



ITOCHU FUEL CORPORATION

ANNUAL REPORT 1999

For the year ended 31st March

ITOCHU
FUEL
CORPORATION

PROFILE

ITOCHU FUEL Corporation is a major Japanese dealer in all kinds of petroleum products, including asphalt, liquefied petroleum gas (LPG), and industrial gases.

Other interests include general merchandise catalog sales, and home appliance sales. Being the core affiliate of ITOCHU CORPORATION, a leading Japanese general trading company, ITOCHU FUEL Corporation has 7 branches, 27 sales offices, 93 subsidiaries and affiliates, and 8 domestic storage facilities, and its products are distributed by a nationwide network of about 2,050 service stations and 1,450 gas retailers.

Non-consolidated net sales came to ¥321,217 million (US\$2,654,686 thousand) for the term ended March 31, 1999. Total assets stood at ¥186,495 million (US\$1,541,495 thousand), and shareholders' equity stood at ¥74,957 million (US\$619,479 thousand) at the end of the term. The Company had 891 full-time employees as of March 31, 1999.

CONTENTS

Financial Highlights (Non-Consolidated)	1
To Our Shareholders	2
Review of Operations.....	4
Non-Consolidated Balance Sheets	6
Non-Consolidated Statements of Income	8
Non-Consolidated Statements of Shareholders' Equity.....	9
Non-Consolidated Statements of Cash Flows.....	10
Notes to Non-Consolidated Financial Statements	11
Independent Auditors' Report	15
Company Data	16

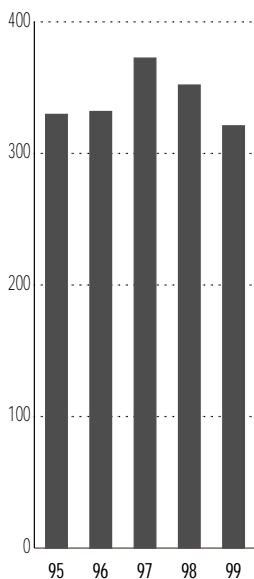
FINANCIAL HIGHLIGHTS (NON-CONSOLIDATED)

Years ended 31st March

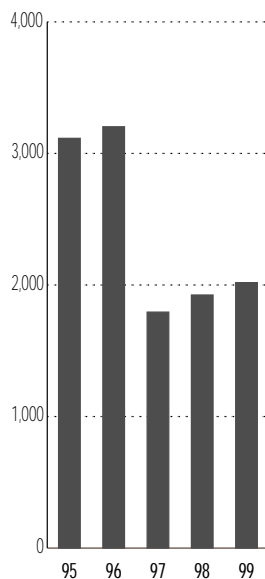
	Millions of yen				
	1995	1996	1997	1998	1999
Net sales	¥329,769	¥331,938	¥372,545	¥352,920	¥321,217
Income before income taxes	7,555	7,343	3,984	5,014	4,428
Net income	3,115	3,203	1,794	1,924	2,018
Total assets	167,285	174,198	185,868	190,269	186,495
Shareholders' equity	65,028	74,522	75,274	76,166	74,957
Common stock	16,233	19,878	19,878	19,878	19,878
Per share of common stock (in yen):					
Net income	¥ 30.76	¥ 31.24	¥ 16.44	¥ 17.63	¥ 18.73
Shareholders' equity	642.07	683.02	689.92	698.09	726.98
Number of employees	1,125	1,085	1,033	989	891

The computation of net income per share is based upon the weighted average number of shares outstanding during the period.

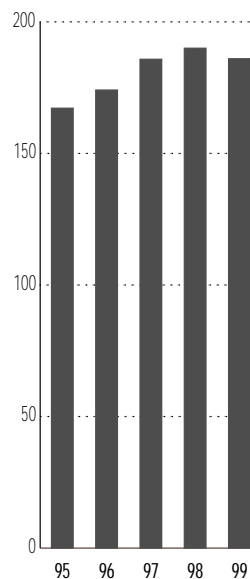
Net Sales
(¥ Billion)



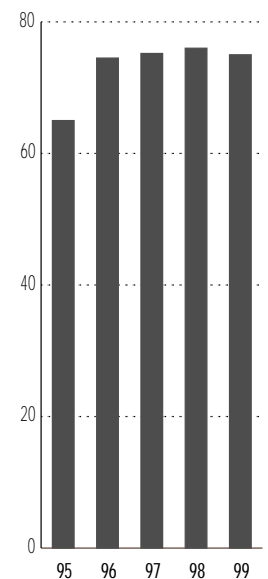
Net Income
(¥ Million)



Total Assets
(¥ Billion)



Shareholders' Equity
(¥ Billion)



TO OUR SHAREHOLDERS



Hideo Matsumura / President

The real growth rate of Japan's GDP for the term under review fell to a postwar low due to a slump in domestic private-sector demand, exemplified by a steep drop in housing investment and capital investment, as well as further stagnation in exports. Despite a recovery in sales of household electric appliances and subcompact cars, and of a few other product categories, personal consumption as a whole continued to decline. This came against the background of increasing apprehension over the outlook for employment and incomes, fueled by a rising unemployment rate and a decline in bonuses, and in spite of the implementation of special tax breaks.

