01

SHANDONG RUYI

Special Feature:

ITOCHU's Investment

Gross strategic investment in growth areas of ¥1,840 billion—¥1,450 billion in net investment—over the past five years testifies to the importance of business investment in ITOCHU's growth strategy. Meanwhile, because general trading companies invest significant amounts, attention tends to focus exclusively on their functions as investment companies that seek dividends and capital gains. However, this is only one facet of a general trading company. This special feature aims to further understanding of the true nature of ITOCHU's investment activities. First, we explain our approach to investment and our main investments in the first year of "*Brand-new Deal 2012*." Then, we give several examples of advancing growth strategies through business investment. Finally, we focus on how we control investment risk.

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Strategy

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KWIK-FIT

Creating and Expanding Businesses through Investment

Investment as a Means of Advancing Strategies

When entering a market or creating a new business, we begin our involvement in business areas where we can take the most advantage of our strengths and knowledge and obtain the maximum earnings. Using these areas as bridgeheads, ITOCHU and its Group companies build partnerships with a range of companies in various business areas, and create a chain of new businesses with a view to increasing earnings further. Among methods we use to create businesses, business investment is an option that is as important as strategic tie-ups. Based on our strategic goals, we select the optimal format through which to create a new business from among a variety of methods and investment ratio. These range from establishing a subsidiary independently through to investing to strengthen a partnership, and participating in business management or making a company into a subsidiary to heighten the corporate value of a company invested in. A good example is our use of investment to deepen partnerships as part of our strategy for China in the food business. In China, aiming to laterally develop Strategic Integrated System (SIS) strategy*, a business model that has brought us success in Japan, we have formed capital and business tie-ups with various leading partners, such as the holding company of the Ting Hsin Group, TING HSIN (CAYMAN ISLANDS) HOLDING CORP. This has engaged us in areas stretching from food resource procurement and production through to retail businesses.

Rather than simply seeking dividends or capital gains, we exploit capabilities and sales channels in which we have particular expertise to acquire earnings in a multifaceted manner. For example, when we acquire upstream equity interests in natural resources and energy business, as well as obtaining profits from those interests, we aim to synergistically increase trade by acquiring priority sales rights. Based on the principle of long-term ownership of assets invested in, after investing we take full advantage of our expertise and capabilities to maximize the corporate value of companies invested in and our earnings. In the textile business for example, as well as ensuring stable commercial rights over the long term by acquiring brands, we are working to maximize the return on our investment by drawing on our marketing capabilities and creating new brand-based business models.

Photo: Courtesy of AIOC (Azerbaijan International Operating Company)

* A strategy for supply chain optimization through vertical integration, from upstream procurement of food resources to mid-stream product processing and marketing and distribution and through to downstream retail businesses.

Revising Investment Criteria to Suit a New Growth Stage

When making investment decisions, we use a hurdle rate. Until we revised our investment criteria in fiscal 2011, we applied uniform criteria to all business areas in order to weed out low return projects, improve asset efficiency on a companywide basis, and thereby strengthen our financial position. These measures succeeded and improved our balance sheet significantly, which laid the foundations for proactively seeking new opportunities. To enable us to build an appropriate investment portfolio in a new stage of growth, we revised our investment criteria for "*Brand-new Deal 2012*," which sets out proactively seeking new opportunities as a basic policy.

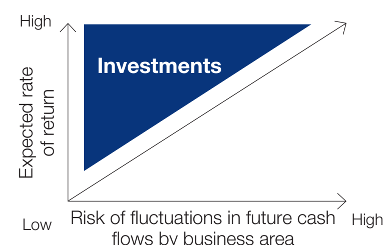
Under the new investment criteria, in making investment decisions, cash flow, based on carefully considered business plans that take into account fluctuation risk, is discounted to the present value using a hurdle rate that reflects the situations of individual countries and business areas. The resulting amount is compared to the investment amount. As a result of this change, we can now make investment decisions that take

Previous Approach

Use of the uniform hurdle rate for all projects

New Approach

Use of different hurdle rate for each business area



into account the specific characteristics of industries and regions. Consequently, our range of investment options has broadened to include areas that, while not promising high returns, are likely to generate stable long-term earnings, such as IPP projects.

Meanwhile, as we accumulate stockholders' equity, we need to manage our business portfolio with even greater consideration of ROE. Accordingly, we are managing our business portfolio to ensure that companywide ROE does not deteriorate.

Our Investment Policy under "*Brand-new Deal 2012*" and Achievements in Its First Fiscal Year

"*Brand-new Deal 2012*" marked a change in course toward increasing the scale of our earnings and assets by accumulating highly profitable assets through an emphasis on proactively seeking new opportunities for investment. This proactive stance is reflected in the medium-term management plan's call for gross investment in fiscal 2012 and fiscal 2013 of ¥800 billion, compared with gross investment of ¥560 billion over two years under the previous plan, Frontier[e] 2010. We implemented tightly focused allocation of assets while maintaining balance among four business sectors: the consumer-related sector; the natural resource / energy-related sector; the machinery-related sector; and the chemicals, real estate, and others sector.

