# To Our Stakeholders

President and CEO Motoyuki Oka

Fiscal year 2004 was an epoch-making year for Sumitomo Corporation, in terms of achieving a risk-adjusted return ratio* of 7.5%—a target since fiscal year 1999. With the results of reforms implemented to date, we are now at the stage of creating corporate value in excess of shareholders' capital cost.

To generate greater value as we move into the future, our task now is to broaden our business base while securing profitability in excess of shareholders' capital cost.

By further expanding our businesses, we will realize greater "prosperity and dreams" for all stakeholders, including shareholders, business partners, employees, and society in general—and thus maximize the value of Sumitomo Corporation.

## Fiscal Year 2004 in Review

### Second Successive Year of Record-High Profits

In fiscal year 2004, ended March 2005, the Sumitomo Corporation Group reported consolidated net income of ¥85.1 billion, up 28% from the previous year and a record-high level for the second consecutive year. Basic profit,** a measure used to assess earning power, jumped 65%, to ¥110.0 billion. All Business Units posted higher basic profit, each steadily reinforcing its existing earnings base and securing new earnings base through acquisitions and other means, while also taking advantage of global economic growth.

### Steady Growth in Each Segment's Earnings Base

Let's take a look at some businesses that contributed significantly to results in each segment. These include steel service center operations, centering on Asia (Metal Products), automobile businesses in Japan and elsewhere in Asia (Transportation & Construction Systems), and power plant EPC business (Machinery & Electric). Other solid performers were our media business (Media, Electronics & Network), copper and gold mining project and coal business (Mineral Resources & Energy), food supermarket operations, including Summit, Inc. (Consumer Goods & Service), and condominium sales (Materials & Real Estate). Overseas, our metals and chemicals trading business performed well, mainly in the United

*Risk-adjusted return ratio = A measure of the profitability of a business against the risks involved in it. It is calculated as a fraction whose numerator is the return on the business as measured by the consolidated net income (after taxes) during an accounting period, and whose denominator is the value of the maximum losses that could be incurred if all the potential risks were actually to occur during the same period ("risk-adjusted assets").

** Basic Profit = (Gross profit - Selling, general and adminstrative expenses - Interest expenses, net of interest income + Dividends) x (1-Tax rate) + Equity in earnings (losses) of associated companies, net
(Tax rate was 42% for the years through fiscal year 2003, and 41% for fiscal year 2004 and after)

States. In addition, acquisitions made during the fiscal year—such as The Hartz Mountain Corporation, a pet care business—made a swift contribution to our results.

### Stronger Financial Position

Total assets at fiscal year-end were ¥520.7 billion higher than a year earlier. This stemmed from a rise in operating assets resulting from increased trading transactions, as well as strategic investments. Total shareholders' equity grew ¥204.0 billion, due to increased earnings and the issuance of new shares in July 2004, raising the shareholders' equity ratio to 16.9%, up 2.3 percentage points from previous year-end. Total interest-bearing liabilities (net) remained mostly unchanged (edging down ¥1.6 billion), and the debt-equity ratio (net) declined to 2.5 times, from 3.3 times a year earlier. In summary, therefore, we further reinforced our financial position. Moreover, the substantial increase in net income exceeded the rise in shareholders' equity stemming from the share issue and retained earnings, improving return on equity (ROE) by 0.3 percentage point, to 10.2%.

Not only the favorable external environment, but also resolute actions to broaden our earnings base, represented the driving force behind our record-high profits.

## Progress and Results of Management Plans

### Improved Profitability and Broader Earnings Base

In fiscal year 1999, when it commenced its management reforms, Sumitomo Corporation had a number of unprofitable businesses and financial performance was ailing, after facing difficult conditions stemming from the Asian currency crisis and instability in the domestic financial system. Our first challenge, therefore, was to improve profitability. We set a risk-adjusted return ratio target of 7.5% to cover shareholders' capital cost, regarding this target as a necessary requirement for a "leading global company." We began by comprehensively cutting unprofitable businesses and replacing our assets to improve our corporate strength amid a depressed domestic economy and deflationary factors. Under the AA ("Approach for Achievement") Plan, covering fiscal years 2003 and 2004, we switched to an offense-oriented approach and focused on increasing profitable assets, with a view to further boosting profitability while strengthening our business base.

### Achievement of Risk-Adjusted Return Ratio Target

Our reforms did not always proceed smoothly. In the first four years, in particular, business conditions were tough for Japanese companies, who faced major obstacles. When our Reform Package began in fiscal year 1999, our risk-adjusted return ratio was 3.7%. However, under the Step Up Plan, which started in fiscal year 2001, the ratio at one time fell to 3.0%, due to a drastic stock market decline and depressed real estate prices. Despite the challenges, we steadily enhanced the quality of our portfolio, and under the AA Plan, which began in fiscal year 2003, we achieved a risk-adjusted return ratio of 8.2%—exceeding our 7.5% target with the fair wind of a turnaround in operating environment.

By consistently pursuing reforms despite the challenging operating environment, we achieved profitability in excess of shareholders' capital cost.

