



## To Our Shareholders

### Overview of Fiscal 2004

Crude oil prices rose to record levels during the fiscal year ended December 31, 2004, presenting Showa Shell with a challenge that we met without flinching. With crude oil accounting for the majority of the Company's manufacturing costs, Showa Shell has to react swiftly to rising prices of crude oil. Although not immediately apparent during the first half of fiscal 2004, Showa Shell succeeded in adjusting its gasoline and other prices to compensate for rising crude oil prices by the second half of fiscal 2004. Net sales for fiscal 2004 rose to ¥1,839.4 billion, up 6.5 percent year on year. With gross profit of ¥173.4 billion, the gross profit margin on net sales was 9.4 percent, up 0.3 percentage point from fiscal 2003.

A continuing effort to reduce costs enabled Showa Shell to lower its selling, general and administrative (SG&A) expenses to ¥113.2 billion, down 6.2 percent year on year. The ratio of SG&A expenses to net sales was 6.1 percent, down from 7.0 percent in fiscal 2003. As a result of these initiatives, income from operations rose significantly to ¥60.2 billion, up 67.3 percent from fiscal 2003.

### Enhanced Profitability, Independent of Fluctuations in Crude Oil Prices

Ordinary income was significantly higher than our initial forecast, reaching a record-high ¥61.9 billion, up 62.2 percent year on year. In years when crude oil prices rise, profits tend to be boosted by the effect of valuation of inventory. For the fiscal year ended December 31, 2004, valuation gains on inventories boosted profits by ¥21.5 billion. The Company's ordinary income, based on the current cost of supply (CCS), minus valuation gains on inventories, was ¥40.4 billion, up 11.3 percent compared with ¥36.3 billion in fiscal 2003. This result indicates that Showa Shell's profits have grown steadily, independent of the ups and downs of crude oil prices.

Net income was ¥2.3 billion in fiscal 2004, due to the early adoption of accounting for impairment of assets, which will not be mandatory for two more years. The special loss from impairment of assets was ¥33.7 billion, which led to a temporary drop in net income. However, this move is expected to benefit Showa Shell by strengthening our financial position and improving the transparency of financial activities. Return on equity (ROE), calculated on a basis that eliminates special factors such as accounting for impairment of

