Prime Minister as required by the Financial Instruments and Exchange Act in Japan and in accordance with accounting principles generally accepted in Japan ("Japanese GAAP"), which are different in certain respects as to the application and disclosure requirements from International Financial Reporting Standards. Certain reclassifications have been made in the accompanying consolidated financial statements to facilitate understanding by readers outside Japan.

The translations of the Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2019, which was ¥111.01 to U.S.$1.00. The translations should not be construed as representations that the Japanese yen amounts have been, could have been or could in the future be converted into U.S. dollars at this or any other rate of exchange.

As permitted, fractional amounts have not been adjusted.

2.

Significant accounting policies

(a) Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and significant companies over which the Company has power of control through majority voting rights or the existence of certain other conditions evidencing control. The consolidated financial statements include the accounts of the Company and 94 subsidiaries (93 in the year ended March 31, 2018). The aggregate amount of total assets, net sales, profit and retained earnings of the excluded subsidiaries would not have had a material effect on the consolidated financial statements if they had been included in the consolidation.

(b) Application of the equity method of accounting

Investments in nonconsolidated subsidiaries and affiliates over which the Company has the ability to exercise significant influence over operating and financial policies are accounted for by the equity method. For the year ended March 31, 2019, 17 affiliates (17 in 2018) were accounted for by the equity method. For the year ended March 31, 2019, investments in 10 affiliates (13 in 2018) were stated at cost without applying the equity method of accounting. If the equity method had been applied for these investments, the profit and retained earnings of these excluded subsidiaries and affiliates would not have had a material effect on the consolidated financial statements.

(c) Consolidated subsidiaries' fiscal year-end

For the year ended March 31, 2019, the fiscal year-end of 30 consolidated subsidiaries (29 in 2018) was December 31. These subsidiaries were consolidated as of December 31, and significant transactions for the period between December 31 and March 31, the Company's fiscal year-end, were adjusted for on consolidation.

(d) Foreign currency translations

Receivables and payables denominated in foreign currencies are translated into Japanese yen at year-end rates. The balance sheets of the consolidated overseas subsidiaries are translated into Japanese yen at year-end rates, except for shareholders' equity accounts, which are translated at historical rates. The income statements of the consolidated overseas subsidiaries are translated at average rates. The Company and its domestic subsidiaries report foreign currency translation adjustments in net assets.

(e) Revenue recognition

<Sales of products and construction contracts>

The percentage-of-completion method is applied to construction contracts if the outcome of the construction activity is deemed certain during the period of the activity. Otherwise, the completed contract method is applied.

(f) Cash and cash equivalents

Cash on hand, readily available deposits and short-term highly liquid and low risk investments with maturities not exceeding three months at the time of purchase are considered to be cash and cash equivalents in preparing the consolidated statements of cash flows.

(g) Allowance for doubtful receivables

An allowance for possible losses from notes and accounts receivable, loans and other receivables is provided based on past experience and the Companies' estimates of losses on collection.

(h) Assets and liabilities arising from derivative transactions

Assets and liabilities arising from derivative transactions are stated at fair value.

(i) Inventories

Inventories are stated mainly at historical cost computed using the specific identification cost method, the moving average cost method or the first-in, first-out method. The ending balance of inventories is measured at the lower of cost or market.

(j) Investment securities

The Company and its consolidated subsidiaries classify securities as (a) debt securities intended to be held to maturity (hereafter, "held-to-maturity debt securities"), (b) equity securities issued by subsidiaries and affiliated companies and (c) all other securities (hereafter, "available-for-sale securities"). There were no trading securities at March 31, 2019 or 2018. Held-to-maturity debt securities are stated mainly at amortized cost. Equity securities issued by subsidiaries and affiliated companies which are not consolidated or accounted for using the equity method are stated at moving average cost. Available-for-sale securities with available fair market values are stated at fair market value. Unrealized gains and unrealized losses on these securities are reported, net of applicable income taxes, as a separate component of net assets. Realized gains and losses on the sale of such securities are computed using moving average cost. Other securities with no available market value are stated at moving average cost.

If the market value of held-to-maturity debt securities, equity securities issued by nonconsolidated subsidiaries or affiliated companies or available-for-sale securities declines significantly, such securities are stated at market value, and the difference between the market value and the carrying amount is recognized as loss in the period of the decline. If the market value of equity securities issued by a nonconsolidated subsidiary or affiliated company not subject to the equity method is not readily available, the securities should be written down to net asset value with a corresponding charge in the statements of income in the event the net asset value declines significantly. In these cases, the market value or the net asset value will be the carrying amount of the securities at the beginning of the next year.

(k) Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation is computed mainly by the straight-line method over the estimated useful life of the asset.

(l) Intangible assets
Amortization of intangible assets, including software for the Company's own use, is computed by the straight-line method over the estimated useful life of the asset.

An equivalent amount of goodwill is amortized by the straight-line method over the period the Company benefits from its use. If the amount is not significant, it is expensed when incurred.

(m) Provision for bonuses
Accrued bonuses for employees are provided for based on the estimated amount of payment.

(n) Provision for construction warranties
The provision for construction warranties is based on past experience or provided separately when it can be reasonably estimated.

(o) Provision for losses on construction contracts
A provision for losses on construction contracts at the fiscal year-end is made when substantial losses are anticipated for the next fiscal year and beyond and such losses can be reasonably estimated.

(p) Provision for the in-service issues of commercial aircraft jet engines
Of the costs related to the significant in-service issues of commercial aircraft jet engines that arose in the Rolls-Royce Trent 1000 engine program, in which the Company participates as a risk and revenue sharing partner, the Company has made a provision for the abnormal costs related to the in-service issues which the Company would cover as a member of this program.

(q) Retirement benefit liability
Employees who terminate their services with the Company or some consolidated domestic subsidiaries are generally entitled to lump-sum payments, the amounts of which are determined by reference to basic rates of pay at the time of termination and length of service.

The liabilities and expenses for retirement and severance benefits are determined based on amounts actuarially calculated using certain assumptions. The Company and its consolidated domestic subsidiaries provide the allowance for employees' retirement and severance benefits based on the estimated amounts of projected benefit obligation and the fair value of plan assets, including assets in the retirement benefit trust.

Actuarial gains and losses and prior service costs are charged to income on a straight-line basis primarily over 10 years commencing with the following period and the current period, respectively. With regard to previously unrecognized actuarial gains and losses and unrecognized prior services costs, after adjusting for tax effects, the Company records any accumulated adjustment for retirement benefits as part of accumulated other comprehensive income within net assets.

In calculating retirement benefit obligations, the Company uses a benefit formula basis to attribute expected benefits to periods of service.

Employees of the Company's overseas consolidated subsidiaries are generally covered by various pension plans accounted for in accordance with generally accepted accounting principles in the respective country of domicile.

(r) Hedge accounting
The Company and its consolidated subsidiaries employ deferred hedge accounting. If derivative financial instruments are used as hedges and meet certain hedging criteria, the Company and its consolidated subsidiaries defer recognition of gain or loss resulting from a change in the fair value of the derivative financial instrument until the related loss or gain on the hedged item is recognized.

(s) Finance leases

Lease assets under finance leases that transfer ownership of the lease assets to the lessee are amortized by the same method as that used for property, plant and equipment and intangible assets. Lease assets under finance leases that do not transfer ownership of the lease assets to the lessee are amortized by the straight-line-method over the lease term with zero residual value.

(t) Accounting for consumption taxes

National and local consumption taxes are accounted for based on the net amount.

(u) Application of consolidated tax reporting

The Company and its wholly owned consolidated domestic subsidiaries file a consolidated tax return.

3. Accounting standards issued but not yet adopted

The following guidance was issued but not yet adopted.

1. The Company and its affiliated companies

- "Accounting Standard for Revenue Recognition" (ASBJ Statement No. 29, March 30, 2018)
- "Implementation Guidance on Accounting Standard for Revenue Recognition" (ASBJ Guidance No. 30, March 30, 2018)

(a) Overview

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) initiated a joint project to develop a comprehensive accounting standard for revenue recognition. In May 2014, the Boards published "Revenue from Contracts with Customers" (IFRS 15 for the IASB; Topic 606 for the FASB). IFRS 15 is effective from January 1, 2018, and Topic 606 is applied from fiscal years beginning after December 15, 2017. In response to these developments, the ASBJ developed a comprehensive accounting standard related to revenue recognition and published this standard together with its implementation guidance.

