Management's Discussion and Analysis

Scope of Consolidation

Yamato's consolidated financial statements include 43 major consolidated subsidiaries. The number of subsidiaries included in the statements was 40 at fiscal 2004 year-end. However, in fiscal 2005, 4 new companies, including Yamato Career Service Co., Ltd., were included to reflect their contribution to the business, while one company was dissolved due to a merger between consolidated subsidiaries. There are no non-consolidated subsidiaries or affiliates accounted for by the equity method during the period under review.

Results of Operations

In the fiscal year ended March 31, 2005, the Japanese economy showed some encouraging signs of recovery, underpinned by increased exports and capital expenditures in the private sector. These gains, however, fell short of full recovery in consumer spending and other deflationary trends, and the economic environment remained difficult.

The domestic transportation industry faced tighter environmental laws and safety regulations and strove to fulfill its social responsibility. The business environment remained harsh amid escalating competition among transportation companies, including the aggressive entry of Japan Post into the private sector with its renewed *Yu-Pack*, a package delivery service launched in October 2004.

In this context, the Group aimed for higher profit by taking proactive steps to expand its business. Entering the final year of the Yamato Group "Rebirth and Evolution Three-Year Plan," the Group offered products and services that satisfy customers even more and strengthened its corporate structure.

As a result of the above and other factors, Yamato Transport recorded consolidated operating revenues of ¥1,071,903 million (U.S.$9,981.4 million), up ¥60,559 million, or 6.0%, from the previous fiscal year. Operating income also grew ¥4,544 million, or 9.7%, to ¥51,203 million (U.S.$476.8 million). Total operating costs included ¥723 million that reflects a change in the depreciation method used for all *Cool Takkyubin* facilities from the straight-line method to the declining-balance method.

The operating income margin rose 0.2 of a percentage point to 4.8%. This is mainly due to the transfer of the premium and the additional portion of the basic portion of the governmental pension program to the cash balance plan of the new retirement benefit system on March 31, 2004, as well as to the reduced provision for retirement funds resulting from the transfer of the retirement allowance plan to the cash balance plan on October 1, 2004.

Review by Operating Segment

The following are summaries from each operating segment:

Delivery

The Delivery business is mainly focused on small parcel delivery services for consumers and corporate clients and includes *Takkyubin* and *Kuroneko Mail* services. Both the total delivery volume and revenue for the *Takkyubin* service increased strongly, due to introduction of new services and active measures taken to improve customer convenience. Overall delivery volume in the parcel delivery business climbed to 1,063.1 million parcels, up 5.1% year on year. Contributing to growth was *Cool Takkyubin*, where volume increased 5.3% to 129.2 million units. Moreover, the *Collect Service* handling volume increased 7.9% to 68.5 million units. Meanwhile, the unit price for the *Takkyubin* service dropped ¥16 from ¥682 in fiscal 2004 to ¥666, due to acquisition of large accounts and intensifying competition in the parcel delivery business. Consequently, total *Takkyubin* service revenue increased 2.7% to ¥708,503 million.

Both total delivery volume and revenue for the *Kuroneko Mail* service grew substantially, reflecting stronger operations including increased handling services for corporate customers and expansion of service counters. Handling volume increased 44.1% to 1,432.4 million units. Meanwhile, the unit price for the *Kuroneko Mail* service dropped ¥11 from ¥84 in fiscal 2004 to ¥73, reflecting volume discounts offered by Japan Post starting February 2003. Consequently, revenue for the *Kuroneko Mail* service grew 24.3% to ¥103,959 million.

Total operating revenues, including Domestic Air Freight, *Yamatobin*, moving services and Rail-Freight Forwarding and Others, were ¥866,752 million (U.S.$8,071.1 million), an increase of ¥32,257 million, or 3.9%. Operating income was ¥36,267 million (U.S.$337.7 million), an increase of ¥719 million, or 2.0%, despite higher personnel expenses for strengthening the quality of delivery services.

