Special Feature

Roles of ITOCHU Corporation

Because of our financing functions, general trading companies are now frequently compared to venture capital (VC) firms and investment banks. Unlike VC firms, however, we do not just seek out promising new businesses to invest in, and unlike investment banks, we do more than enhance corporate value using various M&A methods such as mergers, acquisitions and spinoffs. A general trading company enhances value from the inside by proactively being involved in the businesses of the companies in which it invests. As part of its involvement, a general trading company seeks the most appropriate business model for each company and provides concrete solutions in a range of areas, from procurement of materials, to sales of products, aiming to implement the best business model. A general trading company works comprehensively to enhance the value of the companies in which it has a stake not only by supporting their production and logistics, but also by cooperating in product development and marketing and occasionally by arranging front-line personnel. Having strengthened management expertise in recent years, we also post management personnel as needed.

Trade

This proactive involvement in businesses is possible with the trading know-how that general trading companies have built up over many years. Having started as traders, general trading companies kept up with the times by gradually expanding our activities from raw material procurement to processing, logistics, and retail. This has not been, however, a simple shift to downstream. By establishing retail bases in department and convenience stores and rebuilding the logistical, processing, and raw material procurement supply chain management to fit consumer needs, we vertically integrate the upstream, midstream, and downstream segments of our businesses. The synergy between the vast amount of business data that this provides and the global network creates an advantage in securing the suppliers and sales routes best suited for our portfolio companies.

Having started in textiles and clothing, which are characterized by low volumes and a large variety of products, ITOCHU is particularly strong in terms of the large number of product items it handles and the breadth of its customer base. In the retail business, which must respond to increasingly specific and diversified consumer needs, our expertise in supplying the best-suited item from the best-suited place in the best-suited way is a major strength. In addition, ITOCHU has used its own resources to launch projects in every area. The experience we have accumulated in this manner has fostered our pioneering spirit, our prominent business know-how, and our sophisticated risk management.

Diversified Functions

There are also businesses that only become possible with the multiple functions and business areas that general, as opposed to specialized, trading companies possess. One example is our Plant Division's US$450 million financing of a plant construction project for a gas field development business in Indonesia. By signing a long-term off-take contract under which the borrower paid back in crude oil which was a substitute for gas, the Plant Division made risk hedge scheme for such a financing and the Energy Division was able to be involved in oil trading business at the same time. Providing a variety of settlement options that are not possible with conventional financing functions creates important business opportunities for us.

Investment

Furthermore, by pursuing a comprehensive involvement, from production to logistics to sales, ITOCHU has enhanced the corporate value of many of its portfolio companies and reinforced overall group profitability.

One example is our investment in the major convenience store chain FamilyMart. ITOCHU acquired the expertise to handle a variety of consumer needs through this investment, as it enabled us to grasp changes in consumer needs in real time and redirect this information to raw material procurement as well as processing and logistics. At the same time, by providing our diverse functions to FamilyMart as a business partner, we were able to increase our profits both from trading activities with FamilyMart and from equity in earnings from associates.

Examples of joint development with FamilyMart include our Food Division's procurement of optimal ingredients for the development of lunch box and other food products, the Realty Division's presentation of properties for store development, the IT and Telecommunications Division's contribution of e-business know-how for new business development, and the Financial Services Division's cooperation in the credit card business. In merchandising, we have been contributing to a sharp reduction in expenses by revising the procurement structure and logistics process. For ITOCHU, this revision simultaneously contributed to rationalizing its upstream to downstream flow including group companies. In addition, our continuous efforts to support FamilyMart's overseas development, in Asia in particular, have contributed to Taiwan FamilyMart Co., Ltd.'s business growth and stock market listing.

Synergy

To summarize, ITOCHU has enjoyed a great synergy between investment and trading when we invest in businesses, which enables us to pursue greater merits than either investment or trading offers by itself. For the companies in which we invest, there is the advantage not only of receiving financing, but also of gaining a powerful business partner for lightening risk burden. It is a way of doing business that enables the building of a win-win relationship for both parties.

Looking Forward

ITOCHU has expanded business by proactively applying this type of business investment in A&P segments. Going forward, we will also apply it to such new technologies as Bio and Nano and to such emerging markets as China. We believe that one of the greatest roles expected of us today is to work with manufacturers to build new business models especially in cutting-edge areas.