(b) Effective date

Effective from the beginning of the fiscal year ending March 31, 2022.

(c) Effects of application of the standards

The Company and its consolidated domestic subsidiaries are currently in the process of determining the effect Topic 606, "Revenue from Contracts with Customers", will have on the consolidated financial statements.

2. Affiliated companies in the United States

- Topic 606 "Revenue from Contracts with Customers"

(a) Overview

The Financial Accounting Standards Board (FASB) has developed a comprehensive accounting standard for revenue recognition. In May 2014, Topic 606 "Revenue from Contracts with Customers" was announced. Topic 606 is applied from fiscal years beginning after December 15, 2017.

(b) Effective date

Scheduled to be applied from the start of the fiscal year ending March 31, 2020.

(c) Effects of application of the standards

The application of this accounting standard is expected to result in a decrease in retained earnings of approximately ¥4,900 million ($44,140 thousand) on the date that the application begins.

• Topic 842 “Leases”

(a) Overview

These accounting standards require a lessee to recognize assets or liabilities generally for all leases on the balance sheet, whereas no significant changes were made in the accounting for a lessor.

(b) Effective date

Scheduled to be applied from the start of the fiscal year ending March 31, 2021.

(c) Effects of application of the standards

The Company is currently in the process of determining the effects of the application of Topic 842 “Leases” on the consolidated financial statements.

4. Work in process

A trust was established for the Company’s accounts receivable - trade generated in selling certain work in process using a self-settled trust. The Company has a beneficiary interest in the accounts receivable – trade as trust assets. The work in process related to the trust assets as of March 31, 2019 and 2018 amounted to ¥4,926 million ($44,374 thousand) and ¥2,468 million, respectively.

5. Securities

(a) Acquisition costs and book values (market values) of available-for-sale securities with available market values as of March 31, 2019 and 2018 were as follows:

	2019			
	Millions of yen			Thousands of U.S. dollars
	Book value	Acquisition cost	Unrealized gains (losses)	Unrealized gains (losses)
Securities with book values exceeding acquisition costs:				
Equity securities	**¥8,008**	**¥3,488**	**¥4,519**	**$40,708**
Other securities:				
Equity securities	**131**	**141**	**(9)**	**(81)**
Total	**¥8,140**	**¥3,629**	**¥4,510**	**$40,627**

	2018		
	Millions of yen		
	Book value	Acquisition cost	Unrealized gains (losses)
Securities with book values exceeding acquisition costs:			
Equity securities	¥8,996	¥3,208	¥5,788
Other securities:			
Equity securities	390	407	(16)
Total	¥9,387	¥3,615	¥5,771

(b) Sales amounts of available-for-sale securities and related realized gains and losses for the years ended March 31, 2019 and 2018 were as follows:

	2019					
	Millions of yen			Thousands of U.S. dollars		
	Sales amounts	Gains	Losses	Sales amounts	Gains	Losses
Equity securities:	**¥965**	**¥862**	**¥–**	**$8,693**	**$7,765**	**$–**

	2018		
	Millions of yen		
	Sales amounts	Gains	Losses
Equity securities:	¥324	¥ 48	¥(1)

(c) Investment securities subject to impairment

Although impairment loss on other securities was recorded for the years ended March 31, 2019 and 2018, disclosure was omitted as the amounts were immaterial.

Impairment loss on investment securities is recognized when there has been a significant decline in the market value. Investment securities for which the market value as of the end of the fiscal year has fallen to below 50% of the acquisition costs are deemed to have no recovery potential and to be impaired. Investment securities for which the market value has fallen to between 30% and 50% of the acquisition costs are deemed to be partially impaired by an amount that takes into consideration the likelihood of recovery and other factors.

6.

Investments in nonconsolidated subsidiaries and affiliates

Investments in nonconsolidated subsidiaries and affiliates as of March 31, 2019 and 2018 were ¥76,214 million ($686,551 thousand) and ¥78,314 million, respectively.

7.

Claim for damages in overseas LNG tank construction work

In connection with a certain liquefied natural gas (LNG) tank construction project carried out by the Company overseas, the Company filed a petition for arbitration with The International Chamber of Commerce (ICC) during the fiscal year under review concerning losses sustained by the Company due to breach of contract by an overseas construction subcontractor. The Company plans to recover the amount of loss (approximately ¥51,000 million ($459,418 thousand)) in connection with this matter through future arbitration and has recorded a portion of the expected amount in “Others” under “Investments and other assets.”

8.

Short-term debt and long-term debt

Short-term debt and long-term debt as of March 31, 2019 and 2018 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Short-term debt:			
Short-term loans payable, principally bank loans, bearing average interest rates of 1.58% and 1.01% as of March 31, 2019 and 2018, respectively	**¥ 71,698**	¥ 82,798	**$ 645,870**
Current portion of long-term loans payable, bearing average interest rates of 0.50% and 0.39% as of March 31, 2019 and 2018, respectively	**28,324**	26,179	**255,148**
Current portion of bonds, bearing average interest rates of 0.68% and 0.34-0.57% as of March 31, 2019 and 2018, respectively.	**10,000**	20,000	**90,082**
Lease obligations, current	**319**	283	**2,874**
Total short-term debt	**¥110,342**	¥129,261	**$ 993,983**
Long-term debt:			
Loans from banks and other financial institutions, partly secured by mortgage or other collateral, due from 2019 to 2029, bearing average interest rates of 0.48% and 0.49% as of March 31, 2019 and 2018, respectively.	**¥215,892**	¥211,864	**$1,944,798**
Notes and bonds issued by the Company:			
0.34-0.57% notes due in 2018	**–**	20,000	**–**
0.68% notes due in 2019	**10,000**	10,000	**90,082**
0.32–0.99% notes due in 2020	**20,000**	20,000	**180,164**
0.10–1.42% notes due in 2021	**30,000**	30,000	**270,246**
0.15-1.10% notes due in 2022	**20,000**	20,000	**180,164**
0.18–0.99% notes due in 2023	**20,000**	10,000	**180,164**
0.79% notes due in 2024	**10,000**	10,000	**90,082**
0.85% notes due in 2025	**10,000**	10,000	**90,082**
0.40% notes due in 2028	**10,000**	–	**90,082**
0.82% notes due in 2036	**10,000**	10,000	**90,082**
0.90% notes due in 2037	**10,000**	10,000	**90,082**
Long-term lease obligations	**1,832**	1,980	**16,503**
	367,724	363,844	**3,312,530**
Less portion due within one year	**(38,643)**	(46,462)	**(348,104)**
Total long-term debt	**¥329,081**	¥317,382	**$2,964,427**

As of March 31, 2019 and 2018, the following assets were pledged as collateral for short-term debt and long-term debt:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Buildings and structures	**¥ 61**	¥ 65	**$ 550**
Investments in securities	**17**	17	**153**
Other	**80**	80	**721**
Total	**¥158**	¥162	**$1,423**

As of March 31, 2019 and 2018, debt secured by the above pledged assets was as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Notes and accounts payable–trade	**¥ 3**	¥ 2	**$ 27**
Short-term loans payable and long-term loans payable	**18**	53	**162**
Total	**¥21**	¥56	**$189**

The aggregate annual maturities of long-term debt as of March 31, 2019 were as follows:

	Millions of yen	Thousands of U.S. dollars
Year ending March 31		
2020	**¥ 38,643**	**$ 348,104**
2021	**43,710**	**393,748**
2022	**47,399**	**426,980**
2023	**40,102**	**361,247**
2024 and thereafter	**197,870**	**1,782,452**
Total	**¥367,724**	**$3,312,530**

9.

Provision for losses on construction contracts

Inventories for construction contracts with substantial anticipated losses and the provision for losses on construction contracts were not offset. As of March 31, 2019 and 2018, the inventories for the construction contracts for which the provision for losses on construction contracts were provided were ¥20,881 million ($188,100 thousand) and ¥15,590 million, respectively. These amounts were all included in work in process.

As of March 31, 2018, in a certain liquefied natural gas (LNG) tank construction project carried out by the Company overseas, the total cost has increased to a level higher than the original estimate. The causes of this cost increase include the nonfulfillment of a contract by an overseas construction subcontractor. The Company has calculated a provision for losses on construction contracts after deducting a part of the future damages claim amount in relation to losses sustained by the Company owing to the breach of contract by the aforementioned subcontractor from the total cost estimate for the project.

10.

