

SPECIAL FEATURE



The Symbol of Our Strong Determination: “+”

Straight Talk from the President—Frontier+ 2008 and the Road Ahead for ITOCHU

Eizo Kobayashi

President and Chief Executive Officer

We are certainly not complacent about our present condition, and we are beginning to sketch out more ambitious plans and a grand design to advance our operations.

The “+” in Frontier+ 2008 signifies our determination to progress further and to take aggressive business, solid management, and human resources development to the next level.



REVIEW OF FRONTIER-2006

“Quantitative targets were achieved, but qualitative issues remain.”

After recovering from challenging circumstances in the late 1990s, ITOCHU emphasized “solid management” through to the implementation of its Frontier-2006 mid-term management plan. In that sense, Frontier-2006 marked an important turning point for the Company. Under the plan, while strictly enhancing solid management, we shifted to a more aggressive business stance, and in the final year of the plan we achieved net income well above our original target. We also made significant progress in strengthening our financial position. Although there was still room for greater improvement, our ability to clear the quantitative targets set under Frontier-2006, even while absorbing the Orico-related losses, has deepened my confidence in ITOCHU’s basic earning power.

On the other hand, the qualitative results present quite a different picture to the quantitative results. Under Frontier-2006, net investment was ¥310 billion, significantly surpassing the original target. Our evaluation is that we maintained a well-balanced allocation of investment among the priority areas: the Consumer-Related sector, the Natural Resource/Energy-Related sector, and other key sectors. However, the question remains whether our upfront investments to make ITOCHU an attractive growth prospect were sufficient.

On the human resources front as well, progress has not been sufficient. ITOCHU does business on a global basis, but for several years we have been aware that our human resources development has not kept pace with our globalization. Since 2004, we have implemented our “Promotion Plan on Human Resource Diversification.” However, if we look at the number of women in the management layer, or ask ourselves about the kind of positions held by overseas employees, we cannot say that the present level is satisfactory.

To sum up our achievements in the past two fiscal years, the results at the visible, quantitative level can be judged satisfactory. At the qualitative level, despite many initiatives that can be highly evaluated, a number of basic issues remain.

MAIN OBJECTIVES OF FRONTIER+ 2008

“We will make constant efforts to realize improvements daily.”

Frontier+ 2008—Enhancing Corporate Value on the World Stage includes a range of strategies that are designed to address the unresolved issues that have carried over from Frontier-2006. If we look at Japan’s present economic structure, it is likely that the economy will grow at about 2% annually, a low growth rate characteristic of an advanced nation. So, for ITOCHU to achieve sustainable levels of high growth, it must move its earnings base overseas. Under Frontier+ 2008, we will therefore invest overseas more than ever before, with the aim of attaining continuous earnings from overseas of over ¥100 billion a year. An indispensable factor in meeting this target is the utilization of our human resources in every country.



Unfortunately, in this respect, ITOCHU does not compare well with European or U.S. companies, which implement truly borderless strategies for business development.

Looking at our operating branches and offices worldwide, the management layer is almost exclusively Japanese. To become a company that is recognized around the world—a truly global enterprise—we must not only raise earnings in global markets but also develop and utilize a management layer that is drawn from all our international personnel. During the two-year period of Frontier⁺ 2008, I want to create a system whereby personnel from around the world are energetically introduced into our management layer in the major overseas Group companies and at ITOCHU Headquarters.

The “+” in Frontier⁺ 2008 signifies our determination to make even greater progress than we did under Frontier-2006 in the areas of aggressive business, solid management, and human resources development. Our objective of becoming a truly global enterprise is not something that can be achieved in a day. We will devote all our energies to its attainment by making step-by-step improvements on a daily basis.

DEVELOPMENT OF NEW BUSINESS AREAS

“We will pioneer L-I-N-E-s sectors and nurture them to develop into future business pillars.”

In line with the Frontier⁺ 2008 guiding principle of “Create New Initiatives,” we are making concerted efforts to develop new business areas. In the Life & Healthcare sector, as Japan’s society ages, it is estimated that the potential market for business related to medication, functional food, preventive medicine, medical care, and healthcare is about ¥60 trillion. ITOCHU already has more than 20 departments working in these areas, generating sales of roughly ¥100 billion. However, if we implement horizontal integration, I believe we can create even greater synergies.

Functional Infrastructure comprises IT, which is used to make commercial transactions more efficient; Logistics Technologies, which are logistics networks created by logistics services companies; and Financial Technologies, which are utilized primarily for trading company finance. As a general trading company, ITOCHU has worked over a long period of time to refine its expertise in each of these areas, and they may be termed unique strategic tools for the Company.

