

CONSOLIDATED FINANCIAL STATEMENTS

Mitsubishi Heavy Industries America, Inc.

(A Wholly-Owned Subsidiary of Mitsubishi Heavy Industries, Ltd.)

Year ended December 31, 2003

with Report of Independent Auditors

Mitsubishi Heavy Industries America, Inc.  
(A Wholly-Owned Subsidiary of  
Mitsubishi Heavy Industries, Ltd.)

Consolidated Financial Statements

Year ended December 31, 2003

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## Report of Independent Auditors

The Board of Directors  
Mitsubishi Heavy Industries America, Inc.

We have audited the accompanying consolidated balance sheet of Mitsubishi Heavy Industries America, Inc. (a wholly-owned subsidiary of Mitsubishi Heavy Industries, Ltd.) and subsidiaries (the “Company”) as of December 31, 2003. This consolidated balance sheet is the responsibility of the Company’s management. Our responsibility is to express an opinion on this consolidated balance sheet based on our audit. We did not audit the balance sheet of MHI Injection Molding Machinery, a wholly-owned subsidiary, which balance sheet reflects total assets constituting 5.6% of consolidated total assets as of December 31, 2003. That balance sheet was audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for MHI Injection Molding Machinery, is based solely on the report of the other auditors.

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

In our opinion, based on our audit and the report of other auditors, the consolidated balance sheet referred to above presents fairly, in all material respects, the consolidated financial position of the Company at December 31, 2003, in conformity with accounting principles generally accepted in the United States.

We also have reviewed the accompanying consolidated statements of income, stockholder’s equity and cash flows for the year ended December 31, 2003, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these consolidated financial statements is the representation of the management of the Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the consolidated financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated statements of income, stockholder's equity and cash flows in order for them to be in conformity with accounting principles generally accepted in the United States.

*Ernst + Young LLP*

May 21, 2004, except Note 13,  
as to which the date is July 18, 2004

Mitsubishi Heavy Industries America, Inc.  
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Consolidated Balance Sheet

December 31, 2003

**Assets**

Current assets:

Cash and cash equivalents	\$ 55,815,832
Accounts receivable, net of allowance for doubtful accounts of \$4,714,596	198,784,851
Due from Parent	67,340,780
Due from affiliated companies	23,165,867
Unbilled costs on fixed price contracts	17,401,941
Inventories	157,522,373
Notes receivables	2,441,905
Deferred income taxes	16,888,646
Prepaid expenses and other current assets	25,394,508
Total current assets	<u>564,756,703</u>
Property and equipment, at cost	58,244,313
Less accumulated depreciation and amortization	<u>(15,940,594)</u>
Net property and equipment	42,303,719
Notes receivables	55,018,178
Investments	13,261,328
Other assets	3,813,651

Total assets \$ 679,153,579

*See report of independent auditors and accompanying notes.*

**Liabilities and stockholder's equity**

## Current liabilities:

Short-term borrowings from banks	\$ 34,000,000
Accounts payable	44,142,272
Advance receipts	92,130,094
Due to Parent	279,616,351
Due to affiliated companies	11,803,637
Income tax payable	3,693,545
Accrued expenses and other current liabilities	<u>36,660,958</u>
Total current liabilities	502,046,857

Deferred compensation	1,430,131
Deferred tax liability	3,162,431
Long-term accounts payable	6,798,258
Other liabilities	626,991

## Commitments and contingencies

## Stockholder's equity:

Common stock, \$100 par value; authorized 1,500,000 shares; issued and outstanding 1,456,490 shares	145,649,000
Additional paid-in capital	10,121,485
Accumulated other comprehensive loss	(1,257,103)
Retained earnings	<u>10,575,529</u>
Total stockholder's equity	<u>165,088,911</u>
Total liabilities and stockholder's equity	<u><u>\$ 679,153,579</u></u>

Mitsubishi Heavy Industries America, Inc.  
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Consolidated Statement of Income (Unaudited)

Year ended December 31, 2003

Net sales	\$ 631,862,985
Cost of sales	<u>537,280,775</u>
Gross profit	94,582,210
 Operating expenses	 92,318,372
Other income (expenses):	
Service fees and commissions income	1,106,980
Equity in net income of affiliated company	843,633
Interest income	773,276
Interest expense	(1,838,125)
Other, net	<u>601,107</u>
	<u>1,486,871</u>
Income before provision (benefit) for income taxes and minority interest	 3,750,709
Provision (benefit) for income taxes:	
Current	7,884,524
Deferred	<u>(4,341,734)</u>
	<u>3,542,790</u>
Income before minority interest	207,919
Minority interest	<u>259,287</u>
Net income	<u><u>\$ 467,206</u></u>