Employees' retirement and severance benefits

1. The Company and its domestic consolidated subsidiaries have a system of retirement and severance lump-sum payments for employees. The Company and certain consolidated subsidiaries also have a defined contribution pension plan and a cash balance plan (pension plan linked to market interest rates). A portion of the existing retirement and severance benefits are funded. Certain consolidated subsidiaries have a retirement pension plan. The Company has an employees' retirement benefit trust. The Company and certain consolidated subsidiaries made changes to their system of retirement and severance lump-sum payments for employees. As a result, the Company incurred prior service cost (increase in obligation).

   The gain on contribution of securities to the employees' retirement benefit trust was attributable to the contribution of holdings of investments in securities to the employees.

2. Defined benefit plans (including plans that apply a simplified method)

(1) Reconciliation of beginning-of-period and end-of-period balances of retirement benefit obligation

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Balance of retirement benefit obligations at beginning of period	**¥194,948**	¥191,472	**$1,756,130**
Service cost	**11,526**	10,773	**103,828**
Interest cost	**1,848**	1,943	**16,647**
Actuarial gains and losses	**3,168**	1,391	**28,538**
Retirement benefits paid	**(9,564)**	(9,399)	**(86,154)**
Prior service cost	**81**	55	**730**
Other (foreign currency translation difference, etc.)	**(524)**	(1,288)	**(4,720)**
Balance of retirement benefit obligations at end of period	**¥201,484**	¥194,948	**$1,815,008**

(2) Reconciliation of beginning-of-period and end-of-period balances of plan assets

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Balance of plan assets at beginning of period	**¥108,200**	¥109,995	**$974,687**
Expected return on plan assets	**1,252**	1,167	**11,278**
Actuarial gains and losses	**(1,589)**	2,539	**(14,314)**
Contributions paid by the employer	**3,918**	3,797	**35,294**
Retirement benefits paid	**(6,869)**	(7,541)	**(61,877)**
Other (foreign currency translation difference, etc.)	**(937)**	(1,756)	**(8,441)**
Balance of plan assets at end of period	**¥103,976**	¥108,200	**$936,636**

(3) Reconciliation between end-of-period balance of retirement benefit obligations and plan assets to liabilities and retirement benefit liability and retirement benefit asset presented on the consolidated balance sheets

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Retirement benefit obligations on funded plan	**¥174,251**	¥169,362	**$1,569,687**
Plan assets	**(103,976)**	(108,200)	**(936,636)**
	70,275	61,162	**633,051**
Retirement benefit obligations on unfunded plan	**27,232**	25,585	**245,311**
Net amount of liabilities and assets presented on the consolidated balance sheets	**97,508**	86,747	**878,371**
Liability for retirement benefits	**97,602**	86,836	**879,218**
Asset for retirement benefits	**(93)**	(88)	**(838)**
Net amount of liabilities and assets presented on the consolidated balance sheets	**¥ 97,508**	¥ 86,747	**$ 878,371**

(4) Breakdown of retirement benefit expense

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Service cost	**¥11,526**	¥10,773	**$103,828**
Interest cost	**1,848**	1,943	**16,647**
Expected return on plan assets	**(1,252)**	(1,167)	**(11,278)**
Amortization of actuarial gains and losses	**4,624**	6,791	**41,654**
Amortization of prior service costs	**464**	353	**4,180**
Retirement benefit expense related to defined benefit plan	**¥17,210**	¥18,694	**$155,031**

(5) Adjustments for retirement benefits

Adjustments for retirement benefits (before tax effects) comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Prior service cost	**¥382**	¥ 298	**$3,441**
Actuarial gains and losses	**(133)**	7,939	**(1,198)**
Total	**¥249**	¥8,237	**$2,243**

(6) Accumulated adjustments for retirement benefits

Accumulated adjustments for retirement benefits (before tax effects) comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Unrecognized prior service cost	**¥(1,482)**	¥(1,864)	**$(13,350)**
Unrecognized actuarial gains and losses	**(5,979)**	(5,846)	**(53,860)**
Total	**¥(7,462)**	¥(7,711)	**$(67,219)**

(7) Plan assets

(i) Main breakdown of plan assets

The breakdown of main asset categories as a percentage of total plan assets is as follows:

	2019	2018
Bonds	**20%**	18%
Equities	**66%**	70%
Cash and deposits	**1%**	1%
Others	**13%**	11%
Total	**100%**	100%

Note: As of March 31, 2019 and 2018, the employees' retirement benefit trust established as part of the retirement benefit plan is included in the plan assets and represented a 56% and 60% portion of the plan assets, respectively.

(ii) Method for setting long-term expected rate of return

To determine the expected rate of return on plan assets, the Company takes into account the current and expected allocation of plan assets and the expected present and future long-term rate of return on the diverse range of assets that makes up the plan assets.

(8) Underlying actuarial assumptions

The main underlying actuarial assumptions as of March 31, 2019 and 2018, respectively, were as follows:

(presented as the compound average)

	2019	2018
Discount rate	**0.33–3.76%**	0.40–3.87%
Long-term expected rate of return on plan assets	**0.00–5.75%**	0.00–6.00%
Rate of compensation increase	**6.50–7.20%**	6.50–7.20%

3. Defined contribution plan

As of March 31, 2019 and 2018, the required contribution by the Company and its consolidated subsidiaries to the defined contribution plan was ¥2,372 million ($21,367 thousand) and ¥2,212 million, respectively.

11.

The provision for the in-service issues of commercial aircraft jet engines

The Company participates as a risk and revenue sharing partner on the Rolls-Royce Trent 1000 engine program, which has been impacted by the challenge of managing significant in-service issues. Rolls-Royce continues to work hard to remedy this situation and has made further substantial progress on the implementation of long-term solutions and mitigation of the near-term impact on customers. In the FY2018 financial results, the Company has made a provision of the abnormal cost related to in-service issues which the Company would cover as a member of this program.

12. Contingent liabilities

Contingent liabilities as of March 31, 2019 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
As guarantor of indebtedness of employees, nonconsolidated subsidiaries, affiliates and others	**¥24,384**	¥21,786	**$219,656**

13. Net assets

Under the Japanese Corporate Law ("the Law"), the entire amount paid for new shares is required to be designated as common stock. However, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one half of the price of the new shares as capital reserve, which is included in capital surplus. Under the Law, if a dividend distribution of surplus is made, the smaller of an amount equal to 10% of the dividend or the excess, if any, of 25% of common stock over the total of capital reserve and legal earnings reserve must be set aside as capital reserve or legal earnings reserve. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets. Under the Law, legal earnings reserve and capital reserve can be used to eliminate or reduce a deficit or capitalized by a resolution of the shareholders' meeting.

Capital reserve and legal earnings reserve may not be distributed as dividends. Under the Law, all capital reserve and all legal earnings reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for dividends.

The maximum amount that the Company can distribute as dividends is calculated based on the nonconsolidated financial statements of the Company in accordance with the Law.

14. Cost of sales

The ending balance of inventories was measured at the lower of cost or market. Gain on the valuation of inventories included in the cost of sales for the year ended March 31, 2019 was ¥1,645 million ($14,818 thousand). Gain on the valuation of inventories included in the cost of sales for the years ended March 31, 2018 was ¥3,434 million.

Provision for losses on construction contracts included in the cost of sales for the years ended March 31, 2019 and 2018 was ¥14,451 million ($130,177 thousand) and ¥23,718 million, respectively.

15. Research and development expenses

Research and development expenses included in selling, general and administrative expenses and product costs were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Research and development expenses	**¥48,734**	¥45,434	**$439,005**

16.

The payments for the in-service issues of commercial aircraft jet engines

The Company participates as a risk and revenue sharing partner on the Rolls-Royce Trent 1000 engine program, which has been impacted by the challenge of managing significant in-service issues. Rolls-Royce continues to work hard to remedy this situation and has made further substantial progress on the implementation of long-term solutions and mitigation of the near-term impact on customers. In the FY2018 financial results, the Company has made a provision of the abnormal cost related to in-service issues which the Company would cover as a member of this program. The provision was included within the non-operating expenses.

17.

Payments for contract adjustment for commercial aircraft jet engines

The Company faced one-time expenses in connection with contracts with customers related to engine programs in which the Company was participating. These expenses arose from the new requirement to allocate a portion of the engines planned to be delivered to customers for use as spare engines for operational supports. Accordingly, the Company recorded these program expenses as non-operating expenses.

18.