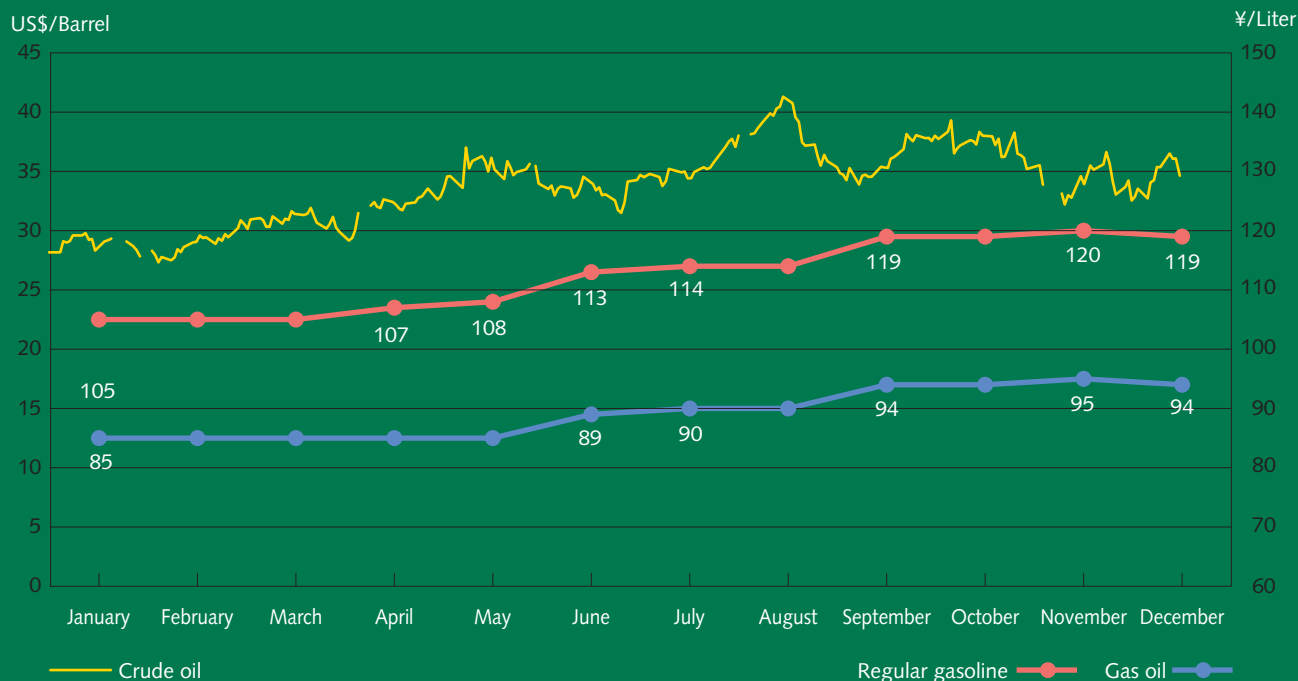


*Haruyuki Niimi, Chairman,  
Representative Director*

*John S. Mills, President,  
Representative Director*

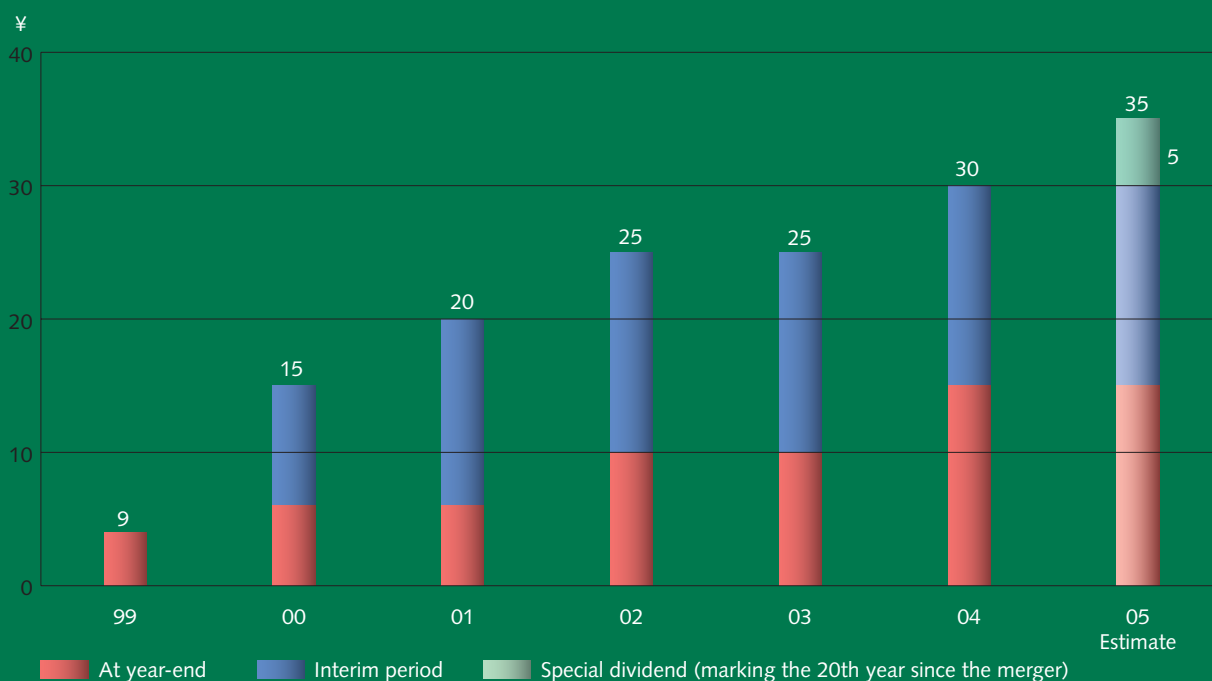
# A year in which Showa Shell dealt with record rises in crude oil prices and redefined its true value as a corporation.