As for investments in fiscal 2012, the plan's first year, in the consumer-related sector we strengthened our tyre business in Europe by acquiring an independent tyre retailer in the United Kingdom, Kwik-Fit, for ¥83.9 billion. Furthermore, an investment of approximately ¥15.0 billion gave us a 30% stake in one of China's major textile-related corporate groups, the Shandong Ruyi Science & Technology Group, making it an equity-method associated company. In addition, in fiscal 2013 we solidified our position as a leading global pulp trader by investing in one of the world's leading softwood pulp producers, METSA FIBRE Oy of Finland. In the natural resource / energy-related sector, aiming to increase our coal interests in light of rising coal demand, we invested ¥131.1 billion in Colombian mining operations and related infrastructure, giving us a 20% stake. In another initiative, ITOCHU expanded its unconventional resource development business by investing ¥82.1 billion for a 25% stake in one of the largest private U.S. oil and gas exploration and production companies, Samson Investment Company. In the machinery-related sector, we reinforced stable earnings platform by investing in a new coal-fired IPP in Indonesia and a wind power generation business in North America. Moreover, in fiscal 2013 we became the first Japanese company to participate in a water utility business in the United Kingdom. In the chemicals, real estate, and others sector, we took a 25% stake in a financial services company in Hong Kong, CITIC International Assets Management Limited (CIAM), based on a comprehensive strategic alliance with a major Chinese government-run conglomerate, the CITIC Group, to which CIAM belongs.

For the plan's second year, fiscal 2013, given our progress in fiscal 2012, we have increased gross investment over the two years from the ¥800 billion initially earmarked to ¥1 trillion, and intend to continue accumulating highly profitable assets. However, due to the uncertain economic environment, we will assess investment candidates even more carefully than before and only select highly profitable assets. Furthermore, we intend to continue replacing assets by withdrawing from assets with low efficiency.

"*Brand-new Deal 2012*" Investment Review

	Fiscal 2012	Amount	*Brand-new Deal 2012* Initial plan (2-year period)	*Brand-new Deal 2012* Revised plan (2-year period)
Natural Resource / Energy-related Sector	Drummond Colombia Coal Brazil Japan Iron Ore Corporation (NAMISA) Samson Investment Company Maules Creek IMEA expansion ACG expansion South Africa Platreef Project	¥380 billion	¥350 – ¥450 billion	¥500 – ¥600 billion
Consumer-related Sector	Kwik-Fit Shandong Ruyi Science & Technology Group	¥130 billion	¥100 – ¥200 billion	¥150 – ¥250 billion
Machinery-related Sector	Shepherds Flat Wind Project Century Tokyo Leasing Corporation Desalination Project in Victoria, Australia	¥70 billion	¥100 – ¥200 billion	¥100 – ¥200 billion
Chemicals, Real Estate, and others Sector	Commercial Real Estate Fund (Overseas) CIAM (CITIC International Assets Management)	¥40 billion	¥50 – ¥150 billion	¥50 – ¥150 billion
Gross Amount		¥620 billion	¥800 billion	¥1 trillion
Net Amount		¥510 billion		

01

Aiming to Increase Business Opportunities in High-value-added Business Areas

—The Shandong Ruyi Science & Technology Group, Major Textile-related Corporate Group in China

Area	China's textile business
Investment	Approximately ¥15.0 billion
Strategic significance	Increases sales in China and strengthens global operations

Strengthening Partnerships to Increase Sales in China

Ahead of other Japanese companies, we established a foothold in China in 1972. Since then, we have viewed building relationships with leading local partners as our first strategic priority and have established relationships of trust with many local companies in areas ranging from textile material procurement and fabrics through to apparel products and retailing. In the textile materials and fabrics area, we are extensively developing a joint-venture business established with China's top-ranking corporate apparel group, Youngor Group Co., Ltd.

Given that China's apparel retail market has overtaken Japan's to become the second largest in the world, we aim to expand our textile businesses in China, particularly in the midstream and downstream areas. In the retail area, working with partners who have market expertise is particularly important. With this in mind, in 2009 we formed a capital and business tie-up with one of China's foremost conglomerates, Shanshan Group Co., Ltd., which began as a textile company. Since then, we have been expanding collaborative initiatives with a focus on developing brand businesses. This partnership is not limited to the textile business. In step with the Shanshan Group's business diversification, we have extended the scope of our collaborative efforts to include such areas as real estate development and the manufacture of cathode materials for lithium-ion batteries. Investing in the holding company of a Chinese corporate group has enabled this type of business expansion.