Gain on sales of property, plant and equipment

Gain on sales of property, plant and equipment for the fiscal year ended March 31, 2018 was due to the sale of the land and building of company dormitories, houses, etc.

19.

Losses from the termination of a shipbuilding contract for an offshore service vessel

These are losses in conjunction with the termination of a shipbuilding contract for an offshore service vessel (losses recognized on valuation of inventories and accounts receivable—trade, etc.).

In November 2013, with the intention of entering the offshore development industry, which is a promising market over the medium to long term, the Company entered into a shipbuilding agreement for an offshore service vessel with a subsidiary* of Island Offshore Shipholding LP (hereinafter, "Island Offshore"). This was the first vessel of its type to be constructed by the Company, and certain problems during the engineering stage arose along with an increase in the cost of materials and other issues.

From the time the order for this vessel was received, the stagnation in crude oil prices led to a very difficult business environment for offshore service providers in general, and Island Offshore began negotiating financial restructuring with its banking partners from November 2016.

Given the above circumstances, the Company proceeded cautiously, including temporarily suspending the construction of the vessel, while paying close attention to the progress of the financial restructuring of Island Offshore. During this time, the Company was holding discussions with Island Offshore regarding the handling of the vessel. Based on the shared understanding that the environment surrounding the offshore service business remained challenging and that uncertainty about the future could not be eliminated, the Company and Island Offshore agreed to terminate the shipbuilding agreement, and the Company therefore carried out the necessary accounting treatment.

**Island Navigator I KS (100% subsidiary company of Island Offshore Shipholding LP)*

20.

Consolidated statement of comprehensive income

Amounts reclassified to profit (loss) in the current period that were recognized in other comprehensive income in the current or previous periods and the tax effects for each component of other comprehensive income were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Unrealized gains (losses) on securities			
Increase (decrease) during the year	**¥ (448)**	¥ 450	**$ (4,036)**
Reclassification adjustments	**(768)**	110	**(6,918)**
Subtotal, before tax	**(1,217)**	560	**(10,963)**
Tax (expense) or benefit	**352**	(222)	**3,171**
Subtotal, net of tax	**(864)**	338	**(7,783)**
Deferred gains (losses) on hedges			
Increase (decrease) during the year	**(3,240)**	114	**(29,187)**
Reclassification adjustments	**2,258**	2,120	**20,341**
Subtotal, before tax	**(982)**	2,235	**(8,846)**
Tax (expense) or benefit	**306**	(618)	**2,757**
Subtotal, net of tax	**(675)**	1,616	**(6,081)**
Foreign currency translation adjustments			
Increase (decrease) during the year	**(796)**	(1,085)	**(7,171)**
Reclassification adjustments	**–**	–	**–**
Subtotal, before tax	**(796)**	(1,085)	**(7,171)**
Tax (expense) or benefit	**–**	–	**–**
Subtotal, net of tax	**(796)**	(1,085)	**(7,171)**
Remeasurements of defined benefit plan			
Increase (decrease) during the year	**(4,839)**	1,092	**(43,591)**
Reclassification adjustments	**5,088**	7,145	**45,834**
Subtotal, before tax	**249**	8,237	**2,243**
Tax (expense) or benefit	**299**	(3,066)	**2,693**
Subtotal, net of tax	**549**	5,170	**4,946**
Share of other comprehensive income of associates accounted for using equity method			
Increase (decrease) during the year	**(4,867)**	2,296	**(43,843)**
Total other comprehensive income	**¥(6,654)**	¥8,336	**$(59,941)**

21.

Dividends

(a) Dividends paid

Year ended March 31, 2019

Resolution	Kind of shares	Total amount of dividends paid	Dividends per share	Date of record	Effective date
June 27, 2018 General Meeting of Shareholders	**Common stock**	**¥5,011 million ($45,140 thousand)**	**¥30.0 ($0.27)**	**March 31, 2018**	**June 28, 2018**
October 30, 2018 Board of Directors Meeting	**Common stock**	**¥5,846 million ($52,662 thousand)**	**¥35.0 ($0.32)**	**September 30, 2018**	**December 3, 2018**

Year ended March 31, 2018

Resolution	Kind of shares	Total amount of dividends paid	Dividends per share	Date of record	Effective date
June 28, 2017 General Meeting of Shareholders	Common stock	¥3,341 million	¥2.0	March 31, 2017	June 29, 2017
September 20, 2017 Board of Directors Meeting (*)	Common stock	¥5,011 million	¥3.0	September 30, 2017	December 1, 2017

(*) Dividends per share indicate the amount before a 10:1 share consolidation of common shares with an effective date of October 1, 2017 and date of record of September 30, 2017.

(b) Dividend payments for which the record date is in the subject fiscal year but the effective date in the succeeding consolidated fiscal year

Year ended March 31, 2019

Resolution	Kind of shares	Source of dividends	Total amount of dividends paid	Dividends per share	Date of record	Effective date
June 26, 2019 General Meeting of Shareholders	**Common stock**	**Retained earnings**	**¥5,846 million ($52,662 thousand)**	**¥35.0 ($0.32)**	**March 31, 2019**	**June 27, 2019**

Year ended March 31, 2018

Resolution	Kind of shares	Source of dividends	Total amount of dividends paid	Dividends per share	Date of record	Effective date
June 27, 2018 General Meeting of Shareholders	Common stock	Retained earnings	¥5,011 million	¥30.0	March 31, 2018	June 28, 2018

22.

Income taxes

Income taxes in Japan applicable to the Company and its consolidated domestic subsidiaries consist of corporate tax (national tax) and enterprise and inhabitants' taxes (local taxes), which, in the aggregate, resulted in a statutory tax rate of approximately 30.5% and 30.7% for the years ended March 31, 2019 and 2018, respectively.

(a) The significant differences between the statutory and effective tax rates for the years ended March 31, 2019 and 2018 were as follows:

	2019	2018
Statutory tax rate	**30.5%**	30.7%
Valuation reserve	**(0.9)**	(25.7)
Equity in income of nonconsolidated subsidiaries and affiliates	**(1.7)**	(3.7)
Changing tax rate	**–**	3.5
Tax credit for research and development expenses	**(4.7)**	(1.8)
Elimination of unrealized profits	**(1.1)**	(1.2)
Other	**(0.9)**	3.2
Effective tax rate	**21.2%**	5.0%

(b) Significant components of deferred tax assets and liabilities as of March 31, 2019 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Deferred tax assets:			
Provision for bonuses	**¥ 7,337**	¥ 6,887	**$ 66,093**
Retirement benefit liability	**38,905**	36,944	**350,464**
Loss from inventory revaluation	**2,980**	3,071	**26,844**
Unrealized loss on marketable securities, investment securities and other	**1,483**	1,550	**13,359**
Loss on valuation of land	**829**	758	**7,468**
Allowance for doubtful receivables	**1,167**	1,437	**10,513**
Depreciation	**8,210**	7,994	**73,957**
Inventories–elimination of intercompany profits	**1,791**	1,848	**16,134**
Fixed assets–elimination of intercompany profits	**563**	559	**5,072**
Provision for construction warranties	**3,379**	3,336	**30,439**
Provision for losses on construction contracts	**8,549**	5,650	**77,011**
Provision for the in-service issues of commercial aircraft jet engines	**3,501**	–	**31,538**
Net operating loss carryforwards	**763**	1,443	**6,873**
Other	**15,631**	14,014	**140,807**
Gross deferred tax assets	**95,095**	85,497	**856,635**
Less valuation reserve	**(6,845)**	(7,179)	**(61,661)**
Total deferred tax assets	**88,250**	78,317	**794,973**
Deferred tax liabilities:			
Reserve for advanced depreciation of non-current assets	**4,286**	4,341	**38,609**
Reserve for special depreciation	**1,465**	1,374	**13,197**
Net unrealized gain on securities	**1,150**	1,509	**10,359**
Retained earnings for foreign subsidiaries	**7,426**	7,038	**66,895**
Other	**4,334**	3,609	**39,042**
Total deferred tax liabilities	**18,664**	17,872	**168,129**
Net deferred tax assets	**¥69,585**	¥60,445	**$626,835**

23.

Cash and cash equivalents

Cash and cash equivalents reconciled to the accounts reported in the consolidated balance sheets in the years ended March 31, 2019 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Cash and deposits:	**¥74,311**	¥70,632	**$669,408**
Time deposits with maturities over three months:	**(6,000)**	(6,269)	**(54,049)**
Total	**¥68,311**	¥64,362	**$615,359**

24.