*See report of independent auditors and accompanying notes.*

Mitsubishi Heavy Industries America, Inc.  
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Consolidated Statement of Stockholder's Equity (Unaudited)

Year ended December 31, 2003

	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Other Comprehensive (Loss) Income</b>	<b>Retained Earnings</b>	<b>Total</b>
Balance at December 31, 2002	\$127,649,000	\$ (400,000)	\$(1,486,415)	\$ 10,108,323	\$135,870,908
Comprehensive income:					
Net income				467,206	467,206
Changes in unrealized depreciation on available for-sale securities, net of income tax of \$195,567			(289,833)		(289,833)
Foreign currency translation adjustment			519,145		519,145
Total comprehensive income					696,518
Issuance of common stock	18,000,000				18,000,000
Forgiveness of debt by the Parent due to liquidation of MCMC		10,521,485			10,521,485
Balance at December 31, 2003	\$145,649,000	\$ 10,121,485	\$(1,257,103)	\$ 10,575,529	\$ 165,088,911

*See report of independent auditors and accompanying notes.*

Mitsubishi Heavy Industries America, Inc.  
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Consolidated Statement of Cash Flows (Unaudited)

Year ended December 31, 2003

<b>Cash flows from operating activities</b>	
Net income	\$ 467,206
Adjustments to reconcile net income to net cash used in operating activities:	
Depreciation and amortization	7,643,086
Loss on disposal of property and equipment	313,775
Deferred compensation	655,104
Equity in net income of affiliated company	(843,633)
Deferred income taxes	(4,341,734)
Minority interest in net income	(259,287)
Changes in operating assets and liabilities:	
Accounts receivable	(23,056,193)
Unbilled costs on fixed price contracts	9,142,432
Due from Parent and affiliated companies	44,433,498
Inventories	(38,077,132)
Prepaid expenses and other current assets	(192,847)
Other assets	(249,884)
Current notes receivable	(2,441,905)
Accounts payable	23,829,155
Advance receipts	(115,217,135)
Due to Parent and affiliated companies	60,677,885
Income tax payable	59,723
Accrued expenses and other current liabilities	(2,505,501)
Long-term notes receivable	(41,332,878)
Other liabilities	354,393
Net cash used in operating activities	<u>(80,941,872)</u>
<b>Cash flows from investing activities</b>	
Purchases of property and equipment	(8,440,228)
Proceeds from sale of property and equipment	<u>1,082,255</u>
Net cash used in investing activities	<u>(7,357,973)</u>
<b>Cash flows from financing activities</b>	
Issuance of common stock	18,000,000
Net decrease in short-term borrowings from banks	<u>(7,100,000)</u>
Net cash provided by financing activities	10,900,000
Effect of exchange rate changes on cash and cash equivalents	<u>519,145</u>
Net decrease in cash and cash equivalents	(76,880,700)
Cash and cash equivalents at beginning of year	<u>132,696,532</u>
Cash and cash equivalents at end of year	<u>\$ 55,815,832</u>
<b>Supplemental disclosures of cash flow information</b>	
Cash paid for interest	\$ 1,687,338
Cash paid for income taxes	2,680,772
<b>Non-cash financing activities</b>	
Forgiveness of debt by the Parent due to liquidation of MCMC	\$ 10,521,485

*See report of independent auditors and accompanying notes.*

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Notes to Consolidated Financial Statements (Unaudited)

December 31, 2003

**1. Organization**

Mitsubishi Heavy Industries America, Inc. (“MHIA”) was incorporated on July 2, 1979 under the laws of the State of Delaware. MHIA distributes and services heavy equipment, including steel manufacturing machinery, machining and turning centers, and corrugated container manufacturing machinery. MHIA is a wholly-owned subsidiary of Mitsubishi Heavy Industries, Ltd. (the “Parent” or “MHI”), a publicly held Japanese corporation.

During 2002, MHIA issued 300,000 shares of common stock to the Parent for an aggregate consideration of \$30,000,000 in cash while MHIA amended its Certificate of Incorporation to increase the number of shares of common stock authorized to 1,500,000 shares.