Turning to the oil industry, although the ban on self-service filling stations was lifted in April 1998, the number of filling stations increased slowly. Due to a slight rise in the number of motor vehicles, demand for gasoline grew 2.7% over the previous year, but this was more than offset by sluggishness in diesel oil owing to rationalization in the distribution sector and a decline in the volume of goods transported, in addition to a drop in demand for kerosene and fuel oil due to the comparatively warm winter and a fall in industrial demand. As a result, demand for fuel oil products as a whole declined 1.4% from the previous year.

Demand for LP gas fell below the previous year's level for the second time in a row, as a result of the effects of the long-lasting recession, the dampening of consumer sentiment, the high level of import prices, and the warm winter, among other factors.

In these circumstances, the Company's sales volume for the term increased strongly over the previous year due to the contribution of service stations under the brand name, Chuboy. Gasoline sales rose by 13.2%, kerosene sales by 13.4%, diesel oil sales by 4.3%, and fuel oil sales by 6.4%. Sales of petroleum products as a whole rose 8.4%, but LP gas sales declined 3.2%. Turnover, however, fell back by 9.0% from the previous year, to ¥321,217 million, despite the increase in sales volume, owing to a fall in prices and the spin-off of the CICOMART convenience store chain. Net income for the term rose 4.9% to ¥2,018 million due to the sale of low-profit assets and securities holdings as well as a reduction in selling, general, and administrative expenses. This was achieved in spite of the following negative factors: the full-scale start-up of the new gas sales company operations; the spin-off of the CICOMART business; a shrinking profit margin in the oil division; the payment of ¥1,369 million in retirement benefits in line with the implementation of a voluntary early retirement scheme; and ¥810 million in other expenses incurred in the consolidation of our holdings in affiliated companies.

Notwithstanding the severe business conditions described above, we maintained our annual dividend per share at ¥9, consisting of an interim-term dividend of ¥4.5 and a term-end dividend of the same amount.

The management environment is expected to be very difficult in fiscal 1999, too. The three most pressing issues for the Company's management are: (1) reinforcing the Itochu Fuel

Group's overall strength; (2) expanding the scale of our business operations; and (3) strengthening our corporate soundness through cost cutting.

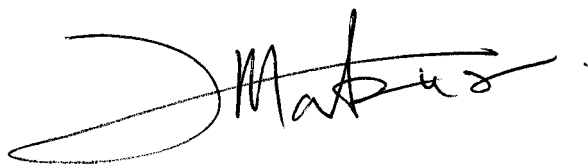
Regarding the first issue, as the earnings of affiliated companies in the oil business are decreasing because of falling retail market prices, this term, we intend to continue amalgamating affiliated companies in some cases and liquidating those that are in the red, as well as closing down unprofitable service stations. Since the previous term, we have integrated a number of retail and wholesale affiliated companies in the LP gas business, and have established a system of LP gas sales companies. We have thus been taking measures to ensure that our marketing functions are more smoothly and directly linked to the retail level, with a view to increasing earnings.

Turning to efforts to expand the scale of our business, we aim to work even more vigorously to raise the sales volume of the petroleum products we handle, and to expand our geographical marketing area. In particular, we plan to increase the number of service stations in our own Chuboy chain.

With regard to strengthening our corporate soundness through cost cutting, we have been reducing expenses since fiscal 1996 by amalgamating branches, streamlining our head office, and reducing our overall workforce via a voluntary early retirement scheme. From the next term onward, we will be integrating the administrative functions of branches still further to create an even stronger corporate structure.

In fiscal 1999, under the overall watchword "Creation & Action '99" and the management motto "Responding Actively to Change – Laying the Foundations for Prosperity in the 21st Century," we will be basing our actions on the following guidelines: (I) securing substantial profits; (II) reorganizing our corporate structure; (III) emphasizing the consolidated accounts; (IV) closing down unprofitable business divisions and offices; and (V) giving priority to laying the groundwork for entry into new business fields. By freeing ourselves from the constraints of conventional methods and attitudes, improving the performance of the Company's sales network, and creating new capabilities in distribution, we aim to become a "comprehensive distribution service and general merchandise enterprise" that makes an important contribution to the prosperity of our customers and of society at large.

We would like to thank all our shareholders in advance for their support and encouragement.

A handwritten signature in black ink, appearing to read "Hideo Matsumura". The signature is stylized with a large, sweeping initial "H" and a long horizontal stroke extending to the right.

Hideo Matsumura
President

REVIEW OF OPERATIONS

Industrial Energy Division

Demand for industrial fuels slumped markedly during the term under review, against the background of extremely severe business conditions affecting all industrial sectors. In addition, prices fell by approximately 20% due to strong price reduction demands from users and intensified competition among suppliers. Itochu Fuel Corporation, however, making full use of its strengths – the overall power of its group and the wide geographical coverage of its sales activity – was able to record both sales volume and earnings in excess of the previous year's.

Meanwhile, to improve the efficiency of the Industrial Energy Division, including affiliated companies, the asphalt sales operations of Toas Co., Ltd. were taken over by the Company, and Itochu Fine Gas Co., Ltd. and Itochu High-Pressure Gas Co., Ltd. were merged into the new entity Itochu Industrial Gas Co., Ltd., thus centralizing the Group's industrial gas division. In this way, more competitive, centralized nationwide systems were created in both fields.