Profit per share

Per share amounts for the years ended March 31, 2019, and 2018 are set forth in the table below.

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Basic profit per share:			
Profit	**¥27,453**	¥28,915	**$247,302**
Profit allocated to common stock	**¥27,453**	¥28,915	**$247,302**

	Number of shares in millions	
	2019	2018
Weighted average number of shares of common stock	**167**	167

Note: As the Company had no dilutive securities at March 31, 2019 or 2018, the Company has not disclosed diluted profit per share for the years ended March 31, 2019 and 2018.

25.

Derivative transactions

(a) Outstanding positions and recognized gains and losses at March 31, 2019 were as follows:

(Derivative transactions to which the Company did not apply hedge accounting)

	2019				
	Millions of yen				Thousands of U.S. dollars
	Contract amount	Contract amount over 1 year	Fair value	Gain (loss)	Gain (loss)
Currency-related contracts:					
Foreign exchange contracts:					
To sell					
USD	**¥46,271**	**¥ –**	**¥(1,143)**	**¥(1,143)**	**$(10,296)**
EUR	**1,137**	**–**	**19**	**19**	**171**
Others	**10,917**	**–**	**(194)**	**(194)**	**(1,748)**
To purchase					
USD	**14,860**	**–**	**11**	**11**	**99**
EUR	**68**	**–**	**(1)**	**(1)**	**(9)**
Others	**1,544**	**28**	**5**	**5**	**45**
Total	**¥74,799**	**¥28**	**¥(1,303)**	**¥(1,303)**	**$(11,738)**

Fair value is based on prices provided by financial institutions, etc.

(Derivative transactions to which the Company applied hedge accounting)

	2019			
		Millions of yen		
	Subject of hedge	Contract amount	Contract amount over 1 year	Fair value
Currency-related contracts:				
Foreign exchange contracts:				
To sell	Accounts receivable–trade			
USD		**¥22,694**	**¥3,354**	**¥(333)**
EUR		**10,761**	**–**	**133**
Others		**906**	**102**	**(33)**
To purchase	Accounts payable–trade			
USD		**8,231**	**3,027**	**221**
EUR		**2,841**	**220**	**(133)**
Others		**3,364**	**589**	**16**
Total		**¥48,799**	**¥7,294**	**¥(129)**

Fair value is based on prices provided by financial institutions, etc.

	2019			
		Thousands of U.S. dollars		
	Subject of hedge	Contract amount	Contract amount over 1 year	Fair value
Currency-related contracts:				
Foreign exchange contracts:				
To sell	Accounts receivable–trade			
USD		**$204,432**	**$30,213**	**$(3,000)**
EUR		**96,937**	**–**	**1,198**
Others		**8,161**	**919**	**(297)**
To purchase	Accounts payable–trade			
USD		**74,146**	**27,268**	**1,991**
EUR		**25,592**	**1,982**	**(1,198)**
Others		**30,304**	**5,306**	**144**
Total		**$439,591**	**$65,706**	**$(1,162)**

Fair value is based on prices provided by financial institutions, etc.

	2019			
		Millions of yen		
	Subject of hedge	Contract amount	Contract amount over 1 year	Fair value
Interest related contracts:				
Fixed-rate payment/ floating-rate receipt	Long-term loans payable	**¥7,500**	**¥7,500**	**¥(79)**
		¥7,500	**¥7,500**	**¥(79)**

Fair value is based on prices provided by financial institutions, etc.

(b) Outstanding positions and recognized gains and losses at March 31, 2018 were as follows:

(Derivative transactions to which the Company did not apply hedge accounting)

	2018			
	Millions of yen			
	Contract amount	Contract amount over 1 year	Fair value	Gain (loss)
Currency-related contracts:				
Foreign exchange contracts:				
To sell				
USD	¥49,033	¥ –	¥1,188	¥1,188
EUR	7,754	–	145	145
Others	13,615	3,942	(58)	(58)
To purchase				
USD	473	–	(8)	(8)
EUR	386	–	9	9
Others	1,152	–	(16)	(16)
Total	¥72,415	¥3,942	¥1,259	¥1,259

Fair value is based on prices provided by financial institutions, etc.

(Derivative transactions to which the Company applied hedge accounting)

	2018			
		Millions of yen		
	Subject of hedge	Contract amount	Contract amount over 1 year	Fair value
Currency-related contracts:				
Foreign exchange contracts:				
To sell	Accounts payable–trade			
USD		¥36,716	¥ –	¥1,017
EUR		1,743	403	27
Others		4,199	2,084	(3)
To purchase	Accounts payable–trade			
USD		9,878	153	(312)
EUR		3,518	387	(19)
Others		5,496	316	(48)
Total		¥61,553	¥3,346	¥ 661

Fair value is based on prices provided by financial institutions, etc.

26. Financial Instruments

Information related to financial instruments as of March 31, 2019 and 2018 was as follows.

(1) Matters related to the status of financial instruments

(a) Policies on the use of financial instruments
The Company meets its long-term operating capital and capital expenditure requirements through bank loans and the issuance of bonds and meets its short-term operating capital requirements through bank loans and the issuance of short-term bonds (electronic commercial paper). Temporary surplus funds are managed in the form of financial assets that have a high level of safety. The Company utilizes derivative financial instruments to hedge the risks described below and does not engage in speculative transactions as a matter of policy.

(b) Details of financial instruments and risks associated with those instruments
Notes and accounts receivable – trade are exposed to the credit risk of customers. The Company operates internationally and has significant exposure to the risk of fluctuation in foreign exchange rates. However, this risk is hedged using exchange contracts, etc., against the net position of foreign currency exposure. Investments in securities comprise mainly equity securities of companies with which the Company conducts business and are held to maintain relationships with these business partners. With such securities, listed stocks are exposed to market fluctuation risk.

Almost all notes and accounts payable – trade and electronically recorded obligations are due within one year. A portion of accounts payable - trade are denominated in foreign currency—specifically those related to payment for imported materials, etc., and are exposed to the risk of foreign currency fluctuation. However, this risk is mitigated principally by the position of accounts payable - trade denominated in foreign currency being less than the position of receivables in the same currency. Loans payable and bonds payable are used mainly to raise operating capital and carry out capital expenditure and are due in a maximum of eighteen years from March 31, 2019 (twenty years in 2018). A portion of these instruments is exposed to the risk of interest rate fluctuation. However, such risk is hedged using derivatives (interest rate and currency swaps) as necessary.

In sum, derivatives comprise exchange and currency option contracts used to hedge foreign currency fluctuation risk on receivables and payables in foreign currencies and interest rate swap contracts to hedge interest rate fluctuation risk on debt. With regard to hedge accounting, see Note 2(r), "Hedge accounting."

(c) Risk management system for financial instruments

(i) Management of credit risk, including customer default risk

The Company's sales management functions and those of its consolidated subsidiaries regularly evaluate the financial circumstances of customers and monitor the due dates and balances by customer to identify and limit doubtful accounts.

With regard to derivative transactions, the Company enters into contracts with highly rated financial institutions to reduce counterparty risk. The amount presented in the balance sheet is the maximum credit risk at the fiscal year-end of the financial instruments that are exposed to credit risk.

(ii) Management of market risk (related to foreign currency exchange rates, interest rates, etc.)

The Company and certain of its consolidated subsidiaries hedge foreign currency fluctuation risk on receivables and payables in foreign currencies using exchange contracts, which are categorized by the type of currency and the monthly due date. In principle, the net position of receivables less payables in a foreign currency is hedged with forward exchange contracts. The Company and certain of its consolidated subsidiaries hedge interest rate risk on debt using interest rate swap contracts.

With regard to investments in securities, the Company reviews its holding policies through periodic analysis of market prices and the financial condition of the issuers, taking into consideration the relationships with its business partners.

With regard to derivatives, in accordance with rules for the provision of transaction authorization, the Company's finance functions and those of its consolidated subsidiaries manage transactions in accordance with an established set of fundamental policies, such as those covering limitations on transaction amounts, under the authority of the director in charge of finance. Transactions are reported to the director in charge of finance on a monthly basis. Consolidated subsidiaries manage derivatives in accordance with the same rules as those of the Company.

(iii) Management of liquidity risk (risk of the Company being unable to meet its payment obligations by their due dates)

The Company manages liquidity risk through its finance department, maintaining and updating its finance plans based on reports from each business division. Liquidity risk is managed through the diversification of financing methods, taking into consideration the financing environment and balancing long- and short-term financing requirements, securing commitment lines, etc.