By integrating this Functional Infrastructure with the social infrastructure of local municipalities, we can promote the creation of highly sophisticated commercial infrastructure networks. Another possible application of Functional Infrastructure is to construct new value chains in regions where infrastructure is still not fully deployed.

We also position biotechnology as an area with significant potential. In step with the development of IT, there has been startling progress in technology related to human genome analysis and genetic information. Application development for nanotechnology is also progressing rapidly, as business, academic institutions, and the public sector partner to pursue research. Estimates suggest that, by 2010, the scale of the biotechnology market could be ¥25 trillion, while that of the nanotechnology market could be ¥27 trillion, testifying to the extremely fast growth in these areas.

We also foresee many business opportunities in areas related to the environment and energy conservation, which constitute the greatest challenge in the 21st century.

We will work to develop new businesses in these sectors, which we term as L-I-N-E-s sectors, and nurture them to become independent business divisions or companies.

CRITERIA FOR INVESTMENT DECISIONS

“We will execute strict risk control based on our unique investment criteria.”

While accelerating the shift to aggressive business, our investment decisions continue to be based on the strict and cautious selection of profitable projects. As a general trading company, ITOCHU is subject to various risks, including market risk and credit risk. To counter these risks, ITOCHU has adopted the Risk Capital Management method and uses the Risk Return Index (RRI) to measure return on risk assets where risk has been quantified. By employing these methods, we measure the efficiency of assets and allocate resources to highly efficient assets.

We define the characteristics of each Division Company’s business field and then strictly select projects where the RRI exceeds 8.0%. In addition, we also apply a range of criteria that must be cleared to give a multifaceted investment judgment, including ROA and income scale. For overseas investment, we are enhancing the precision of our investment judgment by taking into account foreign exchange risk as well as the hurdle rate for each country.

We will apply Exit Rules to companies that we have little reason to hold. By that I mean companies that are making losses, companies that have low efficiency despite being profitable, or companies that have low strategic importance. In this way, we will improve asset efficiency as well as revenue and earnings company-wide.

BUSINESS PROCESS RE-ENGINEERING AN ENDLESS TASK

“We will actively promote the ITOCHU DNA Project.”

Since April 2006, we have been promoting the ITOCHU DNA Project—Designing New Age—. This project concentrates on business process re-engineering and aims to reinforce the “power and ability of each of our organizations,” which is a key factor in determining the competitiveness of general trading companies.

The project enhances the visualization of operational processes, examining routine tasks in order to standardize or integrate them, and promotes more efficient, higher-quality, and speedier operations. Such improvements can raise the overall competitiveness of ITOCHU as an organization—for example, bringing out extra marketing power in a sales division or promoting the specialization of administrative staff. ITOCHU is celebrating its 150th anniversary, and we will deepen this ongoing initiative in order for us to enjoy another 150 years of successful business.

STRATEGY FOR RETAIL FINANCIAL SERVICES

“Our spirit is to overcome challenges and strive for further growth.”

In 2005, ITOCHU acquired 21% of the common stock of Orient Corporation (Orico). The move was designed to enhance ITOCHU’s presence in the payment solutions area of its strong Consumer-Related sector and to expand operations into the credit card business. Under the revised Moneylending Control Law in Japan, Orico posted a significant loss associated with setting up an allowance for losses on interest repayments and recorded a net loss. ITOCHU believes that Orico has resolved future concerns by recording these losses and through the full support of the Mizuho Financial Group.

With 680,000 member stores, a 24-million customer base, and considerable know-how, Orico is an important strategic partner for ITOCHU in the retail finance area. Furthermore, in May 2007, ITOCHU subscribed for a ¥30 billion third-party allotment of preferred shares from Orico, and on this occasion ITOCHU agreed to consider forming a strategic business alliance with the Mizuho Financial Group in order to strengthen its strategy for retail financial services. In particular, we intend to promote business in the card sector, a key infrastructure area for retail financial services, through a strategic alliance with the Mizuho Financial Group. At present, we are exploring the possibility for ITOCHU to participate in the third-party credit-card processing business of Mizuho Financial Group subsidiary UC CARD Co., Ltd. ITOCHU and the Mizuho Financial Group will also discuss the establishment of new financial businesses through the full utilization of their respective business channels and customer base resources.