### Broader Earnings Base and Stronger Corporate Strength—Growth through Both Offensive and Defensive Strategies

Our record shows that our growth has been well balanced between expansion of our earnings base and reinforcement of our corporate strength. Between fiscal year 1999 and fiscal year 2004, total assets grew from ¥4,904.6 billion to ¥5,533.1 billion, a 13% increase. During the same period, total shareholders' equity increased from ¥629.8 billion to ¥934.9 billion, a 1.5-fold rise, and net income surged 2.6-fold, raising ROE from 5.4% to 10.5%—almost double. Meanwhile, we reduced net interest-bearing liabilities, from ¥2,503.8 billion to ¥2,376.0 billion, improving our debt-equity ratio (net) from 4.0 times to 2.5 times. In addition to the net income increase, we raised approximately ¥100 billion by issuing new shares in July 2004. As a result, our financial position has been fortified. Thus, we have built a solid foundation for further increasing profitable assets and expediting growth strategies.

### Progressive Improvements in Management Quality

The results of our management reforms are not limited to improvements in quantitative areas. Back in 1999, we introduced the risk-adjusted return concept, an innovative indicator for companies at the time, and sought to enhance our own management. To ensure stability, we embraced a management policy of balancing company-wide risks and buffers. According to risk-adjusted return measurements, we then efficiently allocated management resources and introduced business portfolio management based on "Plan, Do, and See" cycles. While steadily improving our financial performance by broadening our earnings base, we strove to reinforce our corporate strength and successfully built a framework allowing sustained growth into the future. These achievements represent the progress of our reforms implemented to date.

Sumitomo Corporation's reforms have brought not only quantitative improvements but also progresses in advancing management quality and forming a framework for sustained future growth.

## Overview of New Medium-Term Management Plan: AG Plan

### Expand Business Scope While Maintaining Profitability

The AG ("Achievement & Growth") Plan, our new medium-term management plan, covers fiscal years 2005 and 2006. Under the plan, we are targeting net income of ¥230 billion (two-year total). Building on progress made by the previous AA Plan, through which we raised the risk-adjusted return ratio by increasing profitable assets, we will accelerate expansion of our earnings base, aiming for further growth while securing a risk-adjusted return ratio of 7.5%.

### Important Steps for Stronger Future Growth

To maintain strong growth in the future, our important task is to broaden our business base. Under the AG Plan, nine Business Units will secure risk-adjusted returns of 7.5% and put their dynamic growth strategies into action. Each Business Unit will proceed with strategic investments and replacement of assets depending on their specific conditions. Once all Business Units and regional operations accomplish their plans, our business base will be broadened and the two-year average risk-adjusted return ratio will have improved to 10.2% as a result.

### Accelerate Increasing Risk-Adjusted Assets

Under the AG Plan, we will undertake strategic investments and steadily broaden our earnings base. These actions will center on existing core businesses, where we have already built solid foundations by exerting our integrated corporate strengths, as well as on areas peripheral to our core businesses. Under the previous AA Plan, we increased profitable risk-adjusted assets worth ¥240 billion. At the same time, we actively withdrew or downsized businesses as appropriate, which led to a ¥100 billion decline in risk-adjusted assets. After also taking into account a decrease of ¥50 billion due to a reassessment of risk weighting—such as reflecting improvements in country risks—there was a ¥90 billion net increase in risk-adjusted assets. Moving from the AA Plan to the AG Plan, we have accelerated our growth strategies, targeting a further increase of ¥340 billion in risk-adjusted assets over the next two years.

> Under the AG Plan, we will accelerate increasing assets. This strategy is not limited to the two-year period covered by the plan, but is intended to prepare for medium and long-term sustained growth.

### Fully Mobilize Company-wide Support Functions

Each Business Unit and regional operations will seek to invest in profitable risk-adjusted assets according to its own business and geographic strategies. To achieve more dynamic growth, however, we must complement such segment-specific initiatives by broadening our earnings base across segment boundaries. To this end, we have formed new entities, such as the "Company-wide Project Promotion & Support Committee," to support large-scale projects and cross-organizational projects, and the "M&A Promotion Support Team," to support M&A deals for each segment by specialists. These entities, together with the existing "New Technologies Committee," will support the entry of each segment into new fields, regions, and technologies, as well as the increase of investments in core businesses. For these initiatives, we have budgeted "AG Plan Growth Support Package" of ¥5 billion for fiscal year 2005.

### Effective Use of Human Resources—Key for Successful Growth Strategies

Successfully investing in new businesses and expanding our earnings base require more than capital alone. Expediting growth depends on competent human resources—our most valuable management resources. We must seize new business opportunities and make investments after identifying and evaluating new projects. We must also manage business risks and cultivate our business to make it grow larger. To this end, we must secure highly competent human resources and foster them for maximum effectiveness. Therefore, we established a "Human Resources Management Committee" in each Business Unit and formulated a long-term human resources plan matching our growth strategies. Adopting company-wide perspectives, the "H.R.D. Committee," chaired by myself, examines from various angles how to foster human resources and provide working environments that motivate all employees to develop their full potential.