As no rapid economic recovery is expected in fiscal 1999, demand for industrial fuels is forecast to remain depressed. In these circumstances, the Company is confident of cementing the trust of its users and strengthening its competitiveness, and is working to achieve greater operational efficiency and to step up "adviser-type" marketing efforts.

Oil Division

During the term under review, the oil industry continued to operate under very difficult business conditions, as market prices for petroleum products were depressed, owing to the combined effect of intensified competition and oversupply. Consequently, the number of service stations converted to other forms of business or simply closed down increased rapidly. The Company's Chuboy chain of service stations bucked the trend, however, growing by 82. The total number of service stations operated by the Itochu Fuel Group also increased sharply, rising to 2,037 as of the end of the term. While aggressively expanding our service station network and sales volume, we achieved steady progress in reducing costs.

In line with our main management goal for fiscal 1999 of expanding both the "scale" and the "scope" of our business, as part of our retail strategy, we intend to bolster our computer systems, including that relating to the "Chu-Card," while continuing to construct new service stations in the Chuboy chain and taking other measures to push up total sales volume. We are also pushing ahead with new types of business outlets under our strategy of choosing those with the greatest chance of besting the competition, and we plan to strengthen our sales outlets and affiliated companies with the aim of becoming a "total car business."

LP Gas Division

Combined sales of LP gas in fiscal 1998 for home use and commercial use were at the same level as the previous year, whereas sales of automobile-use gas and industrial-use butane, hit by declining demand due to the prolonged recession, fell below the previous year's levels.

During the term under review, in line with the gas sales concept which we have been pursuing since fiscal 1997, the combined sales network of our 15 gas sales companies was extended to cover all Japan. We have thus succeeded in establishing a complete distribution system covering both the wholesale and retail levels, which enables us to carry out our sales role even more efficiently. The LP Gas Division itself is working to improve its management system still further by lowering costs via centralization. At the same time, we are making steady progress in conforming to the requirements of the revised Law Concerning the Securing and Safety and the Optimization of Transaction of Liquefied Petroleum Gas.

In fiscal 1999, we plan to bolster our network of gas sales companies still further, and to nurture these companies to the point where they fully satisfy their users. Additionally, to strengthen our competitiveness and marketing power, we are actively seeking tie-ups with other companies in our industry in each geographical area of operation. We are also establishing "approved safety organizations" in each region to strengthen the group.

Consumer Goods Marketing & Business Development Division

The CICOMART business was spun off in April 1998 and relaunched as CICOMART Co., Ltd. Simultaneously, we established the Consumer Goods Marketing Department. Thanks to changes to the sales system and the active hiring of qualified staff, the Consumer Goods Marketing Department achieved higher efficiency in its sales activities, and despite a 12% decline in sales from the previous year, the division's earnings improved sharply, with gross profit increasing 11%.

The Business Development Department continues to actively introduce new products, and, while expanding its earnings, is promoting M&As and expanding its business scope with the aim of constructing a new earnings source for the Company.

In fiscal 1999, too, the division will continue to work for earnings improvement by hiring new staff, reinforcing its organization, and seeking out new sales channels.

The Year 2000 Problem

The Company has given the Year 2000 (Y2K) Problem one of the highest priorities among its management tasks, and the issue is being tackled with the full efforts of the Company and its group.

Moreover, to deal with the possibility of computer system malfunction caused by the Y2K problem in spite of all efforts to achieve full Y2K compliance, we have begun drafting a contingency plan to enable us to solve such problems as promptly and efficiently as possible. Under this plan, we will take all possible measures to ensure that any disruptions are kept to the minimum.

Sales Facilities	Number of stations *				
	1995	1996	1997	1998	1999
Gasoline service stations	1,735	1,767	1,776	1,870	2,037
Autogas service stations	124	125	122	129	128
LP gas stations	149	148	148	152	150
Oil tanks, gas terminals, asphalt terminals	8	8	8	8	8
Food chain stores **	155	203	203	180	—

* The above figures include those of subsidiaries and franchised dealers, but exclude those of subsidiaries through which the Company does not sell merchandise.

** As the Company's food chain stores business was spun off in April 1998 with the establishment of CICOMART Co., Ltd., the figure for the number of stores in 1999 has been omitted.

Net Sales by Group of Commodity	Billions of yen *					
	1997		1998		1999	
Gasoline	¥134.8	36.2%	¥133.5	37.8%	¥143.3	44.6%
Kerosene	35.9	9.6	30.9	8.8	28.8	9.0
Gas oil	71.5	19.2	62.4	17.6	55.0	17.1
Heavy fuel oil	39.6	10.6	35.7	10.1	29.7	9.2
Lubricants	1.9	0.5	1.9	0.6	1.6	0.5
Liquefied petroleum gas	41.7	11.2	40.6	11.5	31.0	9.6
Other **	47.1	12.7	47.9	13.6	31.8	10.0
Total	<u>¥372.5</u>	<u>100.0%</u>	<u>¥352.9</u>	<u>100.0%</u>	<u>¥321.2</u>	<u>100.0%</u>

* Both sales and sales volume reflect a seasonal variation in demand which is higher in the six months starting from October than in the other half of the year.