In October 2002, MHIA issued 196,490 shares of common stock to the Parent in exchange for all of the outstanding shares of MHI Injection Molding Machinery, Inc. and Mitsubishi Engine North America, Inc., a 65% interest of MLP U.S.A., Inc. MHIA used the historical net book value of the Parent’s investment to record the exchange as if these were transactions among entities under common control and, therefore, were accounted as if the pooling of interests method was applied. Accordingly, the historical consolidated financial statements of MHIA have been restated as if such entities were always owned by MHIA. On September 30, 2003, MLP issued an additional 3,600 shares of common stock to MHIA for \$18,000,000, raising the interest of MHIA from 65% to 92.4%.

Outlined below is a summary of the consolidated subsidiaries’ activities:

<u>Company</u>	<u>Line of Business</u>
<b>Wholly-Owned Subsidiaries</b>	
Mitsubishi Power Systems, Inc. (“MPS”)	Distributes and services heavy power generation equipment, such as steam, gas and wind turbines throughout North America.
MHI Injection Molding Machinery, Inc. (“MIMM”)	Sells and services plastic injection molding machinery (principally purchased from affiliated companies) and its related parts and components to customers located primarily in North America.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**1. Organization (continued)**

<b>Company</b>	<b>Line of Business</b>
Mitsubishi Engine North America, Inc. ("MENA")	Imports and sells engines, turbochargers, and replacement parts to U.S. and Canadian distributors and original equipment manufacturers for commercial and consumer applications. MENA also provides technical and marketing services on behalf of affiliated companies.
<b>Majority-Owned Subsidiaries</b>	
MLP U.S.A., Inc. ("MLP")	Sells and services new and used printing presses (principally purchased from affiliated companies), and other machinery and equipment related thereto, to commercial printers located principally in the United States. MHIA and Mitsubishi Corporation ("MC") own 92.4% and 7.6%, respectively of MLP.
MHI Corrugating Machinery Co. ("MCMC")	MHIA and the Parent own 70% and 30%, respectively. During 2000, the Board of Directors and shareholders of MCMC approved a formal plan of liquidation. As a result, MCMC changed its basis of accounting as of and for periods subsequent to December 31, 1999 from the going concern basis to the liquidation basis. The liquidation process was completed on September 18, 2003.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**1. Organization (continued)**

MHIA has a 40% ownership interest in MHI Machine Tool U.S.A., Inc. (“MMT”). During 2000, the Board of Directors and shareholders of MMT approved a formal plan of liquidation. The investment was written off in 2000. The liquidation of MMT will be complete upon the resolution of a pending litigation. The Parent owns the remaining shares of MMT.

The consolidated financial statements include the accounts of MHIA and subsidiaries (collectively, the “Company”). All significant intercompany balances and transactions have been eliminated in consolidation.

**2. Significant Accounting Policies**

**Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Revenue Recognition**

MHIA, MLP, MENA, and MIMM recognize revenue when products are shipped and the customer takes and assumes the risk of loss, collection of relevant receivables is probable, the sales price is fixed or determinable and there is persuasive evidence of an arrangement. In addition, MHIA uses the percentage-of-completion method to recognize revenues on long-term contracts.

MPS contract revenues relate to the sale of turbines and generators to MPS’s customers which are generally under long-term contractual arrangements. Revenue and anticipated profits under fixed-price long-term contracts are recorded on a percentage-of-completion basis using the cost-to-cost method of accounting where sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. Estimated contract profits

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**2. Significant Accounting Policies (continued)**

are taken into earnings in proportion to recorded sales. Management periodically estimates the extent of progress toward completion on a cost-to-cost basis. When adjustments in contract value or estimated costs are determined, any changes from prior estimates are reflected in earnings in the current period. Anticipated losses on contracts are charged to earnings when identified. Revenues from sales other than long-term contracts are recognized when the contract is completed.

Amounts representing contract change orders, claims or other items are included in MPS sales only when they can be reliably estimated and realization is probable. Incentives or penalties related to timely delivery on contracts are considered in estimating sales and profit rates and are recorded when there is sufficient information to assess anticipated contract performance. In each contract with an incentive or penalty provision, the portion of the contract that is performed by the Company dictates the percentage of revenues recognized and/or expenses incurred for the incentive or penalty provision while the remainder amount of the provision is recorded on MHI's books. Incentive provisions which increase or decrease earnings based solely on a single significant event are not recognized until the event occurs.