Signing ceremony with the Shandong Ruyi Science & Technology Group

In 2011, looking to obtain a powerful partner who would expand our sales in China and strengthen our global operations in the upstream and midstream areas, we acquired shares in one of China's major textile corporate groups, the Shandong Ruyi Science & Technology Group, making it an equity-method associated company.

Discovering a Common Philosophy on Creating Added Value

Established in 1972 as a state-owned worsted woolen textile factory, the Shandong Ruyi Science & Technology Group was privatized in 2001. Since then, it has responded to economic structural changes by extending its business area from the upstream and midstream textile materials and fabrics areas into downstream retailing. The group boasts advanced production technology, as shown by the fact that it is the only textile company in China that has been honored by the Chinese government for its advanced technology.

As China's apparel retail market continues to grow, competition is becoming ever fiercer, with price wars becoming the norm due to oversupply. In response, the group is stepping up efforts to strengthen the downstream area by distancing itself from price competition and focusing on high added value. Meanwhile, ITOCHU has created a new business model in the downstream area by pursuing added value. This common focus on added value was behind the conclusion of a capital tie-up between the two companies.

Over many years, we have built a favorable relationship with the Shandong Ruyi Science & Technology Group. Tracing its roots to Australian raw wool transactions in the 1990s, our relationship grew in the following decade as we began exporting the group's high-end worsted woolen fabrics to Japan and the United States. The mutual trust built up during this time made this capital tie-up possible.

Accelerating Collaborations in a Wide Range of Areas of the Textile Business

Like many Chinese companies, the Shandong Ruyi Science & Technology Group is diversifying its business. Nevertheless, a feature of the group is that its textile business accounts for more than 90% of its sales. Maintaining the original business of the group as its mainstay business reflects the management policy of its chairman, Yafu Qiu. In addition, its wide range of business areas—spanning upstream, midstream, and downstream—will enable the creation of synergies with a wide array of our textile businesses by exploiting each company's strengths.

Moving forward, in the upstream area ITOCHU will exploit its global production and procurement network to advance the business collaboration. For example, we will procure competitive textile materials from China, Australia, India, and Pakistan. Furthermore, we intend to use our production bases in Asia to supply fabrics and textile products. Our contribution to the collaboration will also take the form of strengthening product competitiveness by providing expertise in production technology and planning. On the other hand, we will make use of the Shandong Ruyi Science & Technology Group's competitive production base to strengthen global operations in the upstream and midstream areas.

In the downstream area, we will support the expansion of the Shandong Ruyi Science & Technology Group's sales channels by utilizing our global sales network. Specifically, as well as collaborating with the group for sales in China, we will roll out its products in

Leading-edge spinning equipment

A worsted woolen textile factory, our new partner's original business

apparel markets in Japan, the United States, and Europe. Furthermore, we intend to broaden the scope of the group's business by acting as an intermediary for business collaborations between the group and Japanese apparel companies.

Growing by 20% annually, China's market for luxury goods is expected to surpass Japan's and become the world's largest in 2012. For ITOCHU, this means more opportunities in the brand business, an area of our strength. We intend to steadily seize these opportunities not only by rolling out the brands we own but also by exploring joint acquisitions of European and North American brands.

To win out against stiff competition, we are already working to effectively utilize the partnership, having dispatched six personnel to the Shandong Ruyi Science & Technology Group, one of whom has become the group's vice chairman. By fully mobilizing such resources as the business management methods we have developed in China for global companies and the production and sales network we have built over many years in Europe, North America, and Asia, we will ensure the success of this tie-up.

Shandong Ruyi Science & Technology Group

Chairman Yafu Qiu

As a result of this capital tie-up, the Shandong Ruyi Science & Technology Group has become an ITOCHU Group company. In a wide range of business areas, we look forward to support from ITOCHU that will increase our business lines and corporate value. For our founding business in the upstream and midstream areas, we will step up the development and sales of high-value-added materials realized through our leading-edge technologies, and accelerate the global roll-out of suits and home furnishings by taking advantage of ITOCHU's procurement and sales networks. Downstream, we will make use of ITOCHU's expertise in the brand business to market our products not only in China but globally and to consider brand-related M&A. China's cotton-spinning industry is approaching a challenging phase because of the uncertain outlook for its largest export destination, the European market. Despite these conditions, almost all of our business areas are growing earnings thanks to equalization of raw material costs and utilization of the latest equipment to manufacture and supply high-value-added products. Moving forward, we will strive to become a major player in the global fashion industry with the support of ITOCHU.

Securing a New Source of Competitive and Stable Coal Supplies

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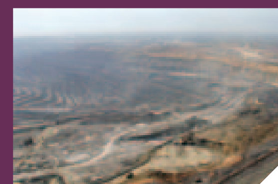
—Drummond Company's Mining Operations and Related Infrastructure in Colombia

Area	Coal resource development
Investment	Approximately ¥131.1 billion
Strategic significance	Secures a new supply source and diversifies regional portfolio



Securing a New Source of Stable Supplies

ITOCHU acquired 20% of the mining operations and related infrastructure of Drummond Company, Inc., and its affiliates in Colombia.