** "Other" consists of asphalt, industrial gas, burners, appliances, apparatus, car parts, and, up to 1998, foodstuffs and sundry goods (foodstuffs and sundry goods are not included in the "Other" figure for 1999 due to the spinning off of this business as CICOMART Co., Ltd. in April 1998).

NON-CONSOLIDATED BALANCE SHEETS

As of 31st March

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 1)
	1999	1998	1999
Current assets:			
Cash and time deposits	¥ 27,849	¥ 26,664	\$ 230,157
Marketable securities (Note 4)	2,952	4,751	24,397
Receivables:			
Trade notes	8,071	10,917	66,702
Trade accounts	28,605	31,209	236,405
Associated companies	17,131	11,979	141,578
Short-term loans	1,678	1,563	13,868
Allowance for doubtful accounts	(535)	(468)	(4,422)
Inventories	820	2,127	6,777
Prepaid expenses and other current assets	872	920	7,207
Total current assets	<u>87,443</u>	<u>89,662</u>	<u>722,669</u>
Property and equipment:			
Land	36,167	36,340	298,901
Buildings and structures	40,077	39,759	331,215
Machinery and equipment	18,809	19,863	155,446
Construction in progress	259	187	2,140
Total	<u>95,312</u>	<u>96,149</u>	<u>787,702</u>
Accumulated depreciation	<u>(31,651)</u>	<u>(29,956)</u>	<u>(261,578)</u>
Net property and equipment	<u>63,661</u>	<u>66,193</u>	<u>526,124</u>
Investments and other assets:			
Investment securities (Note 4)	3,354	3,814	27,719
Investments in and advances to subsidiaries and affiliates	17,529	15,524	144,868
Long-term loans receivable	4,240	4,766	35,041
Lease deposits and other	10,268	10,310	84,860
Total investments and other assets	<u>35,391</u>	<u>34,414</u>	<u>292,488</u>
TOTAL	<u>¥186,495</u>	<u>¥190,269</u>	<u>\$1,541,281</u>

See notes to non-consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 1)
	1999	1998	1999
Current liabilities:			
Short-term borrowings (Note 6)	¥ 26,400	¥ 26,150	\$ 218,182
Current portion of long-term debt (Note 6)	5,219	218	43,132
Trade payables:			
Trade notes	25	47	207
Trade accounts	22,404	22,706	185,157
Associated companies	2,575	2,392	21,281
Income taxes payable (Note 8)	1,465	2,361	12,107
Other current liabilities	5,788	6,864	47,835
Total current liabilities	<u>63,876</u>	<u>60,738</u>	<u>527,901</u>
Non-current liabilities:			
Long-term debt (Note 6)	41,318	46,537	341,471
Retirement benefits (Note 9)	2,185	2,719	18,058
Other, principally deposits received	4,159	4,109	34,372
Total non-current liabilities	<u>47,662</u>	<u>53,365</u>	<u>393,901</u>
Contingent liabilities (Note 12)			
Shareholders' equity (Notes 10 and 13):			
Common stock, ¥50 par value — authorized, 394,000,000 shares; issued and outstanding, 103,106,583 shares	19,878	19,878	164,281
Additional paid-in capital	19,051	21,250	157,446
Legal reserve	1,434	1,330	11,851
Retained earnings	34,594	33,708	285,901
Total shareholders' equity	<u>74,957</u>	<u>76,166</u>	<u>619,479</u>
TOTAL	<u>¥186,495</u>	<u>¥190,269</u>	<u>\$1,541,281</u>

NON-CONSOLIDATED STATEMENTS OF INCOME

Years ended 31st March

	Millions of yen		Thousands of U.S. dollars (Note 1)
	1999	1998	1999
Net sales (Note 11).....	¥321,217	¥352,920	\$2,654,686
Cost of sales (Note 11).....	292,976	321,006	2,421,289
Selling, general and administrative expenses	23,332	26,418	192,827
Operating income	4,909	5,496	40,570
Non-operating income (expenses):			
Interest and dividend income	1,153	851	9,529
Interest expenses	(1,193)	(634)	(9,860)
Other-net (Note 7).....	(441)	(699)	(3,644)
	(481)	(482)	(3,975)
Income before income taxes	4,428	5,014	36,595
Income taxes (Note 8).....	2,410	3,090	19,917
Net income	¥ 2,018	¥ 1,924	\$ 16,678
		Yen	U.S. dollars (Note 1)
Amounts per share (Note 2 i):			
Net income	¥18.73	¥17.63	\$0.15
Cash dividends	¥ 9.00	¥ 9.00	\$0.07

See notes to non-consolidated financial statements.