ITOCHU's China Strategy

The Potential of the Chinese Market

In the high-growth region of Asia, China in particular is poised for a new round of economic development stimulated by fast growing domestic demand, the deregulation and opening of markets resulting from its entry into the World Trade Organization (WTO). As a result, China is transforming itself from an "export and processing base" into a "promising market." International events such as the Olympic Games, which will be held in Beijing in 2008 and the 2010 Shanghai Expo are likely to accelerate this trend.

As illustrated by the ambitious goal put forth at last year's Plenary Session of the Communist Party of increasing GDP 4-fold between 2000 and 2020, China has taken many steps towards becoming an economic superpower.

ITOCHU's Strengths

ITOCHU had taken the lead on other Japanese trading companies by beginning trades with China before the normalization of diplomatic relations between Japan and China in 1972. Through our consistent trade with China, we have built a solid relationship with its central and local governments ahead of other companies.

In addition, we maintain and reinforce interpersonal exchanges with the upper echelons of government agencies including the Economic Adviser to the Mayor of Beijing (C.E.O., Uichiro Niwa), the Economic Adviser to Qingdao City (Sokichi Sasaki, General Manager for China), and the Economic Adviser to Fujian Province (Fumiaki Fujino, Adviser). With many years of interpersonal exchanges, our China business know-how, and participation in infrastructure construction and important national projects, ITOCHU has built a strong position from which it can gain the trust of the Chinese government. In recognition of ITOCHU's strengths, in December 2002 we received a request from the City of Beijing for comprehensive logistical cooperation. Specifically, this will include proposals for logistical models that can cope with the growth in distribution and transportation volume, the construction of the most advanced distribution centers, and providing know-how. In May 2002, we entered into a comprehensive economic and trade alliance with the Shandong Provincial government. We are making a major contribution to revitalizing regional economies through cooperation that takes full advantage of our functions as a trading company. These go beyond trading and investment support to include management consulting for local companies. In addition to Shandong Province, we plan to promote businesses that leverage ITOCHU's strengths in the Huadong region (Jiangsu Province and Zhejiang Province), Sichuan Province, and Liaoning Province.

In April 2003, we set up a China Market Global Development Office at our headquarters. It will formulate a company-wide China strategy that fits the globalization of Chinese business stemming from China's economic development and WTO membership and that includes the expansion of transactions not only between Japan and China but also between China and other parts of the world, especially Europe and North America. The Office will also promote company-wide sharing of China-related information to create a new business model in China.

