

## Aiming for Sustainable Growth and Achieving the Goals in Our Second Stage of Reforms

### >>> Fiscal 2002 Results

#### Leading the Industry in Profitability

Soaring crude oil prices made 2002 an extremely challenging year for the downstream oil sector, not only in Japan but worldwide. At the same time, it was a year in which we were able to vividly demonstrate the collective strength of the Showa Shell Group over our competitors. We will continue to avoid complacency toward the status quo as we aim for sustainable growth and pursue further changes to our business model as part of the second stage of our program of corporate reforms.



**Haruyuki Niimi**  
Chairman, Representative Director

**John S. Mills**  
President, Representative Director

#### Success of Corporate Reforms Reflected in Business Performance

The domestic oil industry faced an extremely difficult earnings environment in 2002. Sharp increases in crude oil prices were compounded by lower demand due to the prolonged economic downturn and the warm winter. In addition, margins shrank as a result of intensifying competition and oversupply stemming from unused excess capacity, a situation that is still not resolved. However, the Showa Shell Group was able to achieve consolidated income from operations of ¥36.4 billion (a year-on-year increase of 29.8 percent), ordinary income of ¥40.1 billion (a year-on-year increase of 38.0 percent) and net income of ¥18.7 billion (a year-on-year increase of 615.0 percent). These results reflect the steady success of our industry-leading program of corporate reforms initiated in 1996, and attest to the Showa Shell Group's comprehensive strength and high level of profitability compared to our competitors.

Although Showa Shell maintained a high degree of competitiveness in the domestic industry, we are still unsatisfied with this level. Basing consolidated ordinary income on the weighted-average method for valuing inventories, we were able to achieve our target of ¥40 billion. However, consolidated ordinary income on a current cost of supply basis, which uses actual procurement costs excluding the effect of changes in crude oil prices on inventory, and is used by Showa Shell and its Group companies for earnings forecasts and performance evaluation, decreased 26.9 percent from the previous year to ¥29.3 billion. The major factors for this decrease include a tightening supply-demand balance and intensifying competition in Japan, as well as the fact that the rising cost of crude oil has not been fully reflected in product prices. Containing to maintain or increase earnings while minimizing the impact of trends in the industry and among our competitors will be a key issue for Showa Shell in the future.

#### Customer-Led Value Generation: Building a Brand that is Customers' First Choice

During the second stage of reforms, Showa Shell will focus on rationalizing our business portfolio and developing our ability to generate added value by focusing on customers. An example of the success of these efforts is our new high-octane gasoline Shell Pura, launched in 2002.



#### Shifting from Supply-Side Logic to Customer-Led Value

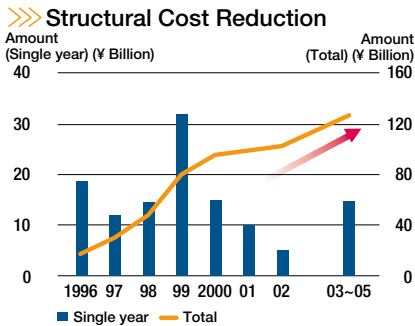
As we enter the second stage of reforms, we will focus more closely on growth potential in addition to efficiency. As a result of its former regulated environment, the Japanese oil industry was based firmly in supply-side logic. Showa Shell previously followed the same way of thinking, making our shift to customer-led value generation the last of the basic strategies among our corporate reforms to be carried out.

Shell Pura, a new high-octane gasoline first launched in the Tokyo metropolitan area last year, was developed in response to the needs of customers, and has won overwhelming support. This successful experience is changing our corporate culture. Retail Renaissance 21, a series of strategies we have been promoting to solidify our relationship with dealers as our business partners, is also generating results. These initiatives made 2002 the year in which the Showa Shell Group began working in earnest to become a brand that is its customers' first choice.

# >>> Sound Financial Structure and Investment Strategies

## Continuing Progress of Structural Cost Reductions and Improvement of the Gearing Ratio

In 2002, Showa Shell reduced structural costs by ¥6.7 billion. Further reduction of interest-bearing debt brought the gearing (debt to equity) ratio to 40.5 percent.

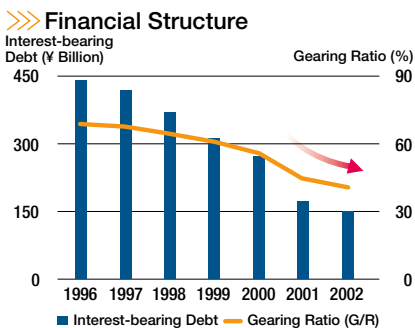


### Reducing Costs by More Than ¥110 Billion and Interest-Bearing Debt by ¥300 Billion

The Showa Shell Group has been working to quickly reduce structural costs, which greatly impact our competitiveness. To concentrate management resources in our core downstream oil business, which comprises refining and sales, we finished dissolving all upstream activities such as oilfield development projects in 2001. In addition, we are aggressively pursuing cost reductions in all areas of our business activities by consolidating and closing refineries, expanding barter arrangements and joint shipping with other companies such as Japan Energy Corporation, and other measures.