NON-CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Years ended 31st March

	Outstanding number of shares of common stock (Thousands)	Millions of yen			
		Common stock	Additional paid-in capital	Legal reserve	Retained earnings
Balance, 1st April, 1997	109,106	¥19,878	¥21,250	¥1,225	¥32,921
Net income	—	—	—	—	1,924
Bonuses to directors	—	—	—	—	(50)
Cash dividends	—	—	—	—	(982)
Transfer to legal reserve	—	—	—	105	(105)
Balance, 31st March, 1998	<u>109,106</u>	<u>¥19,878</u>	<u>¥21,250</u>	<u>¥1,330</u>	<u>¥33,708</u>
Net income	—	—	—	—	2,018
Bonuses to directors	—	—	—	—	(50)
Cash dividends	—	—	—	—	(978)
Transfer to legal reserve	—	—	—	104	(104)
Treasury stocks retired (Note 10)	(6,000)	—	(2,199)	—	—
Balance, 31st March, 1999	<u>103,106</u>	<u>¥19,878</u>	<u>¥19,051</u>	<u>¥1,434</u>	<u>¥34,594</u>

	Thousands of U.S. dollars (Note 1)			
	Common stock	Additional paid-in capital	Legal reserve	Retained earnings
Balance, 31st March, 1998	\$164,281	\$175,620	\$10,991	\$278,579
Net income	—	—	—	16,678
Bonuses to directors	—	—	—	(413)
Cash dividends	—	—	—	(8,083)
Transfer to legal reserve	—	—	860	(860)
Treasury stocks retired (Note 10)	—	(18,174)	—	—
Balance, 31st March, 1999	<u>\$164,281</u>	<u>\$157,446</u>	<u>\$11,851</u>	<u>\$285,901</u>

See notes to non-consolidated financial statements.

Non-Consolidated Statements of Cash Flows

Years ended 31st March

	Millions of yen		Thousands of U.S. dollars (Note 1)
	1999	1998	1999
Operating activities:			
Net income	¥ 2,018	¥ 1,924	\$ 16,678
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	4,114	4,246	34,000
(Gain) loss on sales or disposals of property and equipment	(350)	56	(2,893)
Gain on sales of marketable and investment securities	(1,708)	(317)	(14,116)
Devaluation of marketable and investment securities	475	514	3,926
Exchange gain on long-term forward exchange contracts	—	(37)	—
Allowance for doubtful accounts	67	(82)	554
Provision for retirement benefits	(16)	165	(132)
Reversal of retirement benefits for early retirement plan	(518)	—	(4,281)
Payment of directors' bonus	(50)	(50)	(413)
Changes in operating assets and liabilities:			
Decrease in receivables	183	9,139	1,512
Decrease in inventories	1,307	233	10,802
Decrease in prepaid expenses and other current assets	48	154	397
Decrease in trade payables	(140)	(12,483)	(1,157)
Increase (decrease) in income taxes payable	(895)	1,241	(7,397)
Increase (decrease) in other current liabilities	(1,076)	206	(8,893)
Increase in other non-current liabilities	50	256	413
Net cash provided by operating activities	<u>3,509</u>	<u>5,165</u>	<u>29,000</u>
Investing activities:			
Purchases of marketable and investment securities	(1,346)	(1,834)	(11,124)
Purchases of property and equipment	(2,300)	(5,845)	(19,008)
Proceeds from sales of marketable and investment securities	4,837	3,540	39,975
Proceeds from sales of property and equipment	1,561	895	12,901
Collection of long-term loans receivable, net	526	560	4,347
Decrease in investments in and advances to subsidiaries and affiliates, net	(2,005)	(9,078)	(16,570)
Payment for lease deposits and other, net	(451)	(1,022)	(3,728)
Net cash provided by (used in) investing activities	<u>822</u>	<u>(12,784)</u>	<u>6,793</u>
Financing activities:			
Decrease in short-term bank loans, net	(750)	(2,162)	(6,197)
Issuance of commercial paper	1,000	5,000	8,264
Proceeds from long-term debt	—	11,500	—
Repayments of long-term debt	(219)	(218)	(1,810)
Issuance of bonds	—	15,000	—
Repayment of notes with warrants	—	(14,960)	—
Cash dividends	(978)	(982)	(8,083)
Purchase of treasury stock for retirement	(2,199)	—	(18,174)
Net cash provided by (used in) financing activities	<u>(3,146)</u>	<u>13,178</u>	<u>(26,000)</u>
Net increase in cash and cash equivalents	1,185	5,559	9,793
Cash and cash equivalents, beginning of year	26,664	21,105	220,364
Cash and cash equivalents, end of year	<u>¥27,849</u>	<u>¥26,664</u>	<u>\$230,157</u>
Additional cash flow information:			
Cash paid during the year for:			
Interest expenses	¥1,159	¥ 567	\$ 9,579
Income taxes	¥3,305	¥1,777	\$27,314

See notes to non-consolidated financial statements.

NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

31st March, 1998 and 1999

1. Basis of presenting non-consolidated financial statements:

The non-consolidated financial statements have been prepared from the accounts and records maintained by ITOCHU FUEL Corporation (the "Company") in accordance with the provisions set forth in the Japanese Commercial Code (the "Code") and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Accounting Standards. The non-consolidated financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan. The non-consolidated statements of cash flows are not required as a part of basic financial statements in Japan but are presented herein for the convenience of readers outside Japan.

In preparing the non-consolidated financial statements, certain reclassifications and rearrangements have been made in the financial statements issued domestically in Japan, in order to present these statements in a form which is more familiar to readers outside Japan.

The United States dollar amounts included herein are presented solely for convenience, calculated at the approximate rate of exchange prevailing at 31st March, 1999 of ¥121 to U.S.\$1. The U.S. dollar amounts should not be construed as representations that Japanese yen have been, could have been, or could in future be, converted into U.S. dollars at that or at any other rate.