Takkyubin Revenues, Delivery Volume, and Unit Price

Years ended March 31	2001	2002	2003	2004	**2005**
Takkyubin revenues (Millions of Yen)	658,156	683,589	698,499	690,088	**708,503**
Delivery volume (1,000 parcels)	898,595	947,895	983,938	1,011,150	**1,063,057**
Unit price (Yen)	732	721	710	682	**666**

Unit price 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

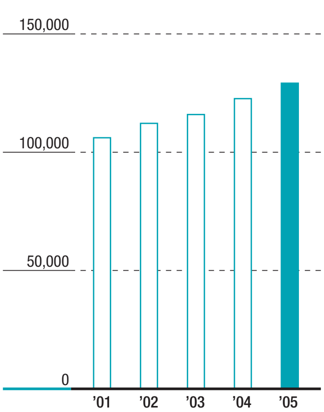
The BIZ-Logistics provides inter-company logistics services aimed at the B2B supply chain management market and includes air-freight forwarding, logistics business and marine forwarding.

The air-freight forwarding business posted an increase of 17.1% to ¥66,448 million, reflecting strong growth of the forwarding business in North America. The logistics business recorded revenue of ¥17,513 million, up 76.9%, due to integrated services encompassing both domestic and international networks.

Combining other areas such as marine forwarding, packing operations, and other services, operating revenue rose ¥20,455 million, or 22.7%, to ¥110,691 million (U.S.$1,030.7 million), with operating income rising by ¥1,063 million, or 34.4%, to ¥4,151 million (U.S.$38.7 million).

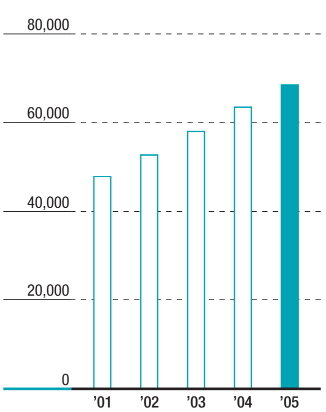
Cool Takkyubin Delivery Volume

(1,000 parcels)



Collect Service Delivery Volume

(1,000 parcels)



Home Convenience

The 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.

Due to intensified competition with rival companies, moving services posted ¥33,090 million in revenue, down 5.2% from the previous fiscal year, despite measures taken to strengthen moving service operations, including reassessment of the service lineup. Meanwhile, merchandise marketing recorded ¥21,261 million in revenue, up 9.1%, reflecting favorable sales of gift merchandise.

As a result, operating revenues, including other businesses, increased ¥773 million, or 1.8%, to ¥43,384 million (U.S.$404.0 million). However, there was an operating loss of ¥638 million (U.S.$5.9 million), reflecting increased fixed expenses for moving services and other items.

e-Business

The e-Business segment encompasses information services targeting business customers, including ASP services and the development of information systems.

During the year under review, e-Business changed its on-premise business format to solution-oriented services and offered other new services, including information security consulting. As a result, operating revenues increased ¥3,350 million, or 15.9%, to ¥24,432 million (U.S.$227.5 million). Operating income rose ¥462 million, or 18.9%, to ¥2,909 million (U.S.$27.1 million).

Financial

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

In the fiscal year ended March 31, 2005, Financial services were actively promoted through campaigns and other initiatives to increase delivery volumes for our *Collect Service* and new settlement services. Consequently, operating revenues increased ¥3,724 million, or 16.2%, to ¥26,644 million (U.S.$248.1 million). Operating income rose ¥81 million, or 1.3%, to ¥6,427 million (U.S.$59.8 million).