(d) Supplemental information on the fair value of financial instruments
The fair value of financial instruments includes values based on market price and reasonably estimated values when market price is not available. However, as variables are inherent in these value calculations, the resulting values may differ if different assumptions are used. With regard to the contract amounts, etc., of the derivatives described in Note 25, "Derivative transactions," these amounts do not represent the market risk associated with the corresponding derivative transactions themselves.

(2) Fair values of financial instruments

The book values, the fair values and the differences between these values as of March 31, 2019 were as follows (Financial instruments for which the fair value was extremely difficult to determine were not included, as described in remark (ii)):

	2019			
	Millions of yen			Thousands of U.S. dollars
	Book value	Fair value	Unrealized gains (losses)	Unrealized gains (losses)
Cash and deposits	**¥ 74,311**	**¥ 74,311**	**¥ –**	**$ –**
Notes and accounts receivable - trade	**427,665**	**427,641**	**(23)**	**(207)**
Investment securities	**8,140**	**8,140**	**–**	**–**
Total assets	**¥510,117**	**¥510,094**	**¥ (23)**	**$ (207)**
Notes and accounts payable - trade	**247,191**	**247,191**	**–**	**–**
Electronically recorded obligations - operating	**123,083**	**123,083**	**–**	**–**
Short-term debt and current portion of long-term debt (excluding lease obligations)	**110,023**	**110,023**	**–**	**–**
Long-term debt, less current portion (excluding lease obligations)	**327,568**	**329,337**	**1,768**	**15,926**
Total liabilities	**¥807,867**	**¥809,636**	**¥1,768**	**$15,926**
Derivative transactions (*)	**¥ (1,511)**	**¥ (1,511)**	**¥ –**	**$ –**

(*) Derivative financial instruments are presented as net amounts. Negative amounts stated with parentheses ( ) indicate that the net amount is a liability.

The book values, fair values and the differences between these values as of March 31, 2018 were as follows (Financial instruments for which the fair value was extremely difficult to determine were not included, as described in remark (ii)):

	2018		
	Millions of yen		
	Book value	Fair value	Unrealized gains (losses
Cash and deposits	¥ 70,632	¥ 70,632	¥ –
Notes and accounts receivable - trade	470,110	470,049	(60)
Investment securities	9,387	9,387	–
Total assets	¥550,130	¥550,069	¥(60)
Notes and accounts payable - trade	245,398	245,398	–
Electronically recorded obligations - operating	117,772	117,772	–
Short-term debt and current portion of long-term debt (excluding lease obligations)	128,978	128,978	–
Long-term debt, less current portion (excluding lease obligations)	315,685	315,686	1
Total liabilities	¥807,835	¥807,836	¥ 1
Derivative transactions (*)	¥ 1,920	¥ 1,920	¥ –

(*) Derivative financial instruments are presented as net amounts. Negative amounts stated with parentheses ( ) indicate that the net amount is a liability.

(i) *Methods used to calculate the fair value of financial instruments and details of securities and derivative instruments*

<Assets>

- Cash and deposits
  The fair value of cash on hand and in banks is stated at the relevant book value since the settlement periods are short and the fair values are substantially the same as the book values.
- Notes and accounts receivable - trade
  The fair value of notes and accounts payable – trade is stated at present value computed by applying a discount rate reflecting the settlement period and the credit risk.
- Investment securities
  Equity securities are stated at the fair value, and bonds are stated at market price or the asking price of financial institutions. See Note 2(j), "Investment securities," for the detailed information by classification.

<Liabilities>

- Notes and accounts payable - trade, Electronically recorded obligations - operating, short-term loans payable and current portion of long-term loans payable
  Since the settlement periods of these items are short and their fair values are substantially the same as their book values, the relevant book values are used.
- Long-term debt, less current portion
  The fair value of bonds payable is calculated based on trading reference data. The fair value of long-term loans payable is calculated by applying a discount rate to the total principal and interest. That discount rate is based on the interest rates of similar new loans.

<Derivatives>

See Note 25, "Derivative transactions."

(ii) *Financial instruments for which the fair value is extremely difficult to determine.*

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Unlisted equity securities and investments in partnerships	**¥ 6,361**	¥ 5,411	**$ 57,301**
Stocks of nonconsolidated subsidiaries and affiliates	**10,639**	10,224	**95,838**
Investments in affiliates	**65,574**	68,090	**590,704**
Total	**¥82,575**	¥83,725	**$743,852**

Since no market values are available for these items and since it is extremely difficult to determine their fair values, the items listed in the table above are not included in investment securities.

(iii) *Planned redemption amounts after the balance sheet date for monetary receivables and investment securities with maturity dates as of March 31, 2019 and 2018 were as follows:*

	2019			
	Millions of yen			
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years
Cash and deposits	**¥ 74,311**	**¥ –**	**¥–**	**¥–**
Notes and accounts receivable - trade	**408,527**	**19,137**	**–**	**–**
Total	**¥482,839**	**¥19,137**	**¥–**	**¥–**

	2019			
	Thousands of U.S. dollars			
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years
Cash and deposits	**$ 669,408**	**$ –**	**$–**	**$–**
Notes and accounts receivable - trade	**3,680,092**	**172,390**	**–**	**–**
Total	**$4,349,509**	**$172,390**	**$–**	**$–**

	2018			
	Millions of yen			
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 10 years	Over 10 years
Cash and deposits	¥ 70,632	¥ –	¥–	¥–
Notes and accounts receivable - trade	453,461	16,648	–	–
Total	¥524,093	¥16,648	¥–	¥–

(iv) Planned repayment amounts after the balance sheet date for bonds payable and long-term loans payable.

See Note 8, "Short-term debt and long-term debt."

27.

Finance leases

Finance leases commenced prior to April 1, 2008 which do not transfer ownership of the leased assets to the lessee are accounted for as operating leases. Information regarding such leases, as required to be disclosed in Japan, is as follows:

<Lessee>

The original costs of leased assets under non-capitalized finance leases and the related accumulated depreciation and amortization, assuming it was calculated by the straight-line method over the term of the respective lease, as of March 31, 2019 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Property, plant and equipment	**¥2,340**	¥5,224	**$21,079**
Accumulated depreciation	**(1,853)**	(4,413)	**(16,692)**
	¥ 487	¥ 809	**$ 4,387**
Intangible assets	**–**	22	**–**
Accumulated amortization	**–**	(21)	**–**
	¥ –	¥ 1	**$ –**

The present values of future minimum lease payments under non-capitalized finance leases as of March 31, 2019 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Current portion	**¥162**	¥355	**$1,459**
Noncurrent portion	**383**	546	**3,450**
Total	**¥546**	¥902	**$4,918**

Lease payments, "as if capitalized" depreciation and amortization and interest expense for non-capitalized finance leases for the years ended March 31, 2019, and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Lease payments	**¥361**	¥905	**$3,252**
Depreciation and amortization	**311**	794	**2,802**
Interest	**19**	35	**171**

28.

Operating leases

The schedule of future minimum lease payments under non-cancellable operating leases as of March 31, 2019 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Within one year	**¥ 3,609**	¥ 2,796	**$ 32,511**
Over one year	**14,817**	12,022	**133,474**
Total	**¥18,426**	¥14,819	**$165,985**

29.

Segment information

(a) Overview of reportable segments

The Company's reportable segments are components of the Company about which separate financial information is available. These segments are subject to periodic review by the Company's Board of Directors to decide how to allocate resources and assess performance. The Company's operations are divided into internal companies based on product categories. Certain authority is delegated to each of the internal companies based on whether they conduct businesses in Japan or overseas. The Company's operations are, therefore, segmented based on each internal company's product categories. The Company's seven reportable segments are the Aerospace Systems segment, the Energy System & Plant Engineering segment, the Precision Machinery & Robot segment, the Ship & Offshore Structure segment, the Rolling Stock segment, the Motorcycle & Engine segment, and the Other segment.

From the fiscal year under review, the Company reorganization was carried out in order to further enhance Kawasaki-ROIC management in response to changes in the business environment. As part of this, the Company reviewed the method of business segment classification from the fiscal year ended March 31, 2019 and changed its reportable segments from the previous Ship & Offshore Structure, Rolling Stock, Aerospace, Gas Turbine & Machinery, Plant & Infrastructure, Motorcycle & Engine, Precision Machinery and Other Operations to Aerospace Systems, Energy System & Plant Engineering, Precision Machinery & Robot, Ship & Offshore Structure, Rolling Stock, Motorcycle & Engine, and Other Operations. Consolidated segment information for the fiscal year ended March 31, 2018 has been prepared using the revised segment classification .