2. Summary of significant accounting policies:

a) Cash and cash equivalents:

For purposes of the statements of cash flows, the Company considers all time deposits to be cash equivalents. Time deposits have original maturities of one year or less and can be withdrawn on demand with no diminution of principal.

b) Marketable and investment securities:

Listed securities included in marketable securities and investment securities are stated at the lower of cost, determined by the moving-average method, or market.

Other securities, including those of subsidiaries and affiliates (companies owned 20 per cent. to 50 per cent. by the Company), are stated at cost which is determined by the moving-average method.

c) Inventories:

Inventories are stated at the lower of cost or market, cost being substantially determined by the moving-average method.

d) Leases:

All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that do not transfer ownership of the leased property to the lessee are permitted to be accounted for as rental transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

e) Property and equipment and depreciation:

Property and equipment are stated at cost.

Depreciation is computed by the declining-balance method based upon the estimated useful lives of the assets.

The overall annual effective rates of depreciation as a percentage of net recorded amount (acquisition cost less accumulated depreciation) by major categories of property and equipment were as follows:

Years ended	1999	1998
31st March		
Buildings and structures	10.2%	9.5%
Machinery and equipment	26.5%	25.8%

f) Stock and bond issuance costs:

Stock and bond issuance costs are charged to income as incurred.

g) Income taxes:

Income taxes are provided for amounts currently payable for each year.

h) Retirement benefits:

The annual provisions for severance payments for employees are sufficient to state the liability at the amount that would be required if all employees eligible for severance payments voluntarily terminated their employment at each balance sheet date, less amounts covered by a noncontributory pension plan for employees who are 55 years of age and over.

In addition, the Company has two funded pension plans for all employees.

The amounts contributed to pension funds, including the amortization of prior service costs over 5 years, are charged to income when paid.

The annual provisions for retirement benefits to directors and corporate auditors are calculated to state the liability at 50 per cent. of the amount that would be required if all directors and corporate auditors retired at each balance sheet date.

i) Amounts per share:

The computation of net income per share is based on the weighted average number of shares of common stock outstanding during each year, retroactively adjusted for stock splits. The average number of common shares used in the computation was 107, 725, 250 and 109, 106, 583 shares for the years ended 31st March, 1999 and 1998, respectively.

Fully diluted net income per share is not disclosed because it is anti-dilutive.

Cash dividends per share presented in the accompanying non-consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

j) Appropriation of retained earnings:

Appropriations of retained earnings are accounted for and reflected in the non-consolidated financial statements when approved by the shareholders in the following year.

3. Accounting change:

Effective April 1, 1998, the Company adopted the straight-line method of amortization of goodwill over five years, which, previously, had been charged to income when paid. The effect of this change was to increase income before income taxes for the year ended March 31, 1999, by ¥121 million (\$1,000 thousand).

4. Marketable and investment securities:

Marketable and investment securities as of 31st March, 1999 and 1998 consisted of the following:

	Millions of yen		Thousands of
	1999	1998	U.S. dollars
Marketable securities:			
Marketable equity securities	¥1,135	¥1,433	\$ 9,380
Government and corporate bonds	548	654	4,529
Trust funds and other	1,269	2,664	10,488
Total	¥2,952	¥4,751	\$24,397
Investment securities:			
Marketable equity securities	¥2,440	¥2,924	\$20,165
Non-marketable securities....	914	890	7,554
Total	¥3,354	¥3,814	\$27,719

The carrying values and aggregate market value of marketable equity securities included in marketable securities and investment securities at 31st March, 1999 and 1998 were as follows:

	Millions of yen		Thousands of
	1999	1998	U.S. dollars
Marketable securities:			
Carrying value	¥1,135	¥1,433	\$ 9,380
Aggregate market value	1,282	1,496	10,595
Net unrealized gain	¥ 147	¥ 63	\$ 1,215
Investment securities:			
Carrying value	¥2,440	¥2,924	\$20,165
Aggregate market value	4,431	7,814	36,620
Net unrealized gain	¥1,991	¥4,890	\$16,455

The difference between the above carrying amounts and the amounts shown in the accompanying balance sheets principally consists of closed-end investment trusts, asset backed commercial paper, and non-marketable securities for which there is no readily-available market from which to obtain or calculate the market value thereof.

5. Leases:

The Company leases certain machinery and other assets. Total lease payments were ¥156 million (\$1,289 thousand) and ¥187 million for the years ended 31st March, 1999 and 1998, respectively.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligations under finance leases, depreciation expense, interest expense of finance leases that do not transfer ownership of lease property to the lessee on an "as if capitalized" basis for the years ended 31st March, 1999 and 1998 were as follows:

	Millions of yen		Thousands of
	1999	1998	U.S. dollars
Class of property:			
Buildings and structures.....	¥ 14	¥ 48	\$ 116
Machinery and equipment	626	764	5,174
Lease deposits and other	16	40	132
Accumulated depreciation....	(401)	(448)	(3,315)
Total	¥255	¥404	\$2,107
	Millions of yen		Thousands of
	1999	1998	U.S. dollars
Due within one year.....	¥111	¥171	\$ 917
Due after one year.....	278	385	2,298
Total	¥389	¥556	\$3,215

The imputed interest expenses portion which is computed using the interest method is excluded from the above obligations under finance leases.