MPS's revenue from termination fees related to contracts is recognized when notification of the termination occurs and collection of the fees is reasonably assured. Contract termination fees included in contract revenues were approximately \$62,343,000 in 2003.

MPS service revenues relate to the provision of long-term service agreements, service and maintenance, and spare parts. Service revenues are comprised of both a variable and fixed component under a long-term service agreement. Revenues associated with the long-term service agreements under the variable component are recognized over the term of the contract based on the number of equivalent operating hours incurred as a percentage of total equivalent operating hours to be incurred over the course of the contract. Revenue associated with the long-term service agreements under the fixed component are recognized on a straight-line basis over the term of the contract in accordance with the monthly fixed-price billing provision in the contracts. Advance payments received on service and maintenance contracts are recognized as revenue based on completion of specified milestones leading up to the commissioning of the unit at which time the full amount of the advance payment will have been fully recognized as revenue. Revenues associated with the spare parts sales are recognized upon delivery to the customer site.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**2. Significant Accounting Policies (continued)**

Additionally, MPS intercompany revenues and cost of sales for the provision of research and development for MHI are included in service revenues and service cost of sales. Intercompany revenues were approximately \$25,577,000, while intercompany service cost of sales were approximately \$23,252,000. The intercompany projects are cost-reimbursement-type contracts on which the revenues are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs compare to total estimated costs. Sales of products and services provided essentially under commercial terms and conditions are recorded upon delivery and passage of title.

Management periodically estimates the extent of progress toward completion on a cost-to-cost basis. When adjustments in contract value or estimated costs are determined, any changes from prior estimates are reflected in earnings in the current period. Anticipated losses on contracts are charged to earnings when identified.

**Shipping and Handling Costs**

Shipping charges are included in cost of sales in the accompanying consolidated statement of income.

**Service Fee Income**

Service fee income is for services provided by the Company on behalf of its Parent, including market research, technical, engineering and after-sales services. During 2003, the service fee income from the Parent amounted to approximately \$42,876,000.

**Advertising Costs**

The Company expenses advertising costs as incurred, which were approximately \$846,000 in 2003.

**Cash and Cash Equivalents**

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**2. Significant Accounting Policies (continued)**

**Accounts Receivable**

Accounts receivable consist of amounts billed and currently due from customers. Credit is extended based on an evaluation of the customer's financial condition and including retainage, generally, collateral is not required. The Company's calculation of the allowance for uncollectable receivables is based on an evaluation of specific customer account balances with potential collection issues and consideration of historical loss experience and aging patterns.

The balances billed but not paid by customers pursuant to retainage provisions in construction contracts which MPS holds, will be due upon completion of the contracts and acceptance by the owner. The retention balance at December 31, 2003 was approximately \$93,745,000.

**Unbilled Costs on Fixed Price Contracts**

Unbilled costs on fixed price contracts at MPS are comprised of costs and accrued profits related to revenues on long-term contracts that have been recognized for accounting purposes but not yet billed to customers. As revenues are recognized, customer advances and progress payments are reflected as an offset to unbilled costs on fixed price contracts.

**Inventories**

The Company's inventories primarily consist of finished goods and parts. Inventories are stated at the lower of cost (using the first-in, first-out method, the average cost method or the specific identification method) or market.

Provisions for decline in value below cost at MPS are based on an evaluation of current market conditions, recent demand by product area and recent recovery experience. Based on management's evaluation, a reserve for obsolete and excess inventory was approximately \$1,026,000 at December 31, 2003 at MPS.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**2. Significant Accounting Policies (continued)**

**Depreciation and Amortization**

Depreciation of property and equipment is provided over the estimated useful lives of the respective assets primarily on the straight-line method. Amortization of leasehold improvements is provided on the straight-line basis over the terms of the leases or the estimated useful lives of the assets, whichever period is shorter.

The estimated depreciable lives are periodically reviewed for reasonableness and revised if necessary. During 2003, MPS revised the estimated useful lives on certain of its machinery and equipment from 84 months to 60 months. The effect of this change was to decrease MPS's net income for the year ended December, 2003 by approximately \$1,032,000 due to the change in estimated depreciable lives.

**Investments**

Management determines the appropriate classification of investments in marketable equity securities as either trading, held-to-maturity or available-for-sale securities.

Available-for-sale securities are valued at fair value with the resulting net unrealized gains or losses recorded in stockholder's equity as accumulated other comprehensive (loss) income, net of applicable income taxes. Fair value is based upon quoted market prices.