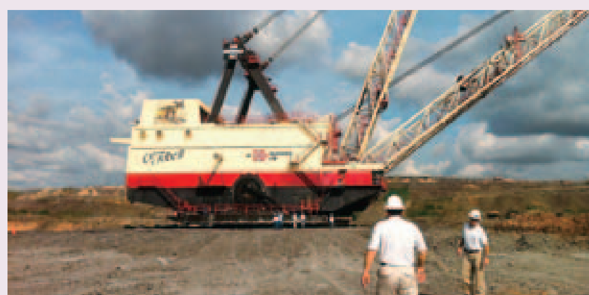
Japan is the world's largest coal importer, relying on imports for 99% of the coal it consumes. In particular, demand for high-quality thermal coal for power generation is growing because coal-fired power stations have been operating at full capacity since the Great East Japan Earthquake in order to compensate for the shortages of power supply it has caused. Meanwhile, supply and demand is particularly tight in Asia as economic growth spurs emerging countries to increase their coal import volume sharply. Furthermore, given that Japan depends on Australia and Indonesia for more than 80% of its imports, mitigating risk associated with concentration of supply source is a task confronting Japan.

In Colombia, the world's fourth largest exporter of coal, the government has adopted a policy of increasing coal production. Because of low domestic demand for coal in Colombia, its capacity to export surplus coal promises to grow. In 1995, Drummond Company started up mining operations in Colombia—one of the largest mining projects in the world. The project accounts for approximately 1.9 billion tons of proven and probable coal reserves and produces and exports 30 million tons of thermal coal annually. This tie-up has opened the door to coal supplies from Colombia, which used to export only a small volume of coal to Japan. Also, by securing a third source of stable supplies alongside Australia and Indonesia, it will contribute significantly to the energy security of Japan and Asia.

Moreover, this tie-up has major strategic significance for ITOCHU. As well as diversifying coal interests that were concentrated in Australia, it will enable us to increase trade based on exclusive marketing rights in Japan for thermal coal produced by the mining operations.

Because they are economical, coal-fired power stations generate more than 40% of the world's power. By 2035, coal-fired power generation is likely to increase 1.5 times*. Particularly in China and India, where coal-fired power generation represents a large part of the countries' power sources—between 70% and 80%*—coal demand is projected to continue rising in step with economic growth. Accordingly, as well as Japan we have set our sights on catering to demand in other Asian countries.

* Source: IEA World Energy Outlook 2011



Dragline operation for overburden removal

Promising to Maintain and Increase Cost Competitiveness in the Medium-to-long Term

We make investment decisions based on careful examination of the profitability and consideration of development phases and the regional balance of our portfolio.

Cost competitiveness was the principle reason we decided to invest approximately ¥131.1 billion—a record amount for newly acquired coal interests by a Japanese company. At present, coal-mining cost is between 20% and 30% lower than in Australia. Moreover, as the project expands the economies of scale are likely to become even more attractive. On the other hand, one of the main reasons that Colombia has not

exported large volumes to Japan and Asia is the high freight cost arising from long-distance transportation. However, we anticipate that freight cost will decrease as transportation capabilities increase after completion of extension work currently under way on the Panama Canal, scheduled for 2014, which will allow wider vessels to pass through. In this way, the cost competitiveness of this project will increase over the medium-to-long term in terms of production cost and freight cost.

Quality was the second decisive factor in this project. The quality of thermal coal significantly affects power generation efficiency. The Drummond Company's mining operations produce high-quality coal that has a high calorific value, low sulfur, and low ash. This enables us to cater to the exacting quality requirements of Japan's utilities, which have some of the world's most efficient coal-fired power generation operations.

Another decisive factor was that the project was already in operation, rather than at the initial exploration or development stage. This enabled us to rapidly realize supplies to Japanese utilities and other customers while minimizing development risk and gaining immediate earnings.

Transportation infrastructure such as railways and ports often becomes a bottleneck when owners of mines and their related transportation infrastructure are different. This is because owners of transportation infrastructure are sometimes unable to increase their capacity flexibly in response to expanded mining operations. By contrast, Drummond Company owns the mining operations and related infrastructure, which enables it to strengthen infrastructure to cope with mining expansion. The company is already adding railway lines and bolstering port facilities in preparation for ramped-up production.

Furthermore, security has improved dramatically in Colombia thanks to the government efforts. In addition, we believe that the comprehensive security measures of the government and Drummond Company help minimize geopolitical risk.

