

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 have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Figures in yen for the fiscal year ended March 31, 2006 ("Fiscal 2006") have been converted into U.S. dollars, solely for the convenience of the reader, using an exchange rate of ¥117.47 = US\$1 as of March 31, 2006 as announced by The Bank of Tokyo-Mitsubishi UFJ, Ltd.

Overview

During Fiscal 2006, the Japanese economy picked up the pace for recovery primarily due to a resurgence of exports mainly to the U.S. and Asian/Middle East countries, a steady increase in consumer spending owing to expansion in employment and higher wages, and steady and favorable equipment investments supported by high-level corporate profits. Further, economic expansion is still expected due to the continuous resolution of the "three excesses," namely facilities, employment, and debt, which have lingered since the "bubble economy" in Japan burst.

Nikkei Stock Average turned upwards in the middle of this year due to the full recovery of economy and exceeded ¥17,000 at the end of Fiscal 2006. Regarding foreign exchange rates, the yen had been dropping since the beginning of Fiscal 2006 in reaction to an increase in the U.S. dollar's interest rate and is currently in the high 110's to the U.S. dollar. Meanwhile, the Bank of Japan lifted the quantitative easing policy, which had continued for five years, in March 2006. Overseas economic conditions continue to be in good condition. In the U.S., the economy enjoyed good growth as robust corporate profits continued to give a rise in employment and capital expenditures. In addition, the European economy has shown some signs of gradual recovery. China has also experienced consistent, high-level growth supported by strong exports and investments in infrastructure. Under these circumstances, the prices of natural resource-related commodities continue to rise due to stronger demands.

ITOCHU Corporation and its group companies have started a new mid-term management plan, "Frontier-2006," a two-year plan for Fiscal 2006 and fiscal year ending March 31, 2007 ("Fiscal 2007").

The "Frontier-2006" plan defines these two years as a period to make ITOCHU a highly profitable corporate group consistently achieving more than ¥100.0 billion in net income. By anticipating changes, always seeking a "frontier" and pursuing the three principles of "challenge, create and commit," ITOCHU has been engaged in growing earnings and strengthening its business base.

Specific achievements during Fiscal 2006 were as follows:

In Consumer-related and Retail-related areas, ITOCHU bought out a casual bag brand company, LeSportsac Inc., jointly with a U.S. bag manufacturer, Brand Science LLC., and started activities in Asia and Oceania as a new brand business in Textile. Also, ITOCHU purchased 40% of the shares of Paul Smith Group Holdings Limited in order to enhance partnership. Furthermore, ITOCHU acquired a master license for the FILA brand to start business expansion in the Japanese market.

ITOCHU signed a Memorandum of Understanding with Uny Co., Ltd., which provides for comprehensive cooperation in food-related business. ITOCHU aims to expand its food distribution business, but also expects to utilize the business resources of both companies including Uny's retail sites and ITOCHU's retail support capability in areas in adoption to the food-related business.

ITOCHU established a new company, ASCLASS LSA Inc., which started its operations to provide remodeling support services for selected local building contractors with Orient Corporation.

In Natural Resource Development-related areas, ITOCHU started an iron-ore production enhancement project in West Australia. Regarding the ACG oil development project in Azerbaijan, crude oil production started in western oil field of Azeri and has been increasing favorably.

In the other areas, ITOCHU invested in the top automobile dealer in Chengdu city in Sichuan province, China to start an automobile dealer business in China.

In Mobile area, NANO Media Inc., which is engaged in content distribution for cellular phones and application development, was listed on the Tokyo Stock Exchange ("TSE") Mothers, while ITC NETWORKS CORPORATION, a cellular phone distributor, was listed on the second section of TSE. This is an achievement of ITOCHU's efforts at business expansion in both hardware and software.

With regard to Chemicals, Forest Products and General Merchandise, ITOCHU decided to join a methanol business, which is the first large chemical product business in Brunei, with Mitsubishi Gas Chemical Company, Inc.