Crude Oil Costs and Retail Oil Prices in 2004



Source: Survey of Market Conditions for Oil Products Sold through Service Stations, The Oil Information Center.

Cash Dividends



assets and valuation gains on inventories, was 10.2 percent, improving 1.0 percentage point from 9.2 percent in the previous year.

### **Continuous Dividend Increases**

Showa Shell has made steady gains in total annual cash dividends since the ¥9 dividend per share recorded in fiscal 1999. For fiscal 2004, the Company paid out a total annual cash dividend of ¥30 per share, up ¥5 year on year. The dividend increase reflects the Company's efforts to achieve a stronger financial position and improve both its cost-competitiveness and revenue earning capability.

For fiscal 2005, the Company plans to issue a special cash dividend of ¥5 marking the 20th anniversary of the merger of Showa Oil and Shell Sekiyu. Combined with the forecasted regular cash dividend of ¥30 per share, the total annual cash dividend is projected at ¥35 per share, for an increase of ¥5 year on year.

### **Embarking on the Path to Growth**

Since 1996, Showa Shell has tended to maintain a balanced state of contraction due to its giving priority to strengthening its financial position. In fiscal 2004, capital expenditures exceeded the Company's depreciation for the first time in eight years, with capital expenditures of ¥25.3 billion exceeding depreciation of ¥24.7 billion. This performance was due to the Company's decision to embark on the path toward sustained revenue growth. As for capital expenditures, Showa Shell made strategic investments and loans, which included raising the investment ratio in Seibu Oil Co., Ltd., taking a stake in Marubeni Energy Corporation, and implementing acquisition of ITOCHU LubNet Inc. Other investments included the purchase of DM Gas Station, Inc., and financing to restructure a dealer in which Showa Shell had invested. In addition to conventional maintenance investment, notable investments in manufacturing equipment included strategic investments for adding value and environmental measures, through facility investment in plant and equipment to supply sulfur-free fuel with a sulfur content of less than 10 ppm.