**Long-Lived Assets**

The Company accounts for long-lived asset impairment under Statement of Financial Accounting Standards ("SFAS") No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets*. The Company recognizes impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. The impairment loss is measured by comparing the fair value of the asset to its carrying amount. Fair value is estimated based on discounted future cash flows. Long-lived assets to be disposed of are recorded at the lower of their carrying amount or estimated fair value less costs to sell.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**2. Significant Accounting Policies (continued)**

**Advance Receipts**

MPS receives advances and progress payments from customers in excess of costs incurred to date on certain contracts. Approximately \$29,279,000 is to related parties and is included in the Due from Parent account, and the approximately \$557,000 is to related parties and is included in the Prepaid expenses and other current assets account.

**Legal Fees**

The Company accrues for legal fees in accordance with Emerging Issues Task Force Topic D-77, *Accounting for Legal Costs Expected to Be Incurred in Connection with a Loss Contingency*, whereby an accrual for expected legal costs is allowable if disclosed. The Company estimates the expected costs for each open legal case based on historical costs and the expectations for the length of the case and accrues for these expected costs accordingly. The accrual for legal fees at MPS was approximately \$6,696,000. The accrual for legal fees was included within accounts payable.

**Income Taxes**

The Company accounts for income taxes using the liability method for financial accounting and reporting of income taxes. Under this approach, deferred taxes are recognized for the estimated taxes ultimately payable or receivable based on enacted tax law for temporary differences between the tax basis and financial reporting basis of assets and liabilities and for operating loss carryforwards. Changes in enacted tax rates are reflected in the tax provisions as they occur.

**Foreign Currency Translation**

Foreign currency translation adjustments resulting from translation of accounts of MCMC's subsidiary in Holland are excluded from the determination of net income and are included in accumulated other comprehensive (loss) income.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**2. Significant Accounting Policies (continued)**

**Fair Values of Financial Instruments**

The Company's financial instruments include cash and cash equivalents, accounts receivable, due from or to Parent and affiliated companies, accounts payable and short-term borrowings. The fair values of these financial instruments were not materially different from their carrying values.

**Accumulated Other Comprehensive (Loss) Income**

As of December 31, 2003, accumulated other comprehensive (loss) income consists of the following:

	Unrealized (Losses) Gains on Securities	Foreign Currency Translation Adjustment	Accumulated Other Comprehensive (Loss) Income
Balance, December 31, 2002	\$ (967,270)	\$ (519,145)	\$ (1,486,415)
Unrealized depreciation of available-for-sale securities, net of income tax of \$195,567	(289,833)	–	(289,833)
Foreign currency translation adjustment	–	519,145	519,145
Balance, December 31, 2003	\$ (1,257,103)	\$ –	\$ (1,257,103)

**3. Inventories**

Inventories at December 31, 2003 consisted of the following:

Raw materials	\$ 1,763,036
Work-in-process	12,337,570
Units and parts	145,530,555
	159,631,161
Inventory reserve	(2,108,788)
	\$ 157,522,373

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**4. Property and Equipment**

Property and equipment were stated at cost as of December 31, 2003 and consisted of the following:

Land	\$ 1,730,760
Buildings and improvements	10,620,731
Machinery and equipment	25,511,283
Furniture and fixtures	4,849,428
Leasehold improvements	1,789,973
Vehicle	237,591
Computers and software	12,309,872
Construction in progress	1,194,675
	<u>\$ 58,244,313</u>

**5. Investments**

Investments include available-for-sale securities and joint ventures.

Investments in available-for-sale securities represent marketable equity securities of a Japanese corporation. The fair value of the equity securities at December 31, 2003 was approximately \$9,622,000. The change in gross unrealized loss for the year ended December 31, 2003 of approximately \$(485,000) was included in stockholder's equity as unrealized depreciation on available-for-sale securities, net of income tax effect of approximately \$(196,000). The investment had been in an unrealized loss position for less than 12 months at December 31, 2003. Accordingly, the Company concluded that the impairment was not "Other-than-temporary" due to the duration of the impairment.

During 2002, MPS entered into an agreement with TPI Composites, Inc. ("TPI") to form a joint venture entitled Vientek, LLC ("Vientek"). Vientek is a manufacturer of blades for wind turbines. The initial investment for each partner member was fixed at approximately \$2,500,000. The agreement also provides for a nine-month period commencing on July 1, 2003 where TPI may elect to sell and MPS may elect to purchase TPI's shares of Vientek in the event that MPS has not placed firm, noncancelable orders for blades at a minimum level, as defined in the agreement. The purchase price of TPI's shares is based on a defined formula in the agreement. The Company accounts for its investment in Vientek using the equity method.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**5. Investments (continued)**

During the year ended December 31, 2003, MPS increased its equity investment by approximately \$844,000 for its 50% interest in Vientek's net income.