Financial Review

Operating Costs

In the fiscal year ended March 31, 2005, Yamato Transport recorded consolidated operating costs and expenses of ¥1,020,700 million (U.S.$9,504.6 million), up ¥56,015 million, or 5.8% from the previous fiscal year. Significant components of the operating costs were as follows:

Breakdown of operating costs — Millions of Yen

Years ended March 31	2004	**2005**	Increase/ decrease
Personnel expenses	¥ 526,882	**¥ 542,306**	¥ 15,424
Subcontracting expenses	311,349	**357,024**	45,675
Vehicle expenses	23,346	**27,277**	3,931
Other expenses	217,143	**235,163**	18,020
Elimination of internal procurement costs	(114,035)	**(141,070)**	(27,035)
Total	¥ 964,685	**¥1,020,700**	¥ 56,015

Personnel expenses increased ¥15,424 million, reflecting a decrease of ¥4,654 million in provision for retirement benefits, offset by an increase of ¥18,748 million in salaries to employees to boost service quality and other factors. The number of employees increased by 9,628 to 141,602, reflecting a higher number of part-time employees in the Delivery business.

Major factors contributing to increased operating costs and expenses are higher subcontracting expenses for *Kuroneko Mail* and increased subcontracting expenses resulting from delivering more diverse types of goods. As a result, subcontracting expenses for fiscal 2005 increased ¥45,675 million, or 14.7%.

Vehicle expenses rose ¥3,931 million due to the conversion of the vehicle maintenance division into a subsidiary in October 2003.

Other expenses increased ¥18,020 million, primarily due to higher expenses to support the launch of more *Takkyubin centers* and the adoption of pro forma standard taxation.

Other Income and Expenses

In fiscal 2005, other income—net decreased ¥30,096 million to ¥10,538 million (U.S.$98.1 million).

The major factor contributing to this decrease was a ¥40,470 million gain on decrease of pension obligation upon transfer of funded retirement benefits plan to cash balance plan booked last year, which was absent this fiscal year, while there was a ¥14,383 million gain on decrease of retirement benefit obligation upon transfer of unfunded retirement benefits plan to cash balance plan in fiscal 2005. Moreover, ¥4,597 million in loss on impairment of long-lived assets was posted due to the application of impairment accounting, continued negative growth in operating activities at five asset groups including major offices in the Saikyo regional branch, and a significant drop in market prices.

Net Income

In fiscal 2005, income before income taxes and minority interests decreased ¥25,552 million, or 29.3%, to ¥61,741 million (U.S.$574.9 million). Income taxes decreased ¥9,556 million to ¥27,959 million (U.S.$260.4 million). The result was a net ¥15,935 million, or 32.0%, decrease in net income to ¥33,848 million (U.S.$315.2 million). This figure reflects a ¥66 million loss in minority interests. Return on equity (ROE) declined 4.2 percentage points to 7.5%.

As a result of these factors, diluted net income per share amounted to ¥72.48 (U.S.$0.67), a decrease of ¥32.72, or 31.1%.

The annual dividend was ¥18.00 (U.S.$0.17), the same level as the previous fiscal year.

Cash Flows

Operating Activities

Net cash provided by operating activities totaled ¥76,642 million (U.S.$713.7 million), an increase of ¥35,578 million from the previous fiscal year. The major factors included a decrease in income before income taxes and minority interests of ¥25,552 million to ¥61,741 million, the amount of decrease in liability for employees' retirement benefits, which fell behind the previous fiscal year by ¥24,397 million, and an increase of ¥31,016 million in notes and accounts payable compared to fiscal 2004.

Investing Activities

Net cash used in investing activities was ¥39,990 million (U.S.$372.4 million), a decrease of ¥694 million. The principal uses of cash in investing activities were ¥36,443 million in acquiring fixed assets, primarily vehicles, though total expenses in acquiring fixed assets decreased ¥10,503 million from the previous fiscal year.

Financing Activities

Net cash used in financing activities totaled ¥33,912 million (U.S.$315.8 million), an increase of ¥17,472 million from the previous fiscal year. The principal use of cash was ¥17,000 million for redeeming company bonds. This was adequately covered by higher cash flow from operating activities.

As a result of these actions, cash and cash equivalents at the end of the fiscal year totaled ¥120,030 million (U.S.$1,117.7 million), up ¥2,999 million from the end of the previous fiscal year.