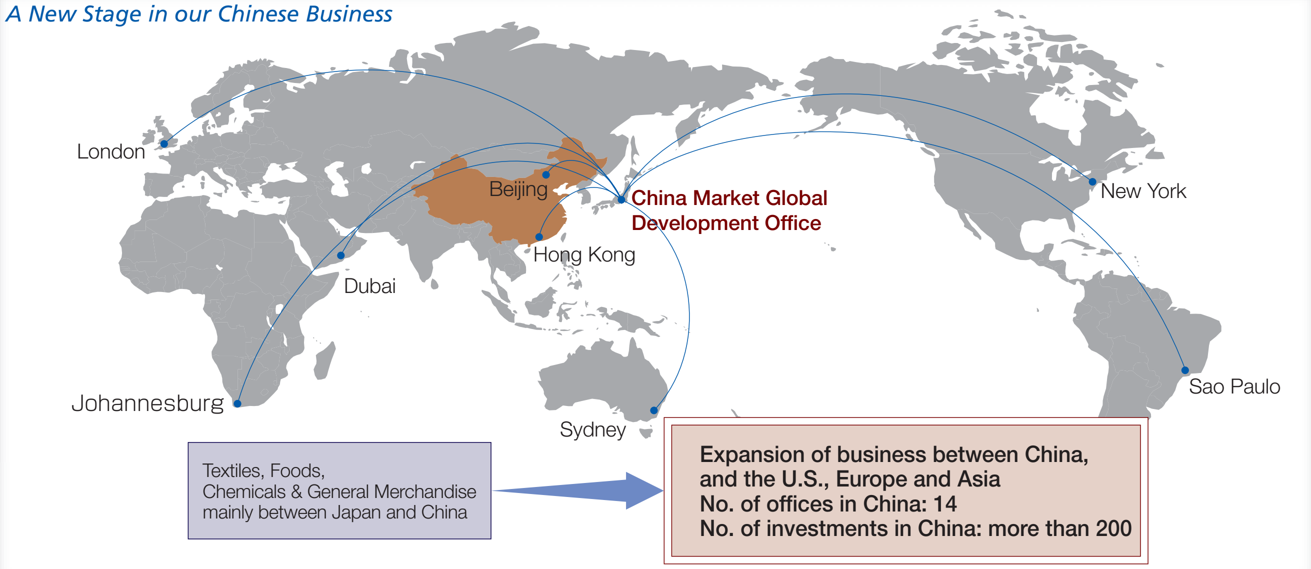
Basic Strategy and Areas of Focus

ITOCHU has accelerated its development of China-related businesses by designating Asia as an A&P region from fiscal year 2003. Our basic strategy for China is to use the synergy of two functions, "trading" and "investment," to focus on trade with Japan and third countries, the domestic sales and distribution business that is adjusting to expanding domestic demand, and large-scale infrastructure projects.

China's service industries and retail market are expected to grow sharply in response to new forms of consumption in areas such as food service, convenience stores, and brand products. As private ownership of cars and homes booms, automobile and housing/construction-related consumption is also expected to expand.

ITOCHU aims to expand trading in these high-growth consumer-related areas where we have expertise. Having established in October 2002 a joint venture for retailing the Italian brand *SASCH*, our Textile Company is already aggressively developing this area. In addition, our Chemicals, Forest Products & General Merchandise Company is considering the development of a home center franchise. In the food-related area, we are expanding processed food and other businesses in Shandong Province and are also developing beer and instant noodle sales throughout

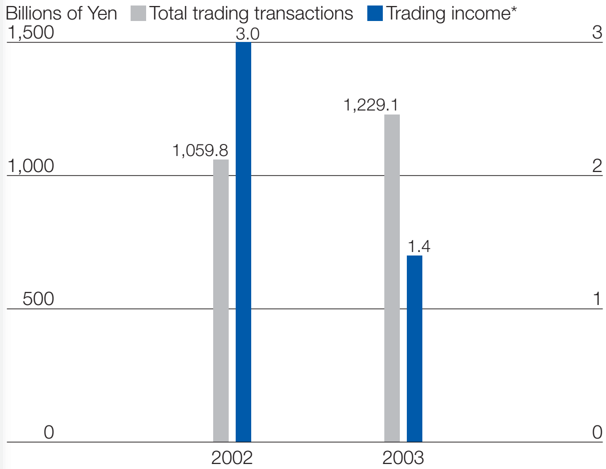
A New Stage in our Chinese Business



China. We are supporting the development of the Chinese market by Ito Yokado Co., Ltd., which currently runs two stores in Beijing and one in Chengdu, and plan to open new stores.

As demand expands and types of retailing change in China, the need to expand and enhance logistics becomes more and more critical. Moreover, there is also increasing demand for more sophisticated logistics to facilitate exports to Japan, Europe and North America. Capitalizing on this opportunity, ITOCHU is expanding logistics-related businesses in China through our subsidiaries, Beijing Pacific Logistics Co., Ltd. and Guangzhou Global Logistics Corp., and exporting and importing activities through subsidiary i-LOGISTICS CORP. As part of this expansion, in September 2002, ITOCHU built China's largest chilled and frozen logistics center in Shandong Province as an export base for frozen foods headed for Japan.

Financial Results of China Segment



Do not include associated companies. Years ended March 31

Investments in prominent projects are also crucial for further growth. We are considering investing in infrastructure businesses in Beijing related to the Olympics. We are also involved in Japanese government ODA and other large-scale projects for regional transportation, environment infrastructure, and energy and natural resource development.

Numerical Targets

In fiscal year 2003, our trading volume with China was US$4.5 billion and we had approximately 210 joint ventures in the country. While we have always been a step ahead of competitors in terms of trading and investments there, we will focus more on capital efficiency from now. Our consolidated net income from China (subsidiaries, associated companies, and overseas trading subsidiaries) including Hong Kong exceeded ¥2.0 billion in fiscal year 2003, and our target in fiscal year 2005 is to generate half of our expected ¥12.0 billion consolidated net income for the Asian region from China.

Commercialization of Innovative Technologies – Creating New Businesses –

The ITOCHU Group is accelerating its drive to develop new revenue sources through the commercialization of innovative technologies. A company-wide, cross-divisional organization, the Innovative Technology Business Development Office, plays the key role in identifying promising technologies worldwide and pursues the commercialization of new businesses in collaboration with the Division Companies.