Reasons for Investment Decision

1. Scale	■ Proven and probable coal reserves: 1.9 billion tons ■ Annual production and export volume: 30 million tons
2. Cost competitiveness	■ Coal-mining cost 20% to 30% lower than in Australia ■ Freight cost likely to decrease due to widening of Panama Canal
3. Quality	■ High calorific value, low sulfur, low ash
4. Operations under way	■ Realizes supply to customers rapidly ■ Minimizes development risk and gains immediate earnings
5. Improvement of geopolitical risk	■ Security measures of Colombian government and Drummond Company

Targeting 20 Million Tons a Year

At the initial bid stage, Mr. Drummond was considering selling 100% of his assets. We submitted a proposal for joint ownership and reached an agreement after intensive negotiations held against the backdrop of competing bids from several resource majors. In fact, we have had an uninterrupted business relationship with Drummond Company for more than 40 years. In addition to Drummond Company appreciating the merits of combining its abundant expertise in Colombia and coal mine management with our sales channels in Japan and Asia, we believe our long-standing relationship of trust contributed significantly to sealing this agreement.

We plan to increase our global coal interests, including those in Colombian mining operations of Drummond Company, from fiscal 2012's 8.9 million tons per year to more than 20 million tons per year by fiscal 2016. We aim to increase our thermal coal interests to account for 14 million tons of this amount. By 2015, Drummond Company plans to expand its annual production volume to 35 million tons. As a result, our coal interests will rise by 7 million tons per year, contributing considerably toward reaching our target.

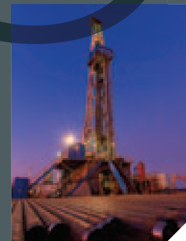
Moving forward, we will fully exploit our trading and other capabilities and strengths to realize mutual development with Drummond Company.

03

Opening the Way to Unconventional Resource Development

—U.S. Oil and Gas Exploration and Production Company, Samson Investment Company

Area	Unconventional natural gas development
Investment	Approximately ¥82.1 billion
Strategic significance	Increases equity interests of ITOCHU and trade



Investing in a Premier Private Oil and Gas Exploration and Production Company, Samson Investment Company

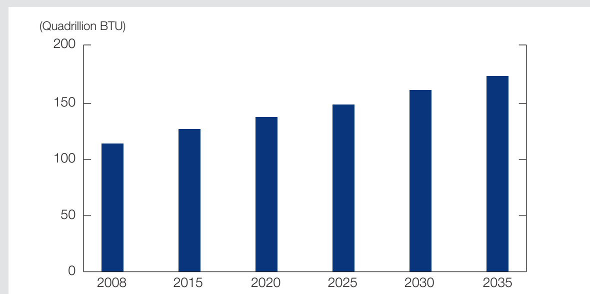
As an alternative to oil, natural gas is attracting attention because of its comparatively light environmental burden and abundant reserves. By 2035, global demand for natural gas will have jumped by 62% from 2008 levels*[1]. Unconventional natural gas development makes it feasible to meet this higher demand by using the advances in development technology of recent years to realize lower cost development and to increase the volume of minable natural gas reserves greatly.

As a major strategic move in readiness for the age of natural gas, ITOCHU with Kohlberg Kravis Roberts & Co. L.P. of the United States jointly acquired a 100% stake in Samson Investment Company. Through a U.S. subsidiary, we now have a 25% stake in Samson Investment, which has built a portfolio that is well-balanced between oil and natural gas. Its assets include approximately 10,000 wells mainly in unconventional gas fields, 4,000 operatorships, and multiple equity interests in undeveloped unconventional resources acquired at competitive prices.

Oil and gas development

*1 Source: IEA World Energy Outlook 2011, Special Report "Are We Entering A Golden Age of Gas?"

Forecast of Global Demand for Natural Gas



Source: EIA International Energy Outlook 2011

Increasing ITOCHU's Equity Interests and Expanding Trading Business in the United States

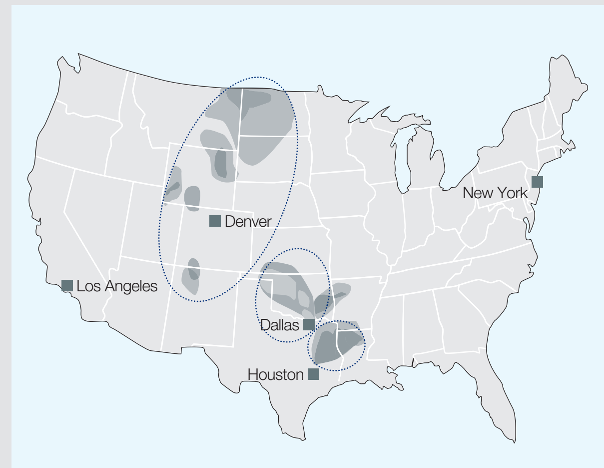
Samson Investment's main equity interests in the United States are in the Rocky Mountains region, the central interior region, and eastern Texas. The company has one of the largest domestic production volumes among private U.S. oil and gas exploration and production companies. Through our investment in Samson Investment, we plan to raise our oil and gas interests from fiscal 2012's 33,000 barrels per day to 60,000 barrels per day in fiscal 2013. Furthermore, Samson Investment expects to continue increasing production volume. Therefore, our investment in the company will contribute significantly to the achievement of our target for oil and gas interests of more than 70,000 barrels per day by fiscal 2016.