In 2002, structural cost reductions totaled ¥6.7 billion on a non-consolidated basis, comprising ¥4.7 billion in refining costs, ¥1.9 billion in distribution costs, and ¥0.1 billion in selling and administrative costs. As a result, we reduced structural costs by a cumulative total of more than ¥110 billion over the six years since 1996. For the three years from 2003 to 2005, we are targeting structural cost reductions of ¥15 billion.

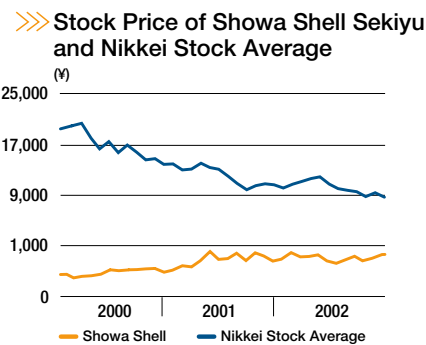
At the same time, we reduced interest-bearing debt from some ¥440 billion in 1996 to approximately ¥150 billion in 2002. Through an aggressive policy of using Group capital to finance subsidiaries, we lowered the consolidated gearing ratio from 68.9 percent in 1996 to 40.5 percent in 2002. Our sound financial structure acts as an advantage in generating free cash flow and offers a broader range of choices for growth investment and capital management.



# >>> New Challenges in the Second Stage of Reforms

## Further Improving Total Shareholders' Return

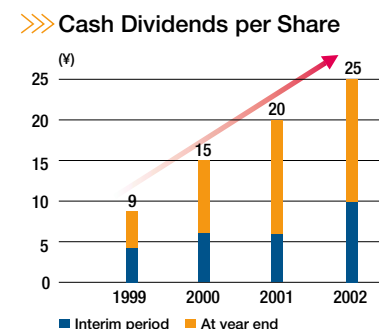
In the second stage of reforms, the Showa Shell Group will work toward growth in order to improve total shareholders' return.



### Toward a Higher Stock Price and Larger Dividends

Over the past seven years, the Showa Shell Group's successful corporate reforms have included efforts to strengthen its core business, reduce structural costs, shift toward the production of white oil, and implement Retail Renaissance 21, a series of strategies to strengthen sales in concert with dealers by increasing our customer orientation. As a result, despite the prolonged stock market slump, Showa Shell's share price levels have risen, earning the Company a strong reputation in the capital market.

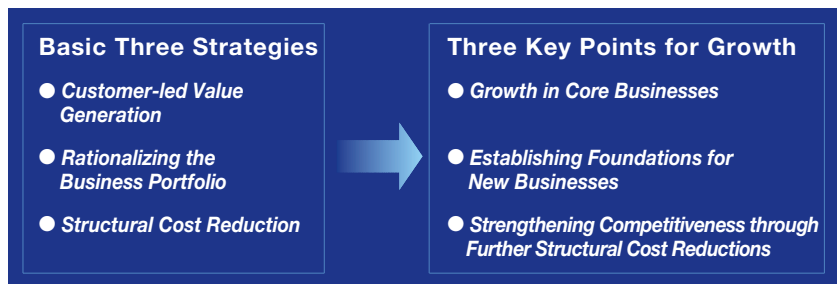
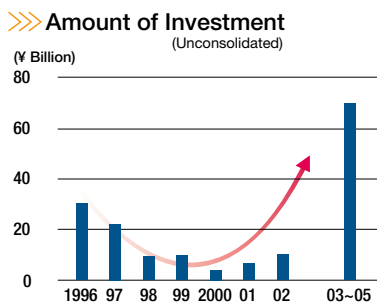
During the second stage of our corporate reforms, we will pursue opportunities for growth in our operations in order to further improve total shareholders' return. Specifically, we must work to meet our shareholders' expectations by increasing shareholder value — specifically, by raising the stock price and increasing dividends. The total annual dividend per share in 2002 was ¥25.00, up ¥5.00 per share from the previous year. We have steadily increased annual dividends per share over the past few years, from ¥9.00 in 1999 to ¥15.00 in 2000 and ¥20.00 in 2001, and we will continue working to maintain or increase the payment of appropriate dividends. Furthermore, we reduced the minimum trading unit from 1,000 shares to 100 shares in October 2002 to enable more people, particularly individual investors, to own stock in the Company.