Global expectations are high for the manufacturing of machinery on the nanometer (10^{-9} meter) scale and for developing applications ranging from information and telecommunications to medicine; biotechnology possesses the potential to administer personalized medicine, having no side-effects and optimized for individual genetic make-ups, and tissue engineering, generating cells and tissues to repair or replace damaged human organs. In Japan alone the size of the nanotech market is anticipated to grow to ¥27 trillion, and the biotech to ¥25 trillion, in the year 2010.

However, innovative technologies will not grow into big businesses on their own. It is necessary to adapt them strategically into new products and services that become parts of our daily lives. ITOCHU, a highly diversified company, leverages its multifunctionality to generate business from potential technologies developed at research institutions it has strategic relationships with. ITOCHU's strong presence in IT and in consumer and retail-related sectors presents us with a tremendous business opportunity.

Bioinformatics Center

The ITOCHU Group demonstrates its strength in the field of bioinformatics where IT and biotechnology meld, through its leading group companies, ITOCHU TECHNO-SCIENCE Corporation (CTC) and CRC Solutions Corp. In April 2002, we established the Bioinformatics Center to provide data analysis and management services to support genomic drug discovery of pharmaceutical companies. Currently, major pharmaceutical companies such as Shionogi & Co., Ltd. and Tanabe Seiyaku Co., Ltd. have joined the center.

Wireless IC Chip "μ-chip"

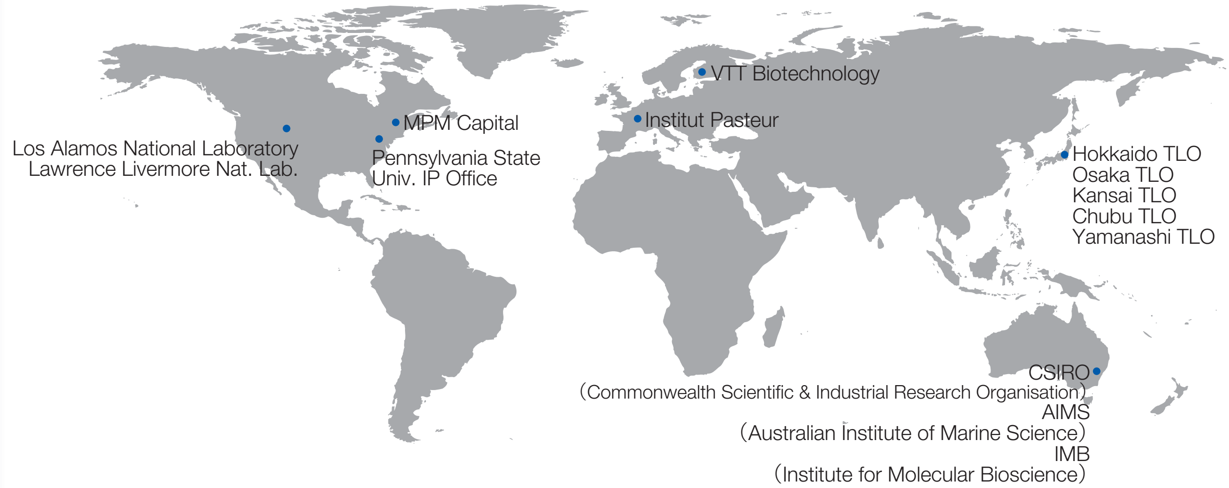
ITOCHU teamed up with Hitachi Ltd. in March 2003 for the development of practical applications for Hitachi's "μ-chip," the world's smallest wireless IC chip. With our strong presence in IT and foods and textiles, among other consumer goods, we will be able to outpace the competition in the dissemination of "μ-chip" and establish them as the de facto industrial standard. Currently we are testing the effectiveness of "μ-chip" in brand protection, distribution and inventory control, by embedding the chips in ITOCHU handled apparel products or price tags. In the steel sector, Marubeni-Itochu Steel Inc. has co-developed and begun sales of trial products of a steel materials inventory management system using these chips.

Functional Foods Business

ITOCHU has a competitive advantage in the food related sector where we are focusing on the development of functional foods in response to the growing importance of preventive medicine as society continues to age. We are developing functional foods business in cooperation with Australia's largest research organization, CSIRO, and Finland's VTT Biotechnology.