As we accumulate equity interests in unconventional resources, we intend to expand our trading capabilities. In the United States, natural gas accounts for roughly 30% of primary energy, and 23% of this natural gas comes from shale gas. By 2035, shale gas is expected to account for 49% of natural gas as the abundance of shale gas will lead to its increased use not only for power generation but also for industry*[2]. Through our U.S. subsidiary, which holds the rights

commensurate with its stake to offtake natural gas produced from Samson's assets, we will advance trade within the United States to increase earnings. Samson Investment has mining areas in some famous production regions for shale oil and wet gas which have high market prices (please see the column below), such as the Bakken shale of the Rocky Mountains and Oklahoma's Woodford shale. This gives the company an asset portfolio that allows it to expand shale oil and wet gas production. Accordingly, Samson Investment will shift the focus of production away from natural gas and heighten the proportion of shale oil and wet gas production, thereby increasing the overall profitability of its assets.

*2 Source: EIA Annual Energy Outlook 2012 Early Release Overview

Mining Areas in Which Samson Investment Has Equity Interests

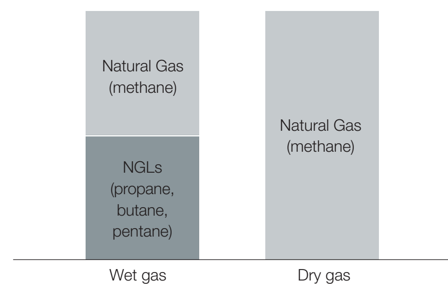


Dry Gas and Wet Gas

Shale gas includes "dry gas," which is just gas and mainly comprises methane. "Wet gas," in addition to methane, includes propane, butane, and other natural gas liquids (NGLs) that become liquid when pressurized at room temperature. Such differences in liquid content result in significant price differences. In the United States, the natural gas (dry gas) price is conspicuously low. Based on the U.S. Henry Hub Natural Gas Index, it is trending around US$2–3 per million BTU (British thermal unit). However, because it includes NGLs for which the market price is high, wet gas sells at approximately US$5–10 per million BTU. Consequently, a gap has emerged in the pricing of the two types of gas. In response, U.S. producers are curbing dry gas production while concentrating efforts on wet gas production.

Dry Gas and Wet Gas

Wet gas is more expensive than dry gas, because it includes NGLs for which the market price is high.



Aiming to Build an LNG Value Chain

Unconventional natural gas development calls for a high level of expertise in development technologies, geology, and environmental measures. Operators must be able to use mining technologies such as horizontal borehole technology and multi-stage hydraulic fracturing, which triggered the shale gas revolution. The United States has the world's highest levels of such know-how. Established in 1971, Samson Investment has many highly experienced engineers and has earned an enviable reputation in the industry for technological excellence. Gaining access to the invaluable expertise this company has garnered has a large strategic significance for ITOCHU's initiatives to develop the unconventional resources business in North America and other regions.

In the United States, natural gas (dry gas) prices are lackluster due to slack supply and demand resulting from increased production of unconventional natural gas. In Asia by contrast, Japan's increased imports following the Great East Japan Earthquake have tightened supply and demand, keeping natural gas prices high. In fact, the CIF price of natural gas for Japan is six times higher than the U.S. domestic price. In response, in the United States, plans to export LNG by establishing liquefying facilities at bases originally established for receiving LNG imports are progressing, although the government's energy policy currently restricts LNG exports. Several projects have already obtained exporting rights for countries that have concluded free trade agreements (FTAs) with the United States. Moving forward, full-fledged obtainment of exporting rights is likely to begin for countries that have not concluded FTAs with the United States. With the future development of an LNG exporting business in mind, we aim to build an LNG value chain. To this end, we will participate in midstream pipeline and liquefying facilities businesses while increasing the upstream business lines of Samson Investment.

