

Financial Strategy

Showa Shell uses assets efficiently by divesting inefficient assets and minimizing working capital. The Company's financial policies are geared towards maximizing earnings and cash flow while repaying interest-bearing liabilities.

During the current year, we will continue to follow these basic strategies while rigorously examining capital investments and investigating the economic viability and growth potential of new businesses.

Profitability

During 2001, the Japanese economy slid further into recession as private capital investment and corporate earnings continued to decline and personal consumption was unable to regain strength due to a lack of improvement in employment and wages.

Under these challenging economic conditions, the Showa Shell Group worked to achieve a reduction in structural costs, rationalize the business portfolio, and pursue customer-led value generation while maximizing profitability.

As a result, although total sales volume remained largely unchanged from the previous year, consolidated net sales increased 1.6 percent to ¥1,664.9 billion due to higher sales volume for gasoline and kerosene.

Operating profit fell 25.5 percent to ¥28.0 billion, and ordinary profit declined 25.3 percent to ¥29.0 billion compared with the previous year. However, excluding the effect of inventory valuation, ordinary profit on a current cost of supply (CCS) basis rose ¥18.3 billion to ¥40.1 billion. Factors included higher sales of more profitable petroleum products, and a reduction in refining costs and selling, general and administrative expenses due to rationalization and improved efficiency, as well as contributions by consolidated subsidiaries and affiliates. The Company recorded a special loss of ¥25.0 billion due to the lump-sum amortization of a ¥30.6 billion difference arising from the application of revised accounting standards for retirement benefits in 2001, as well as a valuation loss on listed company stock due to the adoption of mark-to-market accounting. As a result, net income fell 79.1 percent to ¥2.6 billion. Free cash flow, comprising cash flow provided by operating activities and investing activities, totaled ¥114.3 billion. Total borrowings at the end of the year were ¥170.9 billion, as the Showa Shell Group reduced its dependence on interest-bearing liabilities, thus further strengthening its financial structure.

Segment results were as follows:

Petroleum

Sales increased 1.6 percent to ¥1,648.2 billion and operating profit totaled ¥24.7 billion, compared to ¥34.6 billion the previous year. Although operating profit fell by ¥9.9 billion, if the effect of inventory valuation were excluded, operating profit would have increased by ¥18.3 billion to ¥35.8 billion, compared to ¥17.5 billion the previous year. Factors included higher sales of more profitable petroleum products, and a reduction in refining costs and selling, general and administrative expenses due to rationalization and improved efficiency, as well as contributions by consolidated subsidiaries and affiliates.

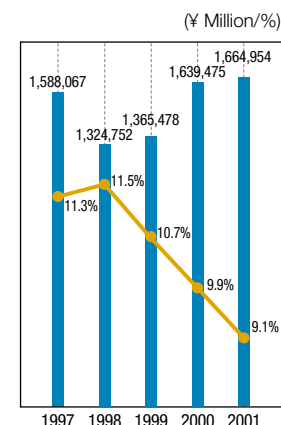
Real Estate

Net sales rose 3.8 percent to ¥4.8 billion as rental income increased due to an influx of new tenants. Operating profit increased 6.0 percent to ¥2.8 billion due to efforts to reduce expenses and raise operating efficiency.

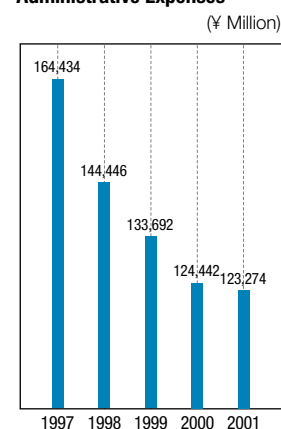
Other

Net sales totaled ¥18.7 billion, as the challenging operating environment in the petroleum industry led to contraction in sales of solar batteries, sales and leasing of automobile-related products, the

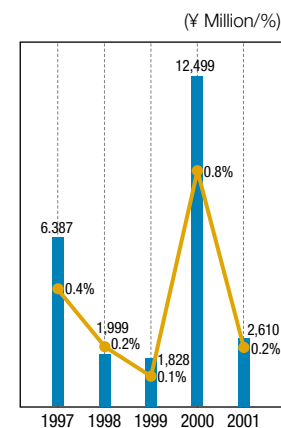
Net Sales/Gross Profit Margin



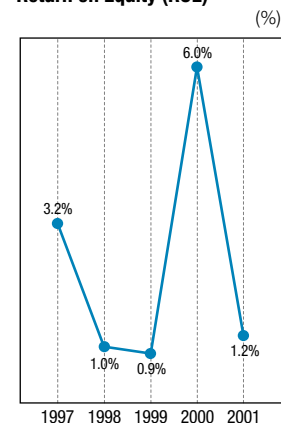
Selling, General and Administrative Expenses



Net Income/Return on Sales



Return on Equity (ROE)



construction business and other businesses. Operating profit totaled ¥0.6 billion as a result of efforts to streamline operations and increase efficiency in all areas.