Depreciation expense and interest related expenses, which are not reflected in the accompanying statements of income by the declining balance method and interest method, were ¥166 million and ¥23 million, respectively, for the year ended 31st March, 1999, and ¥193 million and ¥31 million, respectively, for the year ended 31st March, 1998.

6. Short-term borrowings and long-term debt:

Short-term borrowings at 31st March, 1999 and 1998 consisted of the following:

	Millions of yen		Thousands of
	1999	1998	U.S. dollars
Short-term loans principally from banks, at an approximate average rate of 0.82% (1999) and 1.12% (1998)	¥20,400	¥21,150	\$168,595
Commercial paper, at an approximate average rate of 0.77% (1999) and 1.47% (1998)	6,000	5,000	49,587
Total	¥26,400	¥26,150	\$218,182

Long-term debt at 31st March, 1999 and 1998 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	1999
Unsecured 2.55% Japanese yen bonds, due November 2001	¥ 5,000	¥ 5,000	\$ 41,322
Unsecured 1.85% Japanese yen bonds, due November 1999	5,000	5,000	41,322
Unsecured 2.30% Japanese yen bonds, due December 2002	5,000	5,000	41,322
Unsecured 1.80% Japanese yen bonds, due December 2000	5,000	5,000	41,322
Unsecured 2.23% Japanese yen bonds, due February 2001	10,000	10,000	82,645
Unsecured 2.53% Japanese yen bonds, due February 2002	5,000	5,000	41,322
Unsecured loans from banks and others, at an approximate average rate of 2.10% (1999) and 2.09% (1998)	11,537	11,755	95,348
Total	46,537	46,755	384,603
Less: current portion	5,219	218	43,132
Long term debt, less current portion	¥41,318	¥46,537	\$341,471

Annual maturities of long-term debt as of 31st March, 1999 for the next five years and thereafter were as follows:

Years ending 31st March	Millions of yen	Thousand of U.S. dollars
2000	¥ 5,219	\$ 43,132
2001	15,220	125,785
2002	10,218	84,446
2003	5,787	47,826
2004	6,030	49,835
2005 and thereafter	4,063	33,579
Total	¥46,537	\$384,603

7. Non operating income (expenses) — Other-net:

Non operating income (expenses) — Other-net consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	1999
Gain on sales of investment securities	¥1,746	¥341	\$14,430
Gain on sales of property and equipment	834	224	6,893
Special retirement expenses	(1,369)	—	(11,314)
Loss on liquidation of affiliates and other	(810)	—	(6,694)
Loss on disposals of property and equipment	(484)	(279)	(4,000)
Other-net	(358)	(985)	(2,959)
Total	¥ (441)	¥(699)	\$ (3,644)

8. Income taxes:

The Company is subject to the following income taxes:

Corporate	34.5%
Inhabitants	20.7% of corporate tax
Enterprise	11.0%

Such taxes, in aggregate, normally result in a normal effective statutory tax rate of approximately 47 per cent. after considering the effect of the enterprise tax, which is deductible in the calculation of income taxes when paid.

9. Retirement benefits:

Under most circumstances, employees terminating their employment are entitled to certain severance payments based on their rates of pay at the time of termination, length of service, and certain other factors. If the termination is involuntary, caused by retirement at the normal retirement age, or caused by death, the employee is entitled to greater payments than in the case of voluntary termination.

The Company has two pension plans, one which is a contributory pension plan (the "first pension plan") which covers employees under 55 years of age who terminate employment. Contributions to this plan are made 50 per cent. each by the Company and its employees. The assets of this fund as of 30th September, 1998 (the most recent date of available information) amounted to ¥3,140 million (\$25,950 thousand).

The other pension plan (the "second pension plan") is a noncontributory plan which covers employees 55 years of age and over who terminate employment. The assets of this fund as of 30th September, 1998 amounted to ¥3,149 million (\$26,025 thousand).

Total severance payments and pension costs for employees charged to operations were ¥1,220 million (\$10,083 thousand) and ¥846 million for the years ended 31st March, 1999 and 1998, respectively.

Retirement benefits for directors and corporate auditors are paid subject to approval of the shareholders (in accordance with the Japanese Commercial Code). Retirement benefits at 31st March, 1999 and 1998 included those for directors and corporate auditors in amount of ¥129 million (\$1,066 thousand) and ¥174 million, respectively.

10. Shareholders' equity:

Under the Japanese Commercial Code (the "Code"), at least 50 per cent. of the issue price of new shares, with a minimum of the par value, is to be designated as stated capital. The portion which is to be designated as stated capital is determined by resolution of the Board of Directors. Proceeds in excess of the amounts designated as stated capital are credited to additional paid-in capital. The Company may transfer portions of additional paid-in capital to stated capital by resolution of the Board of Directors. Under the Code, the Company is required to appropriate as a legal reserve portions of retained earnings in the amount equal to at least 10 per cent. of cash payments, including cash dividends and bonuses to directors and corporate auditors, appropriated in each financial period until the reserve equals

25 per cent. of the stated capital. This reserve is not available for cash dividends but may be used to reduce a deficit by a resolution of the shareholders or transferred to the stated capital by a resolution of the Board of Directors.