04

Advancing Our Domination Strategy in the British Tyre Business Significantly

—U.K. No.1 Tyre Retailer, the Kwik-Fit Group

Area	U.K. tyre business
Investment	Approximately ¥83.9 billion
Strategic significance	Strengthens U.K. tyre business through synergies with Stapleton's

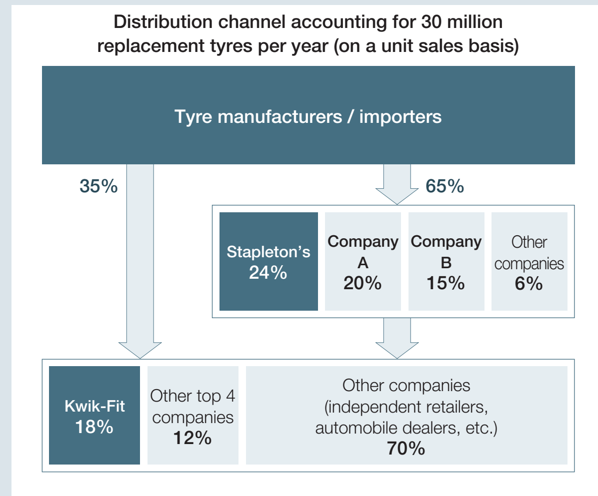
Taking a Large Stride Towards Dominating the U.K. Tyre Business

ITOCHU acquired all of the shares of the Kwik-Fit Group, a tyre retailer in the United Kingdom and other countries, for £637 million, or approximately ¥83.9 billion. Kwik-Fit has built an unshakable leading position and boasts exceptional brand power, particularly in the United Kingdom. This acquisition has significantly furthered our domination strategy for the tyre business, which is one of the core areas of our forest products and general merchandise business.

ITOCHU operates businesses in markets closely connected with people's everyday lives. Therefore, solid, stably growing demand among emerging countries for tyres, natural rubber, pulp, wood, and building materials is one of our mainstays. In such markets, we are pursuing a domination strategy that entails choosing markets and regions that offer considerable scope for us to heighten our presence by leveraging our strengths. Then, with a single stroke, we carve out a large share of the chosen market. The aim of this strategy is to exploit the strengths—capital strength, personnel, business management expertise, and global networks—to build up competitive advantage and grow earnings steadily.

One of our strengths is logistics capabilities, providing services that are large-scale and efficient, and carefully tailored to customer needs by taking advantage of global networks and expertise. Conditions in the British tyre market will give full play to this strength, enabling us to advance our domination strategy. Independent retailers account for the majority of the U.K. tyre market, and tyre manufacturers have not developed production bases or distribution and sales networks in the country. Since establishing a bridgehead for our domination strategy by acquiring Stapleton's (Tyre Services) Ltd. in 1994, we have steadily consolidated our position in this market.

Structure of U.K. Tyre Market



Fully Realizing Quality Expertise in High-volume Operations

As well as being U.K. No.1 tyre distributor, accounting for more than 24% of the market, our wholly owned subsidiary, Stapleton's, operates 124 retail stores.[*1] Directly after investing in Stapleton's, we introduced a variety of our distinctive business management methods to the company. In particular, our efforts to bolster the production lineup and realize carefully customized high-value-added services have become a major source of differentiation. We also introduced rapid, small-lot deliveries that cater immediately to customers' needs and trained personnel with a focus on enhancing

service quality. These initiatives heightened customer loyalty and led to outstanding earnings per store compared with the retail industry average.

Thus, having garnered experience in the U.K. tyre distribution and retail industries through these efforts and anticipating significant synergies with Stapleton's operations, we acquired Kwik-Fit.

Kwik-Fit's 675 stores*1 give the company the largest store network and the highest sales in the tyre retail industry in the United Kingdom. Also underpinning earnings is its fleet business*2, which can better withstand deterioration of the economic climate and claims an overwhelming share of the market. Consequently, Kwik-Fit achieved sales growth for seven consecutive years between 2004 and 2010. Kwik-Fit and Stapleton's account for roughly 40% of distribution volume in the U.K. tyre market—an unassailably dominant position. Combining the No.1 companies in the distribution and retail industries promises increased buying power and a range of other synergistic benefits stemming from economies of scale that will further grow earnings.

We believe the most significant synergies will come by fully realizing the improved business management and service quality that we have established at Stapleton's in Kwik-Fit's high-volume operations, which have roughly five times as many stores as Stapleton's. Through these synergies, we aim to increase our earnings on a greater scale.

*1 As of December 31, 2011
*2 Tyre sales and maintenance business for automobiles that companies provide for employees

Stapletons Tyre Services

- No.1 distributor: Accounts for 24% of unit sales in U.K. tyre market
- 124 retail stores
- Highest profitability per store in U.K. thanks to own differentiated business management methods

+

KwikFit

- No.1 store network: 675 retail stores
- Overwhelming share of fleet market

=

Established dominance by claiming approximately 40% of distribution volume.
Going forward, move into phase of fully realizing Stapleton's quality in Kwik-Fit's high-volume operations.

Shift of the Stage in Creating Synergies, from Heightening Efficiency to Expanding Quantitatively

Immediately after making our investment, we dispatched tyre business experts, who have been rapidly advancing initiatives to create synergies. Already, we have largely finished improving operational efficiency. These efforts involved integrating administrative and IT divisions, integrating the store network, optimizing the procurement of tyres and a range of other products, and introducing Stapleton's expertise in competitive distribution methods. From fiscal 2013 onwards, we will begin fully-fledged efforts to realize the type of high-value-added services that improved Stapleton's competitiveness so significantly. We will then move into a stage of realizing synergies that will prepare the way for expanding quantitatively.