Assets and Liabilities

Total assets decreased ¥92.2 billion year-on-year to ¥909.9 billion. Current assets decreased ¥51.2 billion to ¥386.7 billion. Primary factors included a decrease in notes and accounts receivable due to the effect lower crude oil prices had on sales of crude oil and jointly marketed products. In addition, inventories decreased due to the change in valuation methods.

Current liabilities fell ¥62.1 billion to ¥508.7 billion, due to decreases in notes and accounts payable and short-term borrowings.

Fixed assets decreased ¥41.0 billion to ¥523.1 billion. Factors included a decrease in property, plant and equipment due to a decrease in depreciation and sales of land. Long-term liabilities decreased ¥25.6 billion to ¥185.0 billion due to the repayment of long-term borrowings. Interest-bearing liabilities decreased ¥100.5 billion from the previous year to ¥170.9 billion.

Shareholders' equity decreased ¥4.1 billion to ¥212.1 billion, and the ratio of shareholder's equity to total assets improved 1.7 percentage points to 23.3 percent. Return on average total shareholders' equity (ROE) decreased 4.8 percentage points to 1.2 percent. ROE on a CCS basis was 10.9 percent.

Cash Flow

Cash flow provided by operating activities increased ¥37.0 billion to ¥83.2 billion. The primary reason was an increase in the positive effect on cash flow of provisions to the retirement benefits account. Other contributing factors were a drop in prices of crude oil and petroleum products and a decrease in accounts receivable and inventories due to efforts to accelerate the collections process.

Cash flow provided by investing activities increased ¥18.1 billion to ¥31.0 billion. This was supported by sales of property, plant and equipment in order to improve asset efficiency and reduce interest-bearing liabilities, as well as the redemption of corporate bonds and the sale of investment securities.

Cash flow used in financing activities increased ¥58.7 billion to ¥106.9 billion. The Company actively worked to reduce interest-bearing liabilities in order to strengthen the financial structure.

Cash and cash equivalents as of December 31, 2001 increased by ¥7.6 billion year-on-year to ¥25.0 billion.

Per Share Information

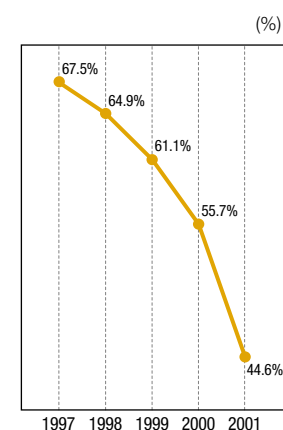
For the year ended December 2001, net income per share decreased from ¥33.19 to ¥6.95, and shareholders' equity per share decreased from ¥574.77 to ¥565.36.

Dividend Policy

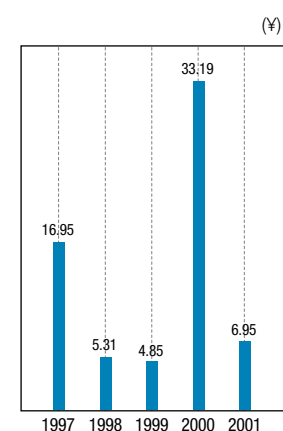
In distributing profits, Showa Shell's fundamental policy is to provide stable dividends, based on the considerations of profitability, the need to strengthen the Company's financial base, and trends in financial markets.

During 2001, the Company achieved a substantial improvement in ordinary profit, excluding the effect of cost of sales on inventory, and continued to generate abundant free cash flow, resulting in a stronger financial structure. Consequently, the Company was able to offer a year-end dividend of ¥14.00 per share. Combined with the interim dividend of ¥6.00 per share, this resulted in a total annual cash dividend of ¥20.00 yen per share, compared to ¥15.00 per share in 2000. The payout ratio was 269.2 percent, and dividend return calculated using shareholders' equity was 3.7 percent. The Company plans to deploy retained earnings to fund strategic capital investments.

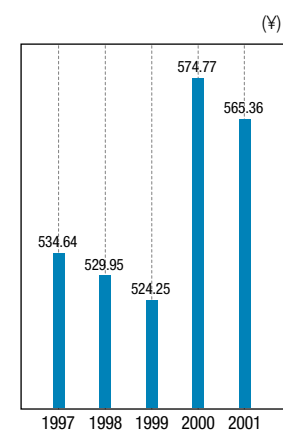
Gearing Ratio



Net Income per Share



Shareholders' Equity per Share



Free Cash Flow