The main businesses in the Company's reportable segments are set forth in the table below.

Business segment	Major products
Aerospace Systems	Production and sale of aircraft, jet engines, etc.
Energy System & Plant Engineering	Production and sale of general-purpose gas turbine generators, prime movers, industrial equipment, boilers, environmental equipment, steel structures, crushers, etc.
Precision Machinery & Robot	Production and sale of industrial hydraulic products, industrial robots, etc.
Ship & Offshore Structure	Construction and sale of ships and other vessels, etc.
Rolling Stock	Production and sale of rolling stock, etc.
Motorcycle & Engine	Production and sale of motorcycles, all-terrain vehicles (ATV), utility vehicles, personal watercraft ("JET SKI"), general-purpose gasoline engines, etc.
Other	Commercial activities, sales/order agency and intermediary activities, administration of welfare facilities, etc.

(b) Calculation methods for sales, profit (loss), assets, liabilities and other items by reportable segment

Accounting methods applied for the calculation of sales, profit (loss), assets, liabilities and other items by business segment largely correspond to the information presented under Note 2, "Significant accounting policies." Segment profit is based on operating profit. Intersegment sales and transfers are based on market prices.

(c) Sales, profit (loss), assets, liabilities and other items by reportable segment

	Year ended March 31, 2019							
	Millions of yen							
	Sales					Other items		
	External sales	Intersegment sales and transfers	Total	Segment profit (loss)	Segment assets	Depreciation/ amortization	Investment in equity method affiliates	Increase in property, plant and equipment and intangible assets
Aerospace Systems	**¥ 463,958**	**¥12,089**	**¥ 476,048**	**¥32,611**	**¥ 649,260**	**¥21,299**	**¥ –**	**¥24,022**
Energy System & Plant Engineering	**253,041**	**19,899**	**272,940**	**11,634**	**301,798**	**3,412**	**18,552**	**2,237**
Precision Machinery & Robot	**222,095**	**17,151**	**239,247**	**21,352**	**205,199**	**8,220**	**634**	**11,636**
Ship & Offshore Structure	**78,974**	**4,549**	**83,523**	**1,090**	**121,918**	**1,559**	**45,955**	**2,360**
Rolling Stock	**124,689**	**27**	**124,716**	**(13,797)**	**211,102**	**2,615**	**133**	**3,358**
Motorcycle & Engine	**356,847**	**718**	**357,566**	**14,366**	**283,770**	**15,317**	**1,549**	**18,505**
Other	**95,136**	**41,136**	**136,273**	**2,501**	**93,601**	**1,527**	**3,509**	**861**
Total	**¥1,594,743**	**¥95,572**	**¥1,690,316**	**¥69,760**	**¥1,866,652**	**¥53,953**	**¥70,334**	**¥62,982**
Adjustments	**–**	**(95,572)**	**(95,572)**	**(5,737)**	**(27,797)**	**5,069**	**–**	**3,918**
Consolidated total	**¥1,594,743**	**¥ –**	**¥1,594,743**	**¥64,023**	**¥1,838,855**	**¥59,022**	**¥70,334**	**¥66,900**

	Year ended March 31, 2018							
	Millions of yen							
	Sales					Other items		
	External sales	Intersegment sales and transfers	Total	Segment profit (loss)	Segment assets	Depreciation/ amortization	Investment in equity method affiliates	Increase in property, plant and equipment and intangible assets
Aerospace Systems	¥ 469,507	¥ 5,030	¥ 474,538	¥30,876	¥ 644,719	¥20,674	¥ –	¥34,613
Energy System & Plant Engineering	251,640	19,695	271,336	7,686	288,895	3,337	19,118	3,738
Precision Machinery & Robot	198,996	15,890	214,887	21,648	188,155	7,165	411	10,974
Ship & Offshore Structure	95,610	3,786	99,397	(3,820)	147,963	1,444	49,749	4,774
Rolling Stock	141,760	105	141,866	(12,438)	180,792	2,567	138	2,505
Motorcycle & Engine	331,659	669	332,329	15,255	266,550	14,163	1,474	20,542
Other	85,066	41,507	126,573	2,925	85,061	1,579	3,336	696
Total	¥1,574,242	¥86,686	¥1,660,929	¥62,133	¥1,802,139	¥50,932	¥74,228	¥77,844
Adjustments	–	(86,686)	(86,686)	(6,207)	(17,110)	5,205	–	4,319
Consolidated total	¥1,574,242	¥ –	¥1,574,242	¥55,925	¥1,785,028	¥56,137	¥74,228	¥82,163

	Year ended March 31, 2019							
	Thousands of U.S. dollars							
	Sales					Other items		
	External sales	Intersegment sales and transfers	Total	Segment profit (loss)	Segment assets	Depreciation/ amortization	Investment in equity method affiliates	Increase in property, plant and equipment and intangible assets
Aerospace Systems	**$4,179,425**	**$108,900**	**$ 4,288,334**	**$293,766**	**$ 5,848,662**	**$191,866**	**$ –**	**$216,395**
Energy System & Plant Engineering	**2,279,443**	**179,254**	**2,458,697**	**104,801**	**2,718,656**	**30,736**	**167,120**	**20,151**
Precision Machinery & Robot	**2,000,676**	**154,500**	**2,155,184**	**192,343**	**1,848,473**	**74,047**	**5,711**	**104,819**
Ship & Offshore Structure	**711,413**	**40,978**	**752,392**	**9,819**	**1,098,261**	**14,044**	**413,972**	**21,259**
Rolling Stock	**1,123,223**	**243**	**1,123,466**	**(124,286)**	**1,901,649**	**23,556**	**1,198**	**30,250**
Motorcycle & Engine	**3,214,548**	**6,468**	**3,221,025**	**129,412**	**2,556,256**	**137,979**	**13,954**	**166,697**
Other	**857,004**	**370,561**	**1,227,574**	**22,530**	**843,176**	**13,756**	**31,610**	**7,756**
Total	**$14,365,760**	**$860,931**	**$15,226,700**	**$628,412**	**$16,815,170**	**$486,019**	**$633,583**	**$567,354**
Adjustments	**–**	**(860,931)**	**(860,931)**	**(51,680)**	**(250,401)**	**45,663**	**–**	**35,294**
Consolidated total	**$14,365,760**	**$ –**	**$14,365,760**	**$576,732**	**$16,564,769**	**$531,682**	**$633,583**	**$602,648**

(d) Reconciliation and the main components of differences between the total for reportable segments and amounts on the consolidated financial statement for the years ended March 31, 2019 and 2018

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Net sales			
Total for reportable segments	**¥1,690,316**	¥1,660,929	**$15,226,700**
Intersegment transactions	**(95,572)**	(86,686)	**(860,931)**
Net sales reported on the consolidated financial statements	**¥1,594,743**	¥1,574,242	**$14,365,760**

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Profit			
Total for reportable segments	**¥69,760**	¥62,133	**$628,412**
Intersegment transactions	**(181)**	(95)	**(1,630)**
Corporate expenses (*)	**(5,555)**	(6,112)	**(50,041)**
Operating profit (loss) on the consolidated financial statements	**¥64,023**	¥55,925	**$576,732**

(*) Corporate expenses comprise mainly general and administrative expenses not attributed to reportable segments.

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Assets			
Total for reportable segments	**¥1,866,652**	¥1,802,139	**$16,815,170**
Intersegment transactions	**(102,520)**	(81,949)	**(923,520)**
Corporate assets shared by all segments (*)	**74,723**	64,838	**673,120**
Total assets on the consolidated financial statements	**¥1,838,855**	¥1,785,028	**$16,564,769**

(*) Corporate assets shared by all segments comprise mainly fixed assets not attributed to reportable segments.

Other items	Millions of yen					
	2019	2018	**2019**	2018	**2019**	2018
	Total for reportable segments		Adjustments (*)		Amounts reported on the consolidated financial statements	
Depreciation/amortization	**¥53,953**	¥50,932	**¥5,069**	¥5,205	**¥59,022**	¥56,137
Increase in property, plant and equipment and intangible assets	**62,982**	77,844	**3,918**	4,319	**66,900**	82,163

(*) Adjustment is due mainly tofixed assets not attributed to reportable segments.