### Management Structure Conducive to Growth Strategies

Maintaining appropriate control frameworks is clearly becoming more important for stepping up our aggressive management focus. Recognizing that business and risk management are inseparable, we have worked to upgrade our risk management systems and ensure compliance awareness. We also understand that no system is perfect, and for this reason we are making constant reviews and enhancements to further raise the stability of our operations. One noteworthy initiative is that we are in the process of introducing an internal control system based on the COSO* Framework, and we are planning to extend this system across the Group.

* COSO: The Committee of Sponsoring Organizations of the Treadway Commission

> We must ensure proper defense while stepping up offense initiatives.

### Maintain Profitability and Stability While Expediting Growth

Over the two-year period covered by the AG Plan, the Sumitomo Corporation Group is targeting net income of ¥230 billion, compared with ¥151.7 billion achieved under AA Plan. Total assets at the end of fiscal year 2006 are expected to exceed ¥6 trillion, up from ¥5.5 trillion at fiscal 2004 year-end. At the same time, we will keep our debt-equity ratio (net) to 3 times or below, thereby maintaining a sound financial position. As for profitability, ROE is expected to be 10% or above. For more information about strategies and specific initiatives of the AG Plan, please refer to the following sections of this report: Special Feature (page 13), Overview of Operations (page 21), and Sumitomo Corporation's Management System (page 45).

## Corporate Value According to Sumitomo Corporation

### Balance of Three Key Elements to Support Sustained Growth

To achieve sustained growth and generate new levels of value, a corporation must pursue a balanced mix of profitability, growth potential, and stability. We are building a business portfolio emphasizing not only profitability and growth potential but also stability. At present, for instance, rising commodities prices are one favorable influence on our financial results. However, business conditions change from time to time, and we cannot grow if we rely on unvarying circumstances. With nine Business Units and regional operations, we are involved in diverse business fields with global economic coverage. By promoting growth strategies that anticipate changes in the operating environment, we will seize broader income opportunities and expand our core businesses. Through this balanced approach to business development, we will be prepared for stable growth.

### Maximizing Corporate Value Utilizing Our Core Competence

It is important to recognize that all corporations have core competences, but if they fail to take advantage of those competences, they will be unable to create satisfactory levels of value. Sumitomo Corporation is an integrated trading company with a core competence not found in other industries. Our competence lies in our business foundation (global network, global relations, trust, and intellectual capital) and our functions (risk management, IT solutions, intelligence gathering and analysis, business development, financial services, and logistics solutions). By integrating our business foundation and functions organically and strategically, we will exert our integrated corporate strength and realize higher levels of profitability and growth.

### Corporate Value As We See It

We are devoted to meeting the expectations of shareholders by exerting our core competence and thus creating greater levels of value. Through our business activities, as well, we will contribute to our business partners and society in general, which in turn will provide opportunities to our employees for self-development. In these ways, we will fulfill our corporate social responsibility (CSR) and thus "realize prosperity and dreams" for all our stakeholders, in our quest to create even higher levels of corporate value.

> I regard the "sum total" of "realized prosperity and dreams of all stakeholders," driven by our "integrated corporate strength," to be our corporate value.

## Return to Shareholders

Our responsibility as a corporation is to ensure that value thus created is properly returned to our shareholders. Until fiscal year 2003, our basic policy was to ensure stable dividends. In the latter half of fiscal year 2004, we complemented this policy with the introduction of a dividend reflecting our consolidated financial results. We believe that accelerating growth, while securing risk-adjusted return above shareholders' capital cost, will provide ample returns in the future. Moreover, in consideration of securing funds for growth under the AG Plan, we have set the payout ratio at around 20%. As a result, for fiscal year 2004, we have raised the annual dividend by ¥3, to ¥11 per share. If we achieve our net income target of ¥110 billion in fiscal year 2005, the first year of the AG Plan, we intend a further ¥7 increase in the dividend, to ¥18 per share. Hereafter, we will consider appropriate dividend levels while evaluating progress in expanding our earnings base and external circumstances.

Philosophies and strategies, no matter how excellent, have no meaning unless they are translated into concrete actions at the business level. By bringing strategies to all our business fronts, we, the management and employees, stand united in our quest to maximize corporate value.

## In Conclusion

I have outlined the progress of Sumitomo Corporation's reforms and described our strategies for the future. However, there is something more important than management telling their company's corporate philosophies and management strategies. All employees at the front line of business activities must share a common view of these philosophies and strategies and implement them accordingly. A company's management must talk directly with employees to explain management policy, the background and essence of management plans, as well as the importance of risk management and compliance awareness. Then, they must obtain employee's sincere agreement and translate strategies into actions. I regularly stress the importance of direct contact with employees and work hard to ensure that top priority is placed on direct communication. Through these initiatives, we are committed to "realizing prosperity and dreams" for all stakeholders.

We look forward to your continued understanding and support.

Motoyuki Oka
President and CEO

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