During 2002, MHIA and an unrelated party, formed Advatech, LLC ("Advatech"), which designs, manufactures, delivers and installs pollution-control equipment. In connection with the transaction, MHIA contributed \$40,000 in cash to obtain a 40% interest in Advatech. Since there was no profit or loss from the joint venture for the year 2003, no equity pickup was recorded by the Company.

**6. Related Party Transactions**

The Company is dependant on the Parent for the purchase of certain inventories sold to its customers. The Company also has service agreements with the Parent and earns service fee income. Under the agreements, the Company provides various services such as market research, technical, engineering and after-sales service.

The following table summarizes the transactions between the Company and the Parent for the year ended December 31, 2003:

Net sales	\$ 7,875,000
Service fee income	42,876,000
Purchases	259,867,000

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**6. Related Party Transactions (continued)**

The Company purchases equipment and parts from related parties. Purchases for the year ended December 31, 2003 and amounts due to and from affiliated companies as of December 31, 2003 were as follows:

Purchases of equipment and parts:	
MHI Equipment Europe	\$ 125,435
Other	82,388
	\$ 207,823
Due from affiliated companies:	
MAC	\$ 21,080,000
Adverttech	417,000
Other	1,669,000
	\$ 23,166,000
Due to affiliated companies:	
MC	\$ 11,096,000
MAC	485,000
Other	223,000
	\$ 11,804,000

Under agreements with MAC Funding Corporation (“MAC”), an affiliated company of MC, MAC provides financing to customers of MLP and MIMM. Either party may terminate these agreements by giving 60 days’ prior written notice and by other events, as defined. Sales financed through this agreement were approximately \$29,079,000 for the year ended December 31, 2003. Receivables sold to MAC are collateralized by presses and machinery.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**6. Related Party Transactions (continued)**

Approximately \$95,964,000 of the receivables sold to MAC by MLP was outstanding at December 31, 2003. MAC has limited recourse to MLP for uncollected amounts in the event of default by customers. The maximum liability to MLP for finance contracts is limited to percentages of the gross outstanding balance as defined (approximately \$22,402,000 at December 31, 2003). In the event of default by a customer, collateral rights will be reassigned to MLP by MAC. A reserve of approximately \$5,671,000 at December 31, 2003 has been recorded to recognize the potential exposure to MLP, resulting from the difference between the uncollected receivables and the anticipated recovery from the presses' resale, for receivables sold to MAC but not yet collected. The reserve was included in accrued expenses and other current liabilities in the accompanying consolidated balance sheet.

MAC has a full recourse to MIMM for all finance contracts entered into by customers of MIMM. In the event of default by the customer, collateral rights will be reassigned to MIMM by MAC. The total outstanding balance of contracts financed through MAC was approximately \$15,411,000 at December 31, 2003. The Company has also entered into financing agreements without recourse with three other parties, except for nine specific leases. Those three parties possess 10% to 30% recourse on the leases. At December 31, 2003, the total values of the possible recourse amounts were approximately \$536,000. The policy of MIMM is to establish a reserve based upon knowledge of a specific customer's probable default due to litigation or bankruptcy claims and an additional reserve based on prior history. Total financing recourse reserves at December 31, 2003 were approximately \$403,000 which was included in Accounts receivable, net of allowance for doubtful accounts.

**7. Income Taxes**

The provision for income taxes differs from the amount computed at the statutory federal income tax rate primarily due to state and local taxes, and the change in the valuation allowance. For 2003, the valuation allowance was increased by approximately \$1,080,000.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**7. Income Taxes (continued)**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The significant components of deferred tax assets and liabilities at December 31, 2003 were as follows:

Deferred tax assets:	
Accruals and reserves	\$ 5,078,050
Net operating loss carryforwards	4,262,359
Allowance for doubtful accounts	2,720,502
Write-off of investments in corporate shares	2,417,400
Financing reserve	2,257,000
Inventory valuation	1,961,396
Inventory capitalization	1,604,979
Discount on notes receivable	1,463,515
Accrued expense for liquidated damages	1,117,004
Unrealized loss on other securities	848,244
Other	501,579
Total deferred tax assets	<u>24,232,028</u>
Deferred tax liabilities:	
Tax over book depreciation	(3,443,053)
Long-term contract	(383,000)
Total deferred tax liabilities	<u>(3,826,053)</u>
Valuation allowance	<u>(6,679,760)</u>
Net deferred tax assets	<u><u>\$ 13,726,215</u></u>

The Company files a consolidated federal income tax return with its subsidiaries.