ITOCHU is securing access to "seeds" of innovative technologies through strategic alliances with overseas partners, and within Japan, serving as a one-stop channel to the Japanese market for our partners around the world. ITOCHU promotes the development of new joint businesses by matching our partners' "seeds" to the "needs" of the market in each and every industry.

Strategic Partnerships



(Name, Country, Date of alliance)	(Features and ITOCHU's strategy)
Los Alamos National Laboratory **Lawrence Livermore National Laboratory** USA (Autumn 2002)	Core laboratories of the U.S. Department of Energy's eight national laboratories. Reputed as the brains of the U.S., they cover a broad area of research, developing technologies for the future 20 years ahead. ITOCHU will introduce these technologies to Japanese companies and function as the intermediary for their commercialization. We may also consider investments in the national laboratories' innovative technologies or joint ownership of intellectual properties, as well as investments and/or collaborative businesses with their spin-off ventures.
CSIRO Australia (September 2002)	ITOCHU, having worked with Australia's largest research organization, CSIRO, since 1996, has entered into a five-year letter of intent to form a closer long-term strategic alliance focusing on innovative technologies.
MPM Capital USA (June 2002)	World's largest biotech venture capital firm. ITOCHU, as a Special Limited Partner, has committed a $20 million investment to a MPM biotech fund, which is operated as part of a $900 million fund. ITOCHU seeks to develop biotech businesses in the Japanese market based on highly promising deal flows.
VTT Biotechnology Finland (February 2002)	Largest biotech research institute in the Nordic countries, operated under Finland's Ministry of Trade and Industry. VTT Biotechnology is leader in the study of functional ingredients derived from wheats and berries. Their research focuses include maintenance and improvement of gut health and antioxidants. ITOCHU will mediate between VTT Biotechnology and Japanese food manufacturers for joint development of novel functional food products.
CSIRO, AIMS, IMB Australia (March 2001)	Our alliance with these three Australian research institutes in biotechnology focuses on commercializing their research in the fields of agricultural and food related biotechnology, marine resources and bioinformatics.
Pennsylvania State University **Intellectual Property Office** USA (December 2001)	Pennsylvania State University is among the top five or six American universities in the fields of biotechnology and nanotechnology. Our alliance with its intellectual property office aims at utilizing University proprietary technologies in the development of new businesses.
Institut Pasteur France (December 2001)	World's most prestigious bioscience research institute, ranks second in the number of technology transfers to industry in the field of microbiology. Our focus is on bringing the institute's technologies to the Japanese market.
Japanese University TLOs** (2001-2003)	We have formed alliances with five regional TLOs, representing a total of 30 major universities, for the commercialization of their technologies.

**A TLO (Technology Licensing Organization) patents university inventions, transfers them to companies, devotes related income to further research, and generates new inventions, thereby creating a cycle of intellectual creation. In Japan, the establishment of TLOs is supported through the Law promoting Technology Transfer from Universities to Industry which was enacted in August 1998.

New Management Benchmark – Promoting Risk Capital Management –

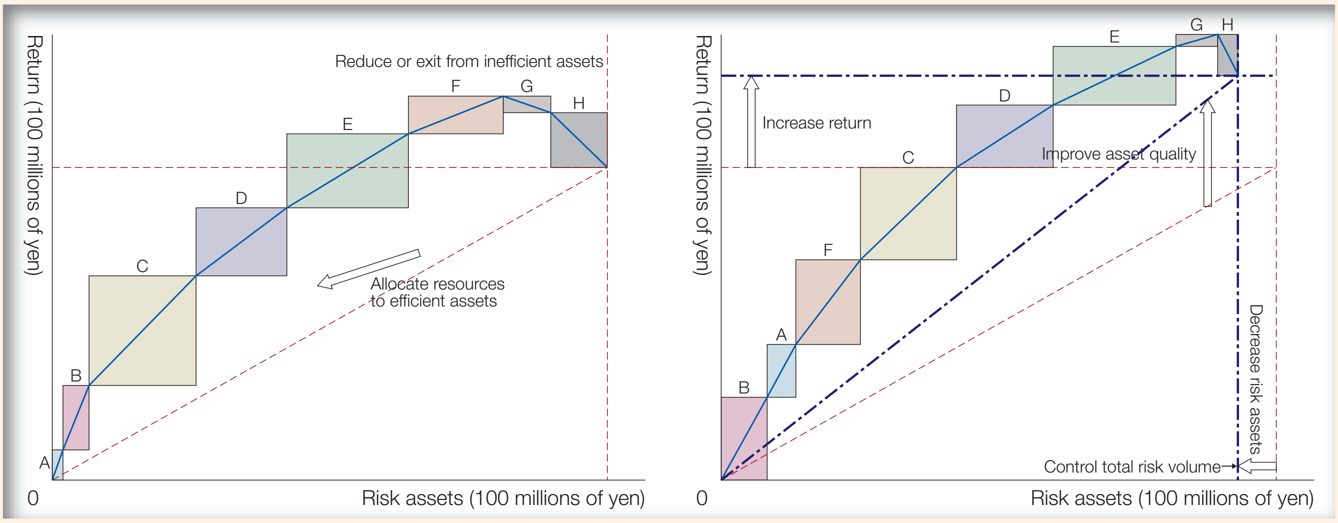
By introducing Risk Capital Management (RCM), a management tool focusing on risk as its key concept, ITOCHU is exiting from inefficient assets and allocating resources to efficient assets to enhance corporate value. RCM is designed to control total risk volume by quantifying risks as risk assets (note 1), and to measure asset efficiency in Risk Return Index (RRI) (note 2), which is return on risk assets.