In addition to initiatives in the United Kingdom, we are strengthening our tyre business by exploiting such strengths as logistics and distribution capabilities in Russia and the United States. Furthermore, we are developing the business of handling and processing natural rubber, the raw material for tyres. This business is among the largest of any general trading company in Indonesia, Thailand, and other countries. Mainly by securing sources of stable supplies of raw materials in the upstream area, while developing sales channels in the downstream area, we will grow the tyre business globally.

Controlling Investment Risk and Maintaining Financial Soundness

Quantifying Risk to Control Investment Risk

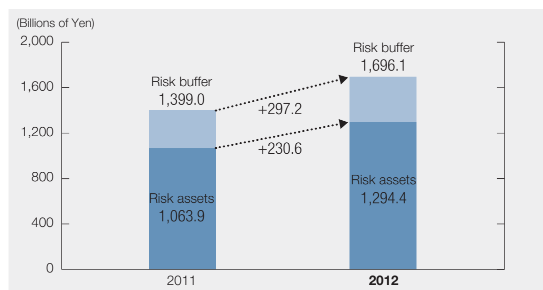
As the strategic importance of business investment increases, we need to control the accompanying diversification of risks and continuously heighten the sophistication of initiatives for maintaining financial soundness.

Since the beginning of the 2000s, ITOCHU has used risk capital management, which quantitatively controls risk related to investment activities. This involves calculating "risk assets" based on the maximum amount of the possible future losses from all assets on the balance sheet as well as for all off-balance-sheet transactions. We then use the balance between risk assets and expected return as a benchmark for investment decisions. Our basic policy is controlling risk assets at a sound level within the risk buffer.

Under "*Brand-new Deal 2012*," we revised our risk asset calculation method for the first time in 10 years. Specifically, we (1) revised the risk weight, which was overly conservative, (2) considered the effects of diversification, and (3) revised the definition of the risk buffer (changed from the previously used consolidated stockholders' equity to consolidated stockholders' equity + noncontrolling interest). While we have changed to a calculation method that better reflects actual conditions, our policy of continuing strict risk control is unchanged. We remain mindful of balancing risk assets and the risk buffer, and at the end of March 2012, risk assets stood at ¥1,294.4 billion, 76% of the risk buffer.

Furthermore, even since revising our investment criteria, we have continued to make investment decisions based on strict adherence with the investment criteria. As a result, we have only invested in highly profitable assets that promise returns above hurdle rates, which are commensurate with the risk of fluctuations in future cash flows, reflecting individual countries and business areas.

Risk Assets at the Fiscal 2012 Year-End

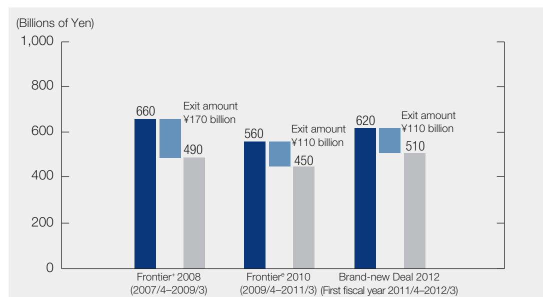


As of March 31

Sustaining High Asset Efficiency by Replacing Assets Flexibly

After investing, we adhere to our policy of exiting from low-efficiency assets that have become less strategically significant or which do not meet certain benchmarks. Our gross investment between fiscal 2008 and fiscal 2012 was ¥1,840 billion, and net investment was ¥1,450 billion. This illustrates that, while proactively investing in growth areas, we have exited from assets worth ¥390 billion. In this way, by controlling risk when selecting assets as well as after investing in them, we are maintaining and enhancing overall asset efficiency.

Replacing Assets Continuously



■ Gross investment ■ Exit amount ■ Net investment

Maintaining Financial Soundness

In accordance with a shift in our focus to proactively seeking new opportunities under "*Brand-new Deal 2012*," we have revised investment criteria. However, our policy of resolutely maintaining financial soundness by implementing the above-mentioned risk capital management and continuing to replace assets is unwavering. Even when making large investments, we will keep net debt-to-equity ratio (NET DER) below 1.8 times, and aim to achieve a credit rating of "A flat" from overseas credit rating agencies following Japanese credit rating agencies*. In conjunction with these efforts, we will carefully monitor the soundness of cash flows.

* Ratings of ITOCHU's long-term debt as of March 31, 2012 are Japan Credit Rating Agency (JCR): AA–, Rating and Investment Information (R&I): A, Moody's Investors Service: Baa1, and Standard & Poor's (S&P): A–.