At December 31, 2003, the Company has a net operating loss carryforward for U.S. tax purposes of approximately \$10,637,000, which expires in 2023 and may be subject to certain restrictions under U.S. federal tax provisions.

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**8. Short-Term Borrowings from Banks**

MLP has non-committed line of credit agreements with four Japanese financial institutions, one of which is affiliated with the stockholder. These line of credit agreements provide for maximum borrowings of \$30,000,000 through short-term notes payable. At December 31, 2003, the Company had short-term borrowings from banks of \$25,000,000 with interest rates between 1.85% and 2.00%.

MENA has a \$3 million line of credit, with interest on borrowings at LIBOR plus 0.25%. The line of credit carries no commitment fee and is renewable annually in September. There were no borrowings against the line of credit at December 31, 2003.

MIMM has entered into non-committed line-of-credit agreements with two Japanese financial institutions, which provide for a maximum borrowing of \$10,000,000 and \$5,000,000, respectively. At December 31, 2003, the Company had a short-term borrowing in an amount of \$1,000,000 with an interest rate of 2.35%, that matured on January 5, 2004.

On December 15, 2003, MIMM borrowed \$8,000,000 under a term loan agreement, due on December 15, 2004 with a current interest rate of 2.17% until March 15, 2004 and an interest rate of 3.17% thereafter. The debt will rank, until paid in full, at least *pari passu* to all other unsecured indebtedness of MIMM.

**9. Warranties**

MENA is a distributor of engines, turbochargers and related parts in North America that are produced by affiliated companies within the Mitsubishi group of companies. The products sold by the Company on behalf of its affiliates have warranties that are issued by the affiliated original manufacturers, rather than by the Company. The specific terms and conditions of the warranties offered on the products vary depending on the type of product sold and other relevant factors.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**9. Warranties (continued)**

In the majority of circumstances, warranty claims are submitted to the Company for their review and investigation, with claim payments made by the Company; however, the affiliates reimburse the Company in full. The Company records a liability for costs that may be incurred under the warranty programs of its affiliates at the time the original affiliate manufacturer approves the claim and, at such time, invoices the affiliate for these costs.

Changes in MENA's warranty reserve (included in accrued expenses and other current liabilities in the accompanying consolidated balance sheet) at December 31, 2003 were as follows:

Balance as of January 1	\$ 328,469
Warranties incurred	768,926
Warranty claims processed	(831,595)
Balance as of December 31	\$ 265,800

MLP provides for the estimated cost of product warranties at the time revenue is recognized. The Company's warranty reserve is impacted by product failure rates, and costs incurred in correcting a product failure. Should actual product failure rates, or costs differ from the Company's estimates, revisions to the estimated warranty reserve may be required.

Changes in MLP's warranty reserve (included in accrued expenses and other current liabilities in the accompanying consolidated balance sheet) at December 31, 2003 were as follows:

Balance as of January 1	\$ 1,519,433
Provision for warranty reserve	1,231,961
Warranty claims processed	(985,637)
Balance as of December 31	\$ 1,765,757

**10. Commitments and Contingencies**

**Lease Commitments**

The Company leases office and warehouse space at various locations, automobiles and office equipment, and machinery and equipment under operating leases.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**10. Commitments and Contingencies (continued)**

At December 31, 2003, the minimum lease payments under non-cancelable operating leases were approximately as follows:

	<b>Operating Leases</b>
Year ending December 31:	
2004	\$ 4,275,000
2005	3,547,000
2006	2,992,000
2007	2,544,000
2008	1,580,000
Thereafter	492,000
Total minimum lease payments	<u>\$ 15,430,000</u>

Total rent expense charged to operations was approximately \$5,249,000 for the year ended December 31, 2003.

**Litigation**

The Company is a defendant in lawsuits encountered in the ordinary course of business, several of such matters the Company believes are fully covered by insurance. Based on the advice of legal counsel, management of the Company is of the opinion that, while the ultimate resolution of the legal actions cannot be predicted with certainty, the resolution of these pending matters will not have a material adverse effect on the consolidated financial position, results of operations or cash flows of the Company.