By segmenting the business areas of Division Companies into business units according to the each business's attributes, we measure and analyze the asset efficiency of each business by using the RCM method. In addition to estimated market growth potential, RRI is used as a criterion for optimizing resource allocation.

Specifically, for each Division Company, we create a graph (note 3), whose example is shown in Graph 1. This graph arranges segments in descending order of efficiency from the left, showing risk asset volume, return (net income), and asset efficiency (RRI = diagonal line) for both each business unit and the Division Company as a whole. In this example, inefficient businesses (ex. G, H) on the right of the graph will basically be subject to a strategy of downsizing or withdrawal, unless growth is expected. Eventually we will reduce assets or exit from inefficient businesses. The resources that are recovered through this process will then be reallocated to new strategic projects to increase the efficient assets (ex. A, B) on the left. By shifting assets in unprofitable business areas to new strategic business areas, we aim to improve overall profitability and enhance corporate value. At the same time, setting a risk asset limit as a covenant, or item to be monitored, for each Division Company, we control total risk volume (risk asset amount), for new investments as well as for existing businesses.

By doing the above activities, we are promoting the Super A&P strategy, in which we accelerate reallocation of assets to shift management resources selectively to more efficient business areas.

Graph1: Example of a Division Company



Note 1: Risk Assets

Risk assets represent the maximum amount of the possible loss caused by the held assets. Statistical methods are used to measure risk weight of each asset according to its attributes and risk assets are then calculated by multiplying asset amount by risk weight. Not only assets on the balance sheet, but guarantees, foreign exchange balances and other off-balance sheet items are subject to this risk asset evaluation and included in the total risk assets.

(Examples)

- •Trade receivables: Each customer is assigned a credit rating based on its financial data, and a risk weight is assigned to each customer based on the credit rating, which is linked with its default rate. Risk assets are then calculated in consideration of collateral and other security. The same method is applied to loans and guarantees.
- •Listed stocks/Land: Risk weight is calculated based on the volatility of stock prices or land prices.
- •Associated company investment: Risk assets are calculated by multiplying risk asset volume of the associated company, which is calculated by each asset account, by ITOCHU's share.
- •Inventories: Risk assets are calculated for the book balance of the item by assigning risk weight based on market price volatility. Risk assets for inventories with sales contracts are calculated by assigning risk weight that considers the probability of cancellation, as well as market price volatility.

Note 2: Risk Return Index (RRI)

Risk Return Index (RRI) = Net income ÷ Risk assets

RRI is used to measure efficiency in comparison with cost of equity. Cost of equity is currently set at 8%. Units with RRI over 8% and ROA over 2% are considered efficient segments.

Note 3: Graph

This graph plots returns (net income) on the vertical axis and risk assets on the horizontal axis. The diagonal line shows RRI.

Please see page 66 of Financial Section for the overall Company's risk management system and methods for managing market, credit, country, and investment risk.

Retirement Pension Plan Reform

In the two years since fiscal year 2001, ITOCHU's consolidated net cost of retirement and severance benefits increased from ¥12.4 billion to ¥22.7 billion, heavily impacting ITOCHU's consolidated financial performance. As ITOCHU Corporation (non-consolidated basis) accounts for most of this, we decided to revise the retirement and severance plan for ITOCHU Corporation employees as follows.

