

Liquidity and Capital Resources

Basic Policy for Funding

The Company aims to ensure flexibility in funding so that it can quickly respond to changes in financial circumstances, and take advantage of opportunities to lower its overall financing costs. It also aims to diversify its funding sources and methods in order to enhance the stability of its financing, while endeavoring to find the optimum balance in its funding structure, including improvement in the long-term funding balance.

In Japan, most corporations still rely on indirect financing as their primary source of funding with the largest percentage of indirect financing with domestic banks. Most domestic banks have adopted a positive earning expansion policy in accordance with near completion of bad loan disposal—a management issue over a number of years—as well as the rebuilding of equity capital. The financial institutions appreciated the Company's improved financial position and recovered profitability. They have shown a favorable attitude towards lending, and the Company expects no difficulty in procuring funds through indirect financing.

With respect to financing from the capital markets, better funding conditions are expected because the Company has received upgrades: a one-notch upgrade of its issuer rating from Ba1 to Baa3 from a U.S. ratings institution Moody's Investors Service (Moody's) in May 2005; a one-notch upgrade of its senior debt rating from A to A+ from a Japanese ratings institution Japan Credit Rating Agency, Ltd. (JCR) in December 2005; a one-notch upgrade of its long-term corporate credit rating from BBB- to BBB from a U.S. ratings institution Standard & Poor's (S&P) in February

2006; and a one-notch upgrade of its domestic commercial paper programme rating from a-2 to a-1 from a Japanese ratings institution Rating and Investment Information, Inc. (R&I) in May 2006. In addition the Company has newly obtained an issuer rating of A- from R&I in May 2006.

In the future, aiming to secure even higher ratings, the Company will continue concerted efforts to improve its financial position through the continuation of high profitability and thorough risk management.

Concerning bonds, the Company registers a bond issuance every two years. In the two years from August 2005 to July 2007, a new issue in the amount of ¥300 billion was registered, enabling the flexible issuance of bonds.

Furthermore, the Company, ITOCHU International Inc. in the U.S. and a finance subsidiary in the U.K., have registered a total of US\$5 billion in an Euro Medium Term Note Programme (MTN) in order to be flexible in fulfilling short- and long-term funding needs.

Interest-Bearing Debt

Interest-bearing debt as of March 31, 2006 decreased by ¥120.2 billion to ¥2,226.5 billion (US\$18,954 million) compared with the previous fiscal year. As a result of efforts to secure long-term funds to provide the structure for stable fund-raising, the ratio of long-term interest-bearing debt to total interest-bearing debt increased to 75% from the previous year's 71%. Moreover, the net DER (debt-to-equity ratio) improved by 1.3 to 2.4 times from 3.7 times compared with the previous fiscal year.

The breakdown of the interest-bearing debt as of March 31, 2006 and 2005 is as follows:

March 31	Billions of Yen		Millions of U.S. dollars
	2006	2005	2006
Short-term debt	¥ 382.4	¥ 421.7	\$ 3,256
Current installments of long-term debt	133.2	160.5	1,134
Current installments of debentures	39.9	94.6	339
Short-term total	555.5	676.9	4,729
Long-term loans payable	1,519.7	1,472.7	12,937
Debentures	160.8	186.0	1,369
Long-term total	1,680.5	1,658.7	14,306
Total interest-bearing debt	2,236.0	2,335.6	19,035
SFAS 133 fair value adjustment (Note)	(9.5)	11.1	(81)
Adjusted total interest-bearing debt	2,226.5	2,346.7	18,954
Cash, cash equivalents and time deposits	502.2	455.6	4,275
Net interest-bearing debt	¥ 1,724.3	¥ 1,891.1	\$ 14,679

(Note) This is in accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). The amount of adjustment to record the fair value, as of the balance sheet date for long-term debt, which is hedged with derivatives.