

# 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, 2005 ("Fiscal 2005") have been converted into U.S. dollars, solely for the convenience of the reader, using an exchange rate of ¥107.39 = U.S.\$1 as of March 31, 2005 as announced

## Overview

In Fiscal 2005 Japan's economy has continued a slow recovery since last summer. The main reasons of the sluggish growth were weak exports and tepid capital equipment spending as well as continued cautious hiring by corporations, which kept a damper on a recovery in personal consumption. At the same time, the Nikkei Stock Index remained in a tight range around ¥11,000 reflecting concerns over the health of the economic recovery. On the foreign exchange rate, the yen fell slightly against the dollar in the first half of the fiscal year on the back of a rising U.S. interest rates but strengthened modestly to around ¥105 in the second half amid fears over the U.S. current account deficits. Economic conditions overseas continued to recover. In the U.S., the economy enjoyed good growth as robust corporate profits helped a rise in employment and capital expenditures. China continued strong growth driven by active infrastructure investment and brisk exports. Amid these conditions, prices for many primary commodities continued to soar on surging demand from China.

Fiscal 2005 was the final year of ITOCHU's mid-term management plan 'Super A&P-2004' (stands for "Active and Powerful") a two-year plan from the fiscal year ended March 31, 2004 ("fiscal 2004") through fiscal 2005, with the year positioned as the capstone to the A&P strategy as a pace quickened to build a solid foundation starting for High Jump expecting from the fiscal year ending March 31, 2006 ("fiscal 2006").

Specific achievements during fiscal 2005, in the consumer and retail related sector, ITOCHU bolstered the textile related business by expanding existing brands such as Paul Smith and LANVIN, and promoted alliances with new brands such as HANG TEN and SPALDING. In food related sector, ITOCHU strengthened domestic food-distribution function by making a follow-on investment in NIPPON ACCESS INC. and by setting up Dolce Co., Ltd, a wholesale confectionary company, with Nishino Trading Co., Ltd. Overseas, together with FamilyMart Co., Ltd. ("FamilyMart"), ITOCHU embarked on a full-fledged development of convenience stores in China and

by The Bank of Tokyo-Mitsubishi, Ltd.

In this Management's Discussion and Analysis of Financial Condition and Results of Operations, "the Company" refers solely to ITOCHU Corporation, "ITOCHU" represents ITOCHU Corporation and its subsidiaries including its associated companies accounted for by the equity method, while "Group companies" refers its subsidiaries and associated companies accounted for by the equity method, unless otherwise indicated.

also established a new company to prepare for the opening of stores in the U.S. In the information and multimedia related sector, the shares of Excite Japan Co., Ltd., a core subsidiary in the e-business field, were listed on the Nasdaq Securities Exchange in November 2004. Excite Japan Co., Ltd. will try to diversify its services and heighten its brand awareness to bolster its role as a core consumer business. In natural resource development related sector, ITOCHU made the decision to invest in expansion of iron ore mines in west Australia to meet a surge in demand led by China. Additionally, the crude oil development project in Azerbaijan launched full-scale production in the Azeru field.

In the financial services related sector, the shares of kabu.com Securities Co., Ltd, an online security broker, listed on the First Section of the Tokyo Stock Exchange in March 2005. In addition, ITOCHU determined to participate in a business of and make an investment in Orient Corporation ("Orico") with the aim of expanding business operations in financial and a wide array of downstream fields. In chemicals, forest products and general merchandise related sector, a new A&P segment, together with ITOCHU Chemical Frontier Corporation, ITOCHU invested in Sanjiuhonsoubou Medical & Pharmaceutical Co., Ltd., a Japanese subsidiary of Sanjiu Enterprise Group, the largest pharmaceutical company in China. In automobile related sector, ITOCHU acquired the preferred shares of Isuzu Motors Ltd. ("Isuzu"), a very important customer, with the aim of expanding the business including production and sales in North America and China. Furthermore, to develop leading-edge technologies into future profit sources, the firm has to actively pursue strategic global tie-ups. To this end, ITOCHU made a capital and business tie-up with Sosei Co., Ltd, a biopharmaceutical company. Additionally, ITOCHU established "AJI New Business Expansion Fund" together with The Small and Medium Size Enterprise Agency to further promote investments in and alliances with small- and medium-sized companies.