

Management's Discussion and Analysis

Scope of Consolidation

Yamato's consolidated financial statements include 40 consolidated subsidiaries and 2 affiliates accounted for by the equity method.

Results of Operations

In the fiscal year ended March 31, 2004, the Japanese economy showed some encouraging signs of recovery, underpinned by capital expenditures and exports. These gains, however, fell short of arresting weak consumer spending and other deflationary trends, and the economic environment remained difficult.

In the domestic transportation industry handling volume increased but average unit prices failed to recover. The business environment remained harsh amid escalating competition among transportation companies, including from the package delivery service of Japan Post following its launch on April 1, 2003.

In these circumstances, the Group restructured its operations into five operating segments—Delivery, BIZ-Logistics, Home Convenience, e-Business and Financial—to facilitate growth and raise the Group's corporate value.

In the core Delivery business, we focused on strengthening marketing power and rebuilding the *Takkyubin* network to reform the structure of our earnings, in readiness for competition from the privatized Postal Services Agency (now Japan Post). We switched from a network of delivery bases to a larger network of delivery centers, each staffed by fewer employees. The move brings us closer to our customers and enables us to provide meticulous service that will lead to higher customer satisfaction, while at the same time raising the awareness among employees of the need to be business oriented. We also consolidated our administrative and service center functions in order to raise the efficiency of back-office operations, while taking measures to make it easier for customers to use our service, differentiating us from competitors.

As a result of the above and other factors, Yamato Transport recorded consolidated operating revenues of ¥1,011,344 million (U.S.\$9,569.0 million), up ¥39,209 million, or 4.0% from the previous fiscal year. Operating income fell ¥10,159 million, or 17.9%, to ¥46,659 million (U.S.\$441.5 million). The principal factor affecting operating income was a sharp ¥49,368 million or 5.4% increase in total operating costs and expenses to ¥964,685 million, mainly due to capital expenditures related to rebuilding the *Takkyubin* network as a part of planning for the future and strengthening the *Kuroneko Mail* network. The operating income margin declined 1.2 percentage points to 4.6%.

Review by Operating Segment

From the fiscal year under review, Yamato Transport's business is divided into five operating segments:

Delivery

The Delivery business is mainly focused on small parcel delivery services for consumers and corporate clients and includes the *Takkyubin* and *Kuroneko Mail* services. Demand for the *Takkyubin* service remained strong. Also contributing to growth was *Cool Takkyubin*, where volume increased 5.8% to 122.6 million units. The *Collect Service* handling volume increased 9.4% to 63.5 million units. Consequently, overall delivery volume in the parcel delivery business climbed to 1,011.2 million parcels, up 2.8% and topping the 1 billion unit mark for the first time. Handling volume in the *Kuroneko Mail* service increased significantly as we revised our rate structure and upgraded service with the introduction of more packet sizes and worked to expand our corporate client base.

Total operating revenues, including Rail-Freight Forwarding, Domestic Air Freight and Others, was ¥834,495 million (U.S.\$7,895.7 million), an increase of ¥34,032 million, or 4.3%. However, operating income fell ¥10,494 million, or 22.8%, to ¥35,548 million (U.S.\$336.3 million) owing to an increase in operating costs, mainly due to the cost related to consolidating back-office operations and strengthening the organization to rebuild the *Takkyubin* network.

Takkyubin Revenues and Unit Prices

Years ended March 31	2000	2001	2002	2003	2004
<i>Takkyubin</i> revenues (millions of Yen)	¥622,666	¥658,156	¥683,589	¥698,499	¥ 690,088
Delivery volume (1,000 parcels)	836,206	898,595	947,895	983,938	1,011,150
Unit price (Yen)	¥ 744	¥ 732	¥ 721	¥ 710	¥ 682

Unit price for calculation purposes declined in the fiscal years ended March 2003 and 2004 due to the merger of Shikoku Yamato Transport Co., Ltd. and Kyushu Yamato Transport Co., Ltd.

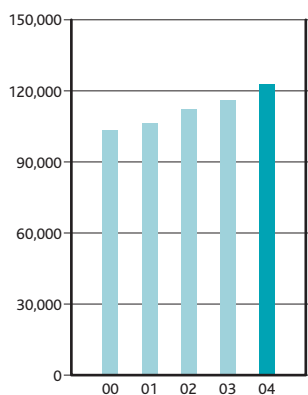
BIZ-Logistics

The BIZ-Logistics provides inter-company logistics services aimed at the B2B supply chain management market and includes international marine forwarding, international air-freight forwarding and the transportation of works of art.

On April 1, 2003, a part of the Logistics business was spun off to Yamato Logistics Corporation. At the same time, marine forwarding, customs clearance, transportation of works of art and international moving operations were transferred to Yamato Global Freight Co., Ltd. As a result of this active reorganization of our domestic and international logistics services, operating revenue rose ¥3,134 million, or 3.6%, to ¥90,236 million (U.S.\$853.8 million), with operating income rising sharply by ¥390 million, or 14.5%, to ¥3,088 million (U.S.\$29.2 million).