Today, investment capital can cross national borders in an instant. We are aware that a company must raise returns on investment to international levels, or it will lose these funds to other opportunities, putting its continued existence at risk. As a part of the largest market in Japan and the most mature market in the world, we are aiming for return on equity (ROE) comparable to other companies involved in the downstream oil business, and are determined to further improve shareholder value.

## Pursuing Growth Potential as a Sustainable Leading Company

Continuing with the basic strategies in our second stage of reforms, we will work to further improve competitiveness while fully focusing on added value as a source of growth.



### Increasing Competitiveness and Seeking Growth Opportunities

In the retail marketing business, one of our core areas of operations, Showa Shell will further accelerate and strengthen the initiatives of Retail Renaissance 21 together with dealers as our business partners. We plan to develop a variety of support measures for service stations, such as expanding the sales area for new high-octane gasoline Shell Pura, revitalizing the Shell Car Inspection service and Shell Repair metal and paint finishing business with sales promotions, reviewing our credit card strategy and upgrading the Shell Helix brand of automotive lubricants. We are also working to strengthen our service station network through an overhaul focused on self-service stations, in order to better address customer needs.

Aiming to reduce structural costs by an additional ¥15 billion by 2005, we plan to further improve the efficiency of our refining operations, reorganize our business process by introducing innovations, and strengthen materials procurement.

### Strategic Investment to Support Our Growth Strategy: ¥36 Billion over Three Years

In the second stage of reforms, we will focus on further solidifying our operating base and developing our business in growth areas. Of the more than ¥60 billion in investment budgeted for the three year period from 2003 to 2005, we will allocate ¥36 billion for strategic investments such as expanding our service station network, particularly self-service stations, and incorporating information technology to spur business innovation. Acquisitions are another alternative for strategic investment, and we are investigating attractive opportunities.

A sound financial structure, growth in core business areas and further cost reductions have freed up capital, which will be used to establish new businesses that will provide a major source of future revenues: specifically, new types of environmentally conscious energy sources such as hydrogen for fuel cells and gas-to-liquid (GTL), as well as potential business opportunities that we have not yet explored. We intend to monitor the market trend toward fuel conversion, and actively concentrate human resources, assets, funds and other management resources in energy-related areas with high growth and asset efficiency.

# >>> Aiming for the Strongest Personnel and Organization

## Key Issues for Individual Employees and the Company as a Whole

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Bringing together the strength and wisdom of many will help us to pursue our growth strategies and achieve our goals.

### Initiative, Independence and Teamwork

In the increasingly competitive business environment of the future, traditional thinking and ways of conducting business will not suffice to achieve the goals of our second stage of reforms. Our greatest efforts must be focused on developing new business models and business processes that break away from conventional approaches. Employee skill building and an organization to support these efforts are indispensable in this regard. Professional, strongly goal-oriented employees who work together as a team within the organization are key to our success. Initiative, independence, and teamwork – too much or too little of any of the three precludes strong results. We believe that our goals for the second stage of reforms can be achieved by bringing together the wisdom of all Showa Shell Group employees. Development of human resources and cultivation of a corporate culture that supports this development will continue to be one of our highest priorities this year.

## Strengthening Corporate Governance

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Showa Shell has further strengthened corporate governance by instituting a management organization to implement measures including strengthening our operating structure, decreasing the number of directors and introducing outside directors.

### A More Functional and Organic Organization

In the current business environment of low margins and slow growth, minimization of opportunity losses and the expansion of business chances are extremely important for sustainable corporate growth. Because delays in internal decision making or a lack of action can be disastrous, we are working to create a more functional and organic organization.

The management organization instituted in March 2003 is tasked with strengthening our operating structure by clarifying the roles and responsibilities of the directors and executive officers, increasing management transparency and improving oversight. Showa Shell has decreased the number of directors from 26 at the time of its incorporation in 1985 to eight, including two part-time directors. In addition, we are increasing corporate activities that encompass all divisions, to create an organization in which employees focus more on maximization of company-wide earnings than on the income of their respective divisions.

We are also working to ensure transparency in all of our management. The appointment of outside directors, a first for the Shell Group, represents one part of that effort. With his international sensibility and comprehensive understanding of the Japanese economy and culture, Yoshihiko Miyauchi, Chairman of ORIX Corporation, is a leading executive whose perspective and advice from outside the oil industry is expected to contribute to further reforms.

If we fail to build on the competitive advantage gained through the first stage of reforms, the competition will soon catch up. To succeed in the industry, we must always stay ahead of our competitors. The Showa Shell Group will continue to work unceasingly to maximize shareholder value through reforms and solid performance. We hope for the continued support of all of our shareholders.