ITOCHU Corporation's retirement and severance plan consists of two pension plans: an employee pension fund and a tax-qualified pension fund. As of the end of fiscal year 2003, projected benefit obligations (PBO) totaled approximately ¥290 billion, assets under management totaled approximately ¥160 billion, and pension trusts totaled approximately ¥130 billion. (Non-consolidated Japan Accounting Standard: Hereinafter all figures are based on non-consolidated Japan Accounting Standard.)

In order to cope with the deterioration in the fund operating environment and with changes such as the introduction of retirement benefit accounting, ITOCHU took steps to ensure the health of pension finances. These steps included the reduction of PBO by, in October 1999, lowering the defined interest rate for the future benefit payment (from 5.5% to 3.5%) and extending the guarantee period (from 15 to 20 years); in September 2000, the establishment of a pension trust in order to make a one-time amortization of the underfunding resulting from the introduction of retirement benefit accounting (¥45.8 billion of net projected benefit obligation (actuarial difference) caused by a change in accounting standard), and the additional contribution to pension trust.

Subsequently, however, due to the prolonged slump in the asset management environment, operated pension asset resulted in negative returns for three years in a row. Also, because of the lowered interest rate, ITOCHU changed the discount rate. In addition, the prices of the stocks in the trust fell. Thus, from fiscal year 2001 through fiscal year 2003, these factors resulted in a total unrecognized actuarial loss (unamortized obligation) of more than ¥200 billion. Judging that there should be limits to how long the retirement and severance plan could last in its existing scheme, given the harshness of the environment, we decided to make a fundamental review of the system.

In fiscal year 2000, we introduced a new human resources management system with remuneration packages based on job responsibility and performance. The retirement and severance plan, however, continued to be based on "years of employment" and "age." It remained a major issue to revise the plan into a more flexible system based on the principles of the new human resources management system.

From fiscal year 2002, in response to the increased number of options for retirement and severance plans by the expected enactment of a series of bills related to retirement and pension systems, ITOCHU began a full-fledged study for a revision of the plan.

The aim of this revision is to minimize the impact of the retirement and severance plan on our management by reducing PBO or lowering PBO risk. In terms of specific changes to the plan, we aim to develop a structure that incorporates the principles of the new human resources management system and respond to the diversification of employees' values.

Negotiations with the labor union on revision of the retirement and severance plan began in August 2002 and culminated in an agreement in March 2003. The agreement seeks to reduce the risk that has hitherto been entirely on the Company's shoulders by dividing it; a portion of the risk will return to the government, a portion will be carried by each employee, and the concept of "market linkage" will be introduced to the portion that the Company continues to bear. Specifics are as follows.

1. ***Returning the public pension portion held by the employee pension fund to the government:*** Returning the future portion has already been authorized and relevant records are being prepared for returning the current and past portions. Returning the public pension portion to the government will eliminate risk for approximately ¥37 billion worth of PBO (as of end of fiscal year 2003).
2. ***Revising the supplementary portion of the employee pension fund:*** When the past public benefit portion is returned to the government, we will introduce a "cash balance plan" that links benefit amounts to market interest rates. This will lower interest rate sensitivity and enable the lowering of asset management hurdles for about ¥190 billion worth of PBO (as of end of fiscal year 2003) for the supplementary portion of the employee pension fund, and thus will minimize the risk for the maintenance and operation of the plan. In addition, although benefits are currently paid entirely as perpetual annuities, we plan to make some portion terminable, expecting to reduce PBO and lower asset management risk.
3. ***Revising tax-qualified pension:*** After reducing the future portion of the tax-qualified pension, in July 2003 we will introduce an "optional defined contribution pension plan." This gives employees the option of receiving the Company's contribution through the "defined contribution pension" that employees manage on their own or as an addition to their monthly salary. The introduction of this new system will not bear PBO.

Summary of ITOCHU Corporation's Retirement Pension Plan Revision

	Old Plan	New Plan
1. Employee Pension Fund (Public Pension Portion)	Perpetual	Returned to government
2. Employee Pension Fund (Supplementary Portion)	Perpetual annuity guaranteed for 20 years Defined interest rate: 3.5%	Introduction of Cash Balance Plan Some portion changed to be terminable
3. Tax-Qualified Pension	Terminable annuity guaranteed for 20 years Defined interest rate: 3.5%	Some portion changed to defined contribution pension