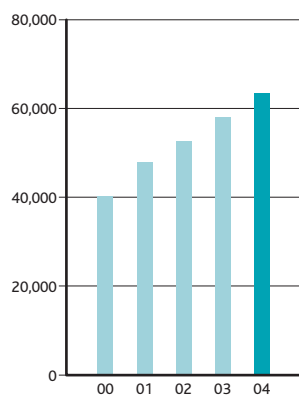
Cool Takkyubin Delivery Volume

(1,000 parcels)



Collect Service Delivery Volume

(1,000 parcels)



Home Convenience

Home Convenience services include moving services and lifestyle support services, such as home services intimately connected with the needs of local markets, in addition to merchandise marketing.

In the fiscal year ended March 31, 2004, the moving service operations of each base were separated and merged with Yamato Home Service Co., Ltd., Yamato Transport's home service subsidiary, which was renamed Yamato Home Convenience Co., Ltd. and started actively marketing these services. Despite this, operating revenues, including moving services and merchandise marketing, declined ¥1,031 million, or 2.4%, to ¥42,611 million (U.S.\$403.2 million). Operating income fell ¥1,498 million to ¥10 million (U.S.\$0.1 million).

e-Business

The e-Business segment includes information services targeted at the business market, including ASP services and the development of information systems.

A new data center, designed to provide safe, reliable and competitively priced services, was completed in Koto-ku, Tokyo in April 2003, helping us actively promote our e-Business. As a result, operating revenues increased ¥1,354 million, or 6.9%, to ¥21,082 million (U.S.\$199.5 million). Operating income rose ¥703 million, or 40.3%, to ¥2,447 million (U.S.\$23.2 million).

Financial

The Financial segment includes financial services targeted at business customers and consumers, such as settlement and collection.

In the fiscal year ended March 31, 2004, Financial services were actively promoted through campaigns and other initiatives to increase delivery volumes for our core *Collect Service*. As a result of these and other factors, operating revenues, including collection service fees and leasing income, increased ¥1,720 million, or 8.1%, to ¥22,920 million (U.S.\$216.9 million) and operating income rose ¥548 million, or 9.5%, to ¥6,346 million (U.S.\$60.0 million).

Financial Review

Operating costs

In the fiscal year ended March 31, 2004, Yamato Transport recorded consolidated operating costs and expenses of ¥964,685 million (U.S.\$9,127.5 million), up ¥49,368 million, or 5.4% from the previous fiscal year. Significant components of the increased operating costs are as follows:

Breakdown of operating costs Years ended March 31	Millions of Yen		
	2003	2004	Increase/ decrease
Personnel expenses	¥ 503,828	¥ 526,882	¥23,054
Subcontracting expenses	318,809	311,349	(7,460)
Vehicle expenses	18,442	23,346	4,904
Other expenses	198,925	217,143	18,218
Elimination of internal procurement costs	(124,687)	(114,035)	10,652
Total	¥ 915,317	¥ 964,685	¥49,368

Personnel expenses increased ¥23,054 million, an increase largely attributed to reallocation of employees as a result of consolidation of back-office operations in support of restructuring the *Takkyubin* network and an increase in the ranks of delivery personnel. The number of employees increased by 19,026 to 131,974. The number of full-time employees went up by 1,540 to 69,398 and the number of part-time employees rose by 17,486 to 62,576. As a result, the share of part-time employees in Yamato Transport's workforce increased 7.5 percentage points to 47.4%. Provision for retirement benefits decreased ¥14,609 million to ¥18,424 million due to exemption from future pension obligation of the governmental program.

Subcontracting expenses declined by ¥7,460 million, due to a ¥17,820 million decline in commission expenses following the merger of Shikoku Yamato Transport Co., Ltd. and Kyushu Yamato Transport Co., Ltd., which reduced delivery expenses.

Vehicle expenses rose ¥4,904 million as our vehicle maintenance facilities were spun off to a subsidiary.

Other Income and Expenses

Other income—net increased ¥6,389 million to ¥40,634 million (U.S.\$384.5 million).

The principal component of other income was a ¥40,470 million gain on decrease of pension obligation with transfer to cash balance plan. Loss on devaluation of land (¥8,697 million in the fiscal year ended March 31, 2003) and unrealized loss on devaluation of investment securities (¥2,002 million in the fiscal year ended March 31, 2003), which significantly affected income in the previous fiscal year, narrowed in the fiscal year ended March 31, 2004.