**Indemnity of Bond**

In December 2002, MHIA agreed to indemnify performance bonds issued by Advatech. At December 31, 2003, Advatech has a commitment to assume joint and several liabilities on a performance bond totaling \$20,000,000.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**10. Commitments and Contingencies (continued)**

**Letters of Credit**

MPS has available letters of credit with one bank for borrowings up to \$65,000,000. The letters of credit consist of agreements that expire on various dates through June 1, 2005. The annual fees on these letters of credit approximate 0.5% of the available balance. The outstanding amount under the letters of credit at December 31, 2003 was approximately \$39,970,000.

MHIA has standby letters of credit with Bank of Tokyo Mitsubishi for approximately \$13,834,000. The letters of credit are issued under agreements that expire on various dates through October 31, 2004. The annual fees on the letters of credit are 0.5% of the standby balances. The letters of credit were originally issued on behalf of Power System Division of MHIA prior to its spin off from the Company in 2002 as Mitsubishi Power Systems Inc. However, the beneficiary, Ratheon, did not agree to change the name of the applicant on the letters; hence the applicant name remained as the Company. The letters of credit are to support the advance payment received from Ratheon.

The Paper Machinery division of MHIA had standby letters of credit with Bank of Tokyo Mitsubishi for approximately \$1,842,000. The letters of credit were issued under agreements that expired on February 14, 2004. The annual fees on the letters of credit were 0.5% of the standby balance. The credit was to support the warranty portion of the project on behalf of Stora Enso North American Corp.

**11. Pension Plans**

The Company maintains a defined contribution plan, which is qualified under Section 401(k) of the Internal Revenue Code of 1986. The plan, which covers employees at MHIA, MLP, MIMM, MENA and MPS, allows eligible employees to make contributions subject to the plans' limitations. The Company's contribution to the plan is based on a percentage of the aggregate amount of defined earnings of such employees for each plan year. During the year ended December 31, 2003, the Company contributed approximately \$913,000 to the plan.

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**11. Pension Plans (continued)**

In January 2002, MPS adopted a new nonqualified plan allowing certain employees to defer a percentage of their earnings until retirement. The Company's employees are included in this plan. The plan provides for neither a minimum or maximum deferral percentage of the participants' base salary and bonus. The Company funds this liability by remitting the participants' deferral to a Rabbi Trust. Each participant's account is comprised of their contribution, the employer's contribution and each participant's share of earnings or losses in the plan. In accordance with EITF No. 97-14, *Accounting for Deferred Compensation Arrangements Where Amounts Are Held in a Rabbi Trust and Invested*, the accounts of the Rabbi Trust are reported in consolidated financial statements.

As of December 31, 2003, the total amount of deferred compensation at MPS was approximately \$1,430,000, which is disclosed as deferred compensation liability in the consolidated balance sheet. The deferred compensation plan investments are included within insurance contracts purchased on behalf of the Company employees. The Company purchased life insurance policies for all plan participants under which the Company is the beneficiary. The cash surrender value of the life insurance policies was approximately \$1,343,000 at December 31, 2003 and is included in other long-term assets on the consolidated balance sheet.

**12. Trade Receivables and Major Customers**

The Company's trade receivables are from customers in diversified industries. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. For the year ended December 31, 2003, the Company had sales to two customers representing 31% of net sales and service fee income.

**13. Notes Receivable**

On July 11, 2003, MPS received a note from a customer with a face value of approximately \$2,535,000 for products sold during 2003. The amount was to be paid by December 31, 2003. On July 7, 2004, the Company agreed to a second note, which called for two installment payments. The first payment of \$1,000,000 was due and paid by July 31, 2004

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Notes to Consolidated Financial Statements (Unaudited) (continued)

**13. Notes Receivable (continued)**

and the second installment for approximately \$1,535,000 is due September 1, 2004, which shall bear interest at the rate of 6% per annum from June 8, 2004 until paid in full. At December 31, 2003, the net present value of the note was approximately \$2,442,000. The Company also included approximately \$67,000 (unaudited) of interest income in current year net income related to the original note dated July 7, 2003.

On July 18, 2004, the Company received a two-year promissory note from a customer with a face value of \$45,000,000 for products sold during 2003. The net present value at December 31, 2003 of the note was approximately \$41,333,000. No interest income related to this note was recorded in 2003.