The Company may also transfer portions of unappropriated retained earnings to stated capital by resolution of the shareholders. Under the Code, the Company may issue new shares of its common stock to the existing shareholders without consideration pursuant to resolution of the Board of Directors as a stock split. The Company may make such a stock split to the extent that the amount calculated by multiplying the number of issued shares after the stock split by the par value per share does not exceed the stated capital and that the amount calculated by dividing the total amount of shareholders' equity by the number of issued shares after the stock split shall not be less than ¥50.

Cash dividends at the fiscal year end must be approved by the shareholders at an annual meeting to be held subsequent to the year end, while interim dividends may be paid after the half-year end upon resolution of the Board of Directors.

Under the Code, the Company may resolve to repurchase its treasury stock for retirement and related reduction of additional paid-in capital and retained earnings pursuant to resolution of the Board of Directors, subject to articles of incorporation approved by the shareholders.

At the general shareholders' meeting held on June 26, 1998, the Company's shareholder authorized the articles for the repurchase of treasury stock for the purpose of retiring the shares, maximum 6,000,000 and 4,000,000 shares against additional paid-in capital and retained earnings, respectively. During the year ended March 31, 1999, the Board of Directors resolved to repurchase 6,000,000 and 2,000,000 shares of treasury stock, an aggregate maximum repurchase amount of ¥3,000 million and ¥1,000 million (\$24,793 thousand and \$8,264 thousand) against additional paid-in capital and retained earnings, respectively, and 6,000,000 shares were repurchased by ¥2,199 million (\$18,174 thousand) from the market and retired by charging such amount against additional paid-in capital.

Retained earnings at 31st March, 1999 included an amount of ¥32,083 million (\$265,149 thousand) which has been designated as general and special reserves, but is available for future dividends subject to approval by the shareholders and legal reserve requirements.

11. Transactions with associated companies:

Major transactions with associated companies, consisting of ITOCHU Corporation and the Company's subsidiaries and affiliates, for the years ended 31st March, 1999 and 1998 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	1999
Sales.....	¥54,522	¥53,798	\$450,595
Purchases.....	18,783	21,918	155,231

12. Contingent liabilities:

Contingent liabilities at 31st March, 1999 for guarantees required in the ordinary course of business, primarily on behalf of subsidiaries, amounted to approximately ¥3,448 million (\$28,496 thousand).

13. Subsequent events:

At the general shareholders' meeting held on 29th June, 1999, the Company's shareholders approved the following appropriation of retained earnings for the year ended 31st March, 1999, and the repurchase of treasury stock for retirement and related reduction of additional paid-in capital:

a) Appropriation of retained earnings

Appropriation of retained earnings for the year ended 31st March, 1999 is as follows:

	Millions of yen	Thousands of U.S. dollars
Year-end cash dividends, ¥4.50 (\$0.04) per share	¥464	\$3,835
Transfer to legal reserve	52	430
Directors' bonuses	50	413
Total.....	¥566	\$4,678

b) Purchase of treasury stock for retirement and related reduction of additional paid-in capital

The Company is authorized to repurchase, at management's discretion, up to 5,000 thousand shares of the Company's stock (the aggregated amount of ¥2,500 million) for the purpose of canceling the shares by crediting such amounts against additional paid-in capital.

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To the Board of Directors of
ITOCHU FUEL Corporation

We have examined the non-consolidated balance sheets of ITOCHU FUEL Corporation as of 31st March, 1999 and 1998, and the related non-consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. Our examinations were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the non-consolidated financial statements referred to above present fairly the financial position of ITOCHU FUEL Corporation as of 31st March, 1999 and 1998, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles and practices generally accepted in Japan consistently applied during the period except for the change, with which we concur, in the accounting for amortization of goodwill, as discussed in Note 3.

Our examinations also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

29th June, 1999

COMPANY DATA

Board of Directors:

President

Hideo Matsumura

Senior Managing Directors

Shinji Yamamoto

Eijiro Kawajiri

Managing Directors

Akio Sadanaga

Masayuki Teshima

Kenkichi Kajiwara

Shushi Sueyasu

Directors

Tadashi Maeda

Haruo Mitsui

Tsuyoshi Matsuki

Toshiyuki Sumitomo

Seiki Yamanishi

Kazumi Tanikoshi

Mutsuo Sezaki

Kiyomi Yamada

Corporate Auditors:

Tsutomu Hasegawa

Osamu Takeyari

Tadao Nakamura

Kunio Miki

(As of 29th June, 1999)

Head Office:

24-12, Meguro 1-chome, Meguro-ku, Tokyo 153-8655, Japan

Phone: 03-5436-8202

Branches:

Sapporo, Sendai, Higashinohon, Chubu, Kansai, Chushikoku, Kyushu

(Business offices operating under these branches total 27.)

Chuo Kenshujo (Itochu Fuel Training Center):

4-298, Kyowa-machi, Ohbu, Aichi 474-0061, Japan

Subsidiaries and Affiliated Companies:

Oita Kyuseki Hanbai Co., Ltd. and 82 subsidiaries and 10 affiliated companies.

Head Office



Service Station

Chuboy





ITOCHU FUEL Corporation

24-12, Meguro 1-chome, Meguro-ku, Tokyo 153-8655, Japan

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