Other items	Thousands of U.S. dollars		
	2019		
	Total for reportable segments	Adjustments	Amounts reported on the consolidated financial statements
Depreciation/amortization	**$486,019**	**$45,663**	**$531,682**
Increase in property, plant and equipment and intangible assets	**567,354**	**35,294**	**602,648**

(e) Related information

(i) Sales by geographic region

Net sales for the years ended March 31, 2019 and 2018 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Japan	**¥ 673,963**	¥ 668,369	**$ 6,071,192**
United States	**393,066**	381,156	**3,540,816**
Europe	**187,764**	172,203	**1,691,415**
Asia	**260,230**	237,298	**2,344,203**
Other areas	**79,718**	115,215	**718,115**
Total	**¥1,594,743**	¥1,574,242	**$14,365,760**

Net sales are based on the clients' location and classified according to country or geographical region.

Property, plant and equipment

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Japan	**¥422,286**	¥420,299	**$3,804,036**
North America	**30,806**	28,030	**277,507**
Europe	**3,219**	3,239	**28,997**
Asia	**28,775**	27,424	**259,211**
Other areas	**582**	804	**5,243**
Total	**¥485,669**	¥479,797	**$4,375,002**

(ii) Information by major clients

Year ended March 31, 2019

Clients	Net sales	Related segments
Ministry of Defense	¥216,989 million ($1,954,680 thousand)	Aerospace Systems, Energy System & Plant Engineering, Ship & Offshore Structure, etc.

Year ended March 31, 2018

Clients	Net sales	Related segments
Ministry of Defense	¥237,737 million	Aerospace Systems, Energy System & Plant Engineering, Ship & Offshore Structure, etc.

30.

Related party transactions

(a) Related party transactions for the years ended March 31, 2019 and 2018 were as follows:

	Year ended March 31, 2019
	Nonconsolidated subsidiaries and affiliates of the Company
Type	**Affiliate of the Company**
Name	**Commercial Airplane Co., Ltd.**
Location	**Chiyoda-ku, Tokyo**
Capital or investment	**¥10 million ($90 thousand)**
Business or position	**Sales of transportation machinery**
Rate of ownership (%)	**Directly 40%**
Description of relationship	**Sales of Company products and board members**
Details of transactions	**Sales of Company products**
Amount of transactions	**¥115,035 million ($1,036,258 thousand)**
Account	**Accounts receivable - trade**
Ending balance	**¥15,003 million ($135,150 thousand)**
Account	**Advances received**
Ending balance	**¥61,246 million ($551,716 thousand)**

	Year ended March 31, 2018
	Nonconsolidated subsidiaries and affiliates of the Company
Type	Affiliate of the Company
Name	Commercial Airplane Co., Ltd.
Location	Chiyoda-ku, Tokyo
Capital or investment	¥10 million
Business or position	Sales of transportation machinery
Rate of ownership (%)	Directly 40%
Description of relationship	Sales of Company products and board members
Details of transactions	Sales of Company products
Amount of transactions	¥116,936 million
Account	Accounts receivable - trade
Ending balance	¥43,820 million
Account	Advances received
Ending balance	¥72,515 million

(b) A summary of the total financial information of affiliates, which was the basis for calculating the equity in income of the nonconsolidated affiliates, including that of Nantong COSCO KHI Ship Engineering Co., Ltd., which is a significant affiliate, for the years ended March 31, 2019 and 2018 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2019	2018	**2019**
Current assets	**¥167,183**	¥158,821	**$1,506,017**
Fixed assets	**149,961**	156,573	**1,350,878**
Current liabilities	**122,176**	116,751	**1,100,586**
Long-term liabilities	**37,275**	33,738	**335,781**
Net assets	**157,693**	164,904	**1,420,530**
Net sales	**197,268**	171,376	**1,777,029**
Profit before income taxes and non-controlling interests	**7,616**	10,675	**68,606**
Total profit	**5,293**	8,446	**47,680**

31.

Subsequent events

On June 26, 2019, the following appropriation of nonconsolidated retained earnings was approved at the ordinary meeting of shareholders of the Company:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥35.0 per share)	**¥5,846**	**$52,662**

32.

Other matters

(a) Quarterly financial information

	Millions of yen			
Year ended March 31, 2019	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	**¥343,785**	**¥688,107**	**¥1,094,583**	**¥1,594,743**
Profit before income taxes	**8,550**	**207**	**19,865**	**37,861**
Profit (loss) attributable to owners of parent	**2,561**	**(3,592)**	**11,385**	**27,453**
	Yen			
Profit (loss) per share – basic	**¥15.33**	**¥(21.50)**	**¥68.15**	**¥164.34**

	Thousands of U.S. dollars			
Year ended March 31, 2019	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	**$3,096,883**	**$6,198,604**	**$9,860,220**	**$14,365,760**
Profit before income taxes	**77,020**	**1,865**	**178,948**	**341,059**
Profit (loss) attributable to owners of parent	**23,070**	**(32,357)**	**102,558**	**247,302**
	U.S. dollars			
Profit (loss) per share – basic	**$0.14**	**$(0.19)**	**$0.61**	**$1.48**

(b) Material lawsuits, etc.

<Snow disaster at NIPPI Corporation>

Due to the heavy snowfall on February 15, 2014, an aircraft hangar's roof at a consolidated subsidiary's NIPPI Corporation's Atsugi Plant collapsed, causing damage to aircraft of the Japan Maritime Self-Defense Force under regular maintenance in the hangar. The Company and NIPPI Corporation entered into discussions with the Japan Ministry of Defense regarding how this matter should be handled. However, in July 2017, the Ministry of Defense, based on the contention that it had suffered losses totaling ¥1,900 million ($17,116 thousand), executed an offset for the same amount in relation to a payment claim held by the Company vis-à-vis the Ministry of Defense (central government). The Company did not accept the Ministry of Defense's contention or its execution of the offset and, consequently, demanded payment from the Ministry of Defense of the ¥1,900 million that had been subject to the offset. However, the Ministry of Defense did not comply with the Company's demand, leading the Company to institute legal proceedings in October 2017 at the Tokyo District Court seeking payment of the amount in question and the trial is continuing now. The future outcome of this legal action may affect the operating performance of the KHI Group.

<Regarding receipt of customs duty reassessment notification in the Kingdom of Thailand>
KAWASAKI MOTORS ENTERPRISE (THAILAND) CO., LTD. (hereinafter, "KMT"), a consolidated subsidiary of the Company in the Kingdom of Thailand, received a reassessment notification of customs duties for 4,029 million baht (equivalent to approximately ¥14,000 million ($126,115 thousand) when converted at a rate of 0.29 yen to 1 baht) from the Revenue Department of Thailand. KMT had until that time filed its customs duties in accordance with guidance from the Revenue Department. Since the content of the notification of reassessment lacked a legitimate basis and was extremely unreasonable, KMT could not accept it and submitted an appeal of the reassessment to the Commission of Appeal, the appeals body for tax assessments received from the Revenue Department of Thailand.
Based on the opinion of attorneys consulted regarding this matter, the Company maintains that there is a strong possibility KMT's assertion will be upheld.

<Claim for damages in overseas LNG tank construction work>
In connection with a certain liquefied natural gas (LNG) tank construction project carried out by the Company overseas, the Company filed a petition for arbitration with The International Chamber of Commerce (ICC) during the fiscal year under review concerning losses sustained by the Company due to the breach of contract by an overseas construction subcontractor. During the arbitration proceedings, the counterparty claimed damages from the Company, but the Company believes that these claims lack legitimate grounds, and are thus unjustified. The Company will continue to assert the legitimacy of its claims through the arbitration process.

Independent Auditor's Report

To the Board of Directors of
Kawasaki Heavy Industries, Ltd.:

We have audited the accompanying consolidated financial statements of Kawasaki Heavy Industries, Ltd. (the "Company") and its consolidated subsidiaries, which comprise the consolidated balance sheets as at March 31, 2019 and 2018, and the consolidated statements of income, statements of comprehensive income, statements of changes in net assets and statements of cash flows for each of the two years in the period ended March 31, 2019, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Japan, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, while the objective of the financial statement audit is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company and its consolidated subsidiaries as at March 31, 2019 and 2018, and their financial performance and cash flows for each of the two years in the period ended March 31, 2019, in accordance with accounting principles generally accepted in Japan.

Convenience Translation
The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2019 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 1 to the consolidated financial statements.

KPMG AZSA LLC

26 June, 2019
Kobe, Japan