Financial Position

Total current assets as of March 31, 2005 were ¥269,489 million (U.S.$2,509.4 million), an increase of ¥18,228 million, or 7.3%, mainly because of a ¥20,816 million, or 21.8 %, increase in notes and accounts receivable.

Net property, plant and equipment decreased ¥2,454 million, or 0.8%, to ¥324,541 million (U.S.$3,022.1 million). The major contributing factor to this decrease was a net ¥3,458 million drop in buildings and structures, ¥1,777 million of which is included as an asset impairment loss. The asset impairment loss for land was ¥2,820 million.

Investment and other assets increased ¥7,590 million, or 10.2%, to ¥82,126 million (U.S.$764.7 million). This was due primarily to an increase of ¥5,383 million in investment securities to ¥23,051 million, from the establishment of long-term time deposits and other factors.

As a result of the foregoing, total assets increased ¥23,364 million, or 3.6%, from the end of the previous fiscal year, to ¥676,156 million (U.S.$6,296.3 million).

Total current liabilities as of March 31, 2005 were ¥188,646 million (U.S.$1,756.6 million), an increase of ¥12,188 million, or 6.9%, from the end of the previous fiscal year, due primarily to an increase in notes and accounts payable by ¥24,641 million, or 31.6%. The decrease of ¥17,000 million in the current portion of corporate bonds is due to the redemption of straight corporate bonds issued by Yamato Transport Co., Ltd. and Yamato Lease Co., Ltd.

Total long-term liabilities fell ¥3,835 million, or 11.8%, to ¥28,620 million (U.S.$266.5 million). The principal factors contributing to the decline were a decrease of ¥5,233 million in pension obligation with transfer to the new retirement allowance plan and an increase of ¥2,000 million in corporate bonds, reflecting bonds issued by Yamato Lease Co., Ltd. Other factors include 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, all implemented since fiscal 2003.

Total shareholders’ equity rose ¥15,077 million, or 3.4%, to ¥458,792 million (U.S.$4,272.2 million). The principal factor was the addition of ¥25,274 million in retained earnings from the posting of net income. The decrease of ¥10,315 million in treasury stocks mainly reflects market purchases during the fiscal year under review. Shareholders’ equity per share rose ¥47.18, or 4.9%, to ¥1,019.02 (U.S.$9.49). The shareholders’ equity ratio dropped 0.1 of a percentage point to 67.9%.

Retirement and Pension Plan

The Group's defined benefits pension plans include a contributory funded defined benefit pension plan based on a cash balance plan and a lump-sum severance payment plan. However, on October 1, 2004, revisions were made to the Group's regulations on pension allowance payments, transferring the retirement allowance plan to the cash balance plan. Some consolidated subsidiaries have a defined contribution retirement benefits plan.

Capital Expenditure

Capital expenditure was ¥40,966 million (U.S.$381.5 million), providing the necessary delivery framework to improve the quality of the core *Takkyubin* services and offer additional services across Japan. The following is a breakdown of capital expenditure.

Breakdown of capital expenditure

	Millions of Yen		Thousands of U.S. Dollars
	2004	**2005**	**2005**
Delivery	¥35,753	**¥26,657**	**$248,225**
BIZ-Logistics	678	**830**	**7,733**
Home Convenience	1,183	**458**	**4,264**
e-Business	857	**906**	**8,433**
Financial	8,972	**11,632**	**108,319**
Eliminations and Corporate	144	**483**	**4,500**
Consolidated	¥47,587	**¥40,966**	**$381,474**

In the Delivery business, capital expenditure was ¥26,657 million, including the opening of new *Takkyubin* centers, additional purchase and replacement of delivery vehicles, new construction of base terminals, purchase of freezers and refrigerators and other items.

Network

	2004	**2005**
Number of vehicles	41,563	**49,046**
Number of delivery channels	8,267	**8,467**
Number of sub-agents	306,986	**296,438**

In the Financial business, capital expenditure was ¥11,632 million, which mainly included the purchase of office equipment such as personal computers and light-duty vehicles for leasing.