Net Income

Income before income taxes and minority interests declined ¥3,770 million, or 4.1%, to ¥87,293 million (U.S.\$825.9 million). Income taxes declined ¥5,023 million to ¥37,515 million (U.S.\$355.0 million). The result was a net ¥1,281 million, or 2.6%, increase in net income to ¥49,783 million (U.S.\$471.0 million). Return on equity declined 0.9 of a percentage point to 11.7%.

As a result of these factors, diluted net income per share amounted to ¥105.20 (U.S.\$1.00), an increase of ¥3.57, or 3.5%. As a part of the program to strengthen group management, profit sharing with shareholders will be linked to consolidated profit. Furthermore, the payout ratio target has been set at a minimum of 30% of the consolidated net income. In line with this policy, the annual dividend was raised by ¥3 per common share to ¥18.00 (U.S.\$0.17).

Cash Flows

(Operating Activities)

Net cash provided by operating activities totaled ¥41,064 million (U.S.\$388.5 million), a decrease of ¥44,971 million from the previous fiscal year. The principal uses of cash in operating activities were capital expenditures for reengineering the *Takkyubin* network and an increase in notes and accounts receivable.

(Investing Activities)

Net cash used in investing activities was ¥40,684 million (U.S.\$384.9 million), an increase of ¥1,309 million. The principal use of cash in investing activities was an increase of ¥14,007 million for the purchase of property, plant and equipment. This included continuing introduction of low-emission vehicles, and the purchase of a complete set of receipt-filing-system equipment for the reengineering of the *Takkyubin* network. Purchases of marketable and investment securities declined ¥10,734 million from the previous fiscal year.

(Financing Activities)

Net cash used in financing activities totaled ¥16,440 million (U.S.\$155.6 million), a decrease of ¥57,155 million, from the previous fiscal year. The principal uses of cash were ¥9,984 million for the buyback of 7.7 million shares (based on a resolution approved by shareholders) and cash dividend payments of ¥7,427 million.

As a result of these actions, cash and cash equivalents at the end of the fiscal year totaled ¥117,031 million (U.S.\$1,107.3 million), down ¥15,362 million from the end of the previous fiscal year.

Financial Position

Total current assets as of March 31, 2004 were ¥251,261 million (U.S.\$2,377.3 million), an increase of ¥3,153 million, or 1.3%, mainly because of a ¥10,188 million, or 12.0%, increase in notes and accounts receivable.

Net property, plant and equipment increased ¥8,201 million, or 2.6%, to ¥326,995 million (U.S.\$3,093.9 million), reflecting continuing investment in the Delivery service and other facilities. There was a net ¥8,498 million increase in buildings and structures, including a ¥3,872 million investment in a new YSD data center and a ¥6,693 million increase in vehicles and transport equipment. In the fiscal year ended March 31, 2004, the Group purchased 6,979 vehicles, including replacements. The Group's network as of March 31, 2004 was as follows:

Network

Years ended March 31	2003	2004
Vehicles (unit)	37,741	41,563
Delivery channels	3,583	8,267
Sub-agents	317,595	306,986

Investments and Other Assets declined ¥14,439 million or 16.2%, to ¥74,536 million (U.S.\$705.2 million). Investment securities declined ¥1,735 million, reflecting the streamlining of the portfolio. Deferred tax assets fell ¥13,302 million as temporary differences upon transfer to a new retirement benefit system were amortized.

As a result of the foregoing, total assets declined ¥3,085 million, or 0.5%, from the end of the previous fiscal year, to ¥652,792 million (U.S.\$6,176.5 million).

Total current liabilities as of March 31, 2004 were ¥176,458 million (U.S.\$1,669.6 million), an increase of ¥5,864 million, or 3.4%, from the previous fiscal year-end. The current portion of corporate bonds was ¥17,000 million.

Total long-term liabilities fell ¥46,073 million, or 58.7%, to ¥32,455 million (U.S.\$307.1 million). The principal factors contributing to the decline were a switch to DA accounting and the introduction of a CMS system to reduce interest-bearing debt, in addition to the establishment of a credit facility to strengthen the Group's financial position. Corporate bonds coming due this year totaled ¥17,000 million and were therefore reclassified as current assets. Liabilities for employees' retirement benefits declined ¥29,479 million as a portion of reserve for employees' retirement benefit was liquidated following the transfer to a new employee retirement benefit system.

Total shareholders' equity rose ¥37,409 million, or 9.2%, to ¥443,715 million (U.S.\$4,198.3 million). The principal factors were the addition of ¥43,394 million in retained earnings from the posting of net income. Another factor was the rebound in stock prices that led to a ¥3,935 million increase in unrealized gain on available-for-sale securities. Continuing purchases of treasury stock led to an increase of ¥9,791 million in treasury stock. Shareholders' equity per share rose ¥96.76, or 11.1%, to ¥971.84 (U.S.\$9.20). The shareholders' equity ratio rose 6.1 percentage points to 68.0%.