

Management's Discussion and Analysis of Financial Condition and Results of Operations

All the financial information provided herein is based on the consolidated financial statements included in this annual report. These consolidated financial statements were made according to United States generally accepted accounting principles (U.S. GAAP).

Overview

During fiscal 2003, ended March 31, 2003, the Japanese economy showed the sign of a slight recovery in domestic production that was mainly due to an increase in exports and on-going adjustments to inventories. On the other hand, falling wage levels meant that private consumption remained depressed, and, although declines in capital investment seemed to have bottomed out, the domestic economy continued to suffer from worsening deflation. Furthermore, a sharp decline in stock prices during the year greatly weakened the financial condition of many Japanese companies. Overseas, U.S. economic growth remained weak on the whole, as the effects of large-scale tax cuts and easy-money policy lessened. Economies in Europe remained sluggish while those in Asia continued to grow steadily.

During fiscal 2002 and 2003, ITOCHU's mid-term management plan "A&P-2002" aimed to discard conventional business models and to develop new businesses focused on an A&P (Attractive and Powerful) strategy. During fiscal 2003, the final year of A&P-2002, ITOCHU accelerated the reorganization of its profit structure and restructuring of its management system.

Reorganization of the Profit Structure

ITOCHU intensively allocated assets and management resources to the A&P segments: information and multimedia; consumer and retail; natural resources development; financial services; North America and Asia. At the same time, ITOCHU has also paved a way to secure future growth by investing in new and innovative fields such as biotechnology and nanotechnology.

Transition of Profitability and Improvement of Financial Strength

To improve and reform its profit structure and financial strength, ITOCHU has intensively allocated management resources to A&P (Attractive & Powerful) segments to increase profits in these particular areas, while it has also reduced total assets and interest-bearing debts by closing unprofitable businesses and operations. Furthermore ITOCHU has tried to maximize group value using its A&P strategy by improving the profitability of group companies. As a result, ITOCHU's profitability has increased steadily, and its financial strength has been significantly improved.

Figures in yen for fiscal 2003 have been converted into U.S. dollars, solely for the convenience of the reader, using an exchange rate of ¥120.20 = U.S.\$1 which was the exchange rate as of March 31, 2003, as announced by The Bank of Tokyo-Mitsubishi, Ltd.

Specifically, in information and multimedia sector, ITOCHU secured a strategic alliance with Hitachi in IT-related field. ITOCHU also strengthened the product lines and service menus of ITC Network, which handles sales of and provides services for cellular phones. In the consumer and retail sectors, ITOCHU became the largest shareholder of Yukijirushi Access, Inc., aiming to reinforce the multi-temperature distribution network. ITOCHU also signed contracts with prestigious European and American fashion brands such as BALLY, gaining exclusive import and sales rights for their products. In the natural resources development sector, ITOCHU has decided to develop a coalmine in Australia and also to participate in the construction of a pipeline that will transport oil from the Caspian Sea to the Mediterranean. ITOCHU strengthened its capital base through a public offering in July 2002, which allowed the Company to increase shareholders' equity, while reducing total assets and interest-bearing debts. As a result, our net DER (Debt-to-Equity Ratio) improved by 1.0 point to 4.8 times from the end of the year before.

Restructuring of the Management System

ITOCHU thoroughly implemented a risk management program for domestic and overseas group companies, enhanced training programs for employees, including national staff, and positioned human resources based on a policy of "right person in the right place." ITOCHU also reinforced the compliance system for group companies, placing them under the direction of the Chief Compliance Officer.

These improvements, and the outlook for fiscal 2004, are discussed further in the following sections. These forecasts are forward-looking statements based on a number of assumptions and beliefs made by management in light of information currently available and thus involve certain risks and uncertainties. Actual results may differ materially depending on a number of factors, including changing economic conditions in major markets and fluctuations in currency exchange rate.