Through such measures, we have transformed the challenge of the revised Moneylending Control Law into an opportunity to expand our business. And we will continue to accelerate our strategy for retail financial services.

BASIC DIVIDEND POLICY

“We aim to further increase the consolidated dividend payout ratio.”

ITOCHU uses retained earnings to replenish stockholders’ equity to promote its growth strategy as well as to maintain and reinforce its competitive power. ITOCHU’s basic policy regarding dividend payments calls for giving consideration to consolidated performance and maintaining a stable distribution of returns to stockholders. During Frontier⁺ 2008, we aim to replenish non-consolidated stockholders’ equity while progressively increasing the dividend and increasing the consolidated dividend payout ratio. We made an annual dividend payment of ¥14.00 per share in the fiscal year under review, and our intention is to raise this by ¥3.00, for a dividend payment of ¥17.00 per share for the fiscal year ending March 2008.



RISK MANAGEMENT FOR NATURAL RESOURCES AND ENERGY PRICE FLUCTUATIONS

“We will cautiously ascertain investment value.”

For coal and iron ore, there is increasing demand from China and other emerging markets, and we do not expect demand to fall significantly. For crude oil and LNG, supply-side surplus production capacity has stabilized, so overall we expect the current price levels to continue. On the other hand, we take account of geopolitical risk and risk related to fluctuations in the supply-demand balance of natural resources and energy. We carefully calculate future cash flow when evaluating new projects, and we strictly select projects that meet our investment criteria. Also, we try to lengthen the period of contracts in order to lighten price fluctuation risk.

FUTURE ROLE OF GENERAL TRADING COMPANIES

“In a period of great change, general trading companies can take the initiative.”

I believe that great business chances are coming the way of general trading companies. Functional specialization is proceeding in many industries at a speed never seen before, and this trend is deepening both domestically and overseas. This gives general trading companies a distinct advantage as they can create business synergies from their know-how and networks, which span many business areas.

General trading companies have functional infrastructure, which they have nurtured in value chains that extend from upstream to midstream and downstream. This infrastructure can give them the advantage to take the initiative in many sectors. To give the example of a company that sells certain commercial goods. When the company completes a sale of commercial goods, its commercial activities in that area come to an end. ITOCHU, on the other hand, has staff with rich know-how that can use this as a starting point for further business development. We can create a new framework, constructing networks based on IT and logistics technology. We are also able to participate in the management of stores, which are in direct contact with consumers.

In this period of dramatic change, as social and economic systems become increasingly complex, the ability of general trading companies to take multiple initiatives across a wide range of sectors is a considerable strength. And there will be greater opportunities in the future.



FUNDAMENTAL STRENGTH OF ITOCHU

“Our dominant positions are in clothing, food, and housing—areas that support daily life.”

Many people would identify ITOCHU’s core competence as textile trading, which Chubei Itoh founded 150 years ago. As our business developed from this origin in textiles, we moved into the clothing, food, and housing areas, and the inheritance of this base of operations is our current strength in the Consumer-Related sector. In clothing and textiles, we are placed well in advance of our competitors. Our business ranges from the procurement of textile raw materials to high-value-added brands and advanced technology. We have a portfolio of more than 100 powerful brands, and our know-how and value chain stretches from discovering exciting brands to marketing. In food, we are promoting our Strategic Integrated System (SIS), a supply and demand system based on customer needs, and we now have an overwhelmingly dominant position in the upstream, midstream, and downstream sectors. In housing, we have established a commanding position in building materials, particularly in Japan and the United States. Furthermore, we are displaying our strengths in the IT, multimedia, and financial services sectors and continually creating new businesses. These are the advantages that clearly differentiate us from competitors. At the same time, our strength lies in our earnings structure, which is well balanced across segments.

PROSPECTS FOR ITOCHU

“Our profile needs to change from a microcosm of the Japanese economy to a microcosm of the global economy.”

In the past, general trading companies were often described as microcosms of the Japanese economy. However, ITOCHU is now seeking to become a microcosm of the global economy. To achieve this, we first have to take a commanding view of the world economy and be acutely aware of which sectors are growing and what our mission should be. Then, we need to strengthen our decision-making power in order to make appropriate investments within carefully considered regions and time frames.

The current earnings level, when contrasted with our future image of ITOCHU, cannot be described as satisfactory. Frontier* 2008 maps out the way forward for realizing our future image of ITOCHU, which has an earnings level of a different dimension.

I believe that our present financial position and earning power give us the perfect opportunity to step onto the world stage and become a truly global enterprise.