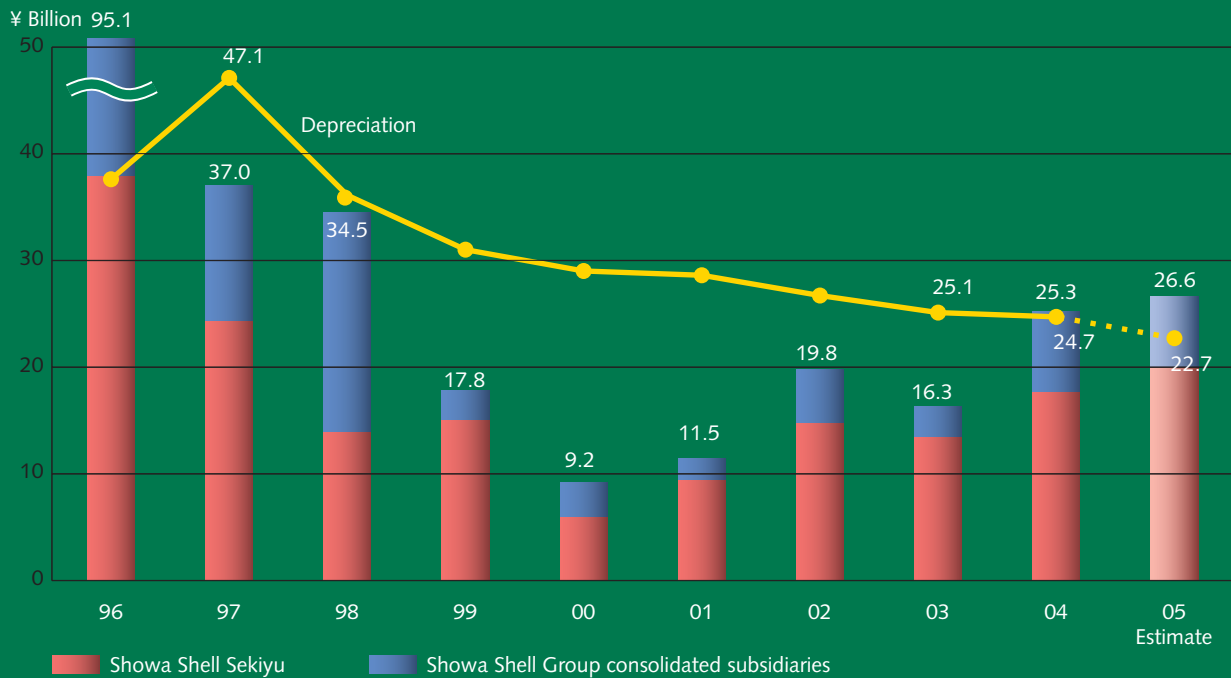
For fiscal 2005, Showa Shell is targeting net sales of ¥2,190.0 billion for a year-on-year increase of 19.0 percent. The goal for ordinary income is ¥60.0 billion, down 3.0 percent from fiscal 2004, while the net income objective is ¥35.0 billion, an increase of approximately 14.8 times over the previous years total. The expected drop in ordinary income in spite of higher net sales is due to the temporary boost in profits from valuation gains in inventories that occurred in fiscal 2004, and in no way indicates a drop in the Company's profitability. Ordinary income based on CCS is forecasted at ¥45.0 billion, increasing again by 11.3 percent over fiscal 2004. Showa Shell will meet its goals through proactive investment leading to sustainable revenue growth, paired with initiatives to further improve management efficiency.

### **Change in Shareholder Composition (Equity Participation by Saudi Aramco and Increase of Individual Shareholders)**

The shareholder makeup at Showa Shell changed significantly during fiscal 2004, when the Company gained a new partner in Saudi Aramco, the national oil company of Saudi Arabia, the world's largest oil producing nation. Saudi Aramco joins the Royal Dutch/Shell Group, one of the world's leading oil conglomerates, as a

# Shifting from a balanced state of contraction to a path of growth. Showa Shell is increasing its capital expenditures to achieve sustained growth in revenue and income.

Capital Expenditures and Depreciation (Consolidated)



Capital Investments Based on Growth Strategy



major shareholder of Showa Shell. The equity participation by Saudi Aramco is important for Showa Shell's business as well as corporate governance.

In December 2004, Showa Shell issued a secondary offering that significantly increased the number of shareholders, individual shareholders in particular, which helped to improve the liquidity of the Company's shares on the stock market. In fiscal 2005, the Company will implement a further stock transfer that will give the Royal Dutch/Shell Group a 35 percent stake and Saudi Aramco a 15 percent stake in Showa Shell, with common shareholders holding a 50 percent stake.

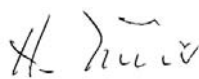
**The "New Foundation" Philosophy**

Showa Shell Sekiyu K.K. was formed 20 years ago through the merger of Showa Oil Co., Ltd., and Shell Sekiyu K.K. in 1985. In the first decade after the merger, the oil industry as a whole received protection under the Provisional Measures Law on the Importation of Specific Kinds of Petroleum Refined Products, or Special Petroleum Law. With the abolishment of Japan's Special Petroleum Law in April 1996, the ensuing decade has brought dramatic changes in the business environment for the Japanese oil industry and an industry restructuring. During this period of restructuring, Showa Shell renewed its focus on its core businesses and sought to reduce structural costs, enabling the Company to achieve a strong financial position and a level of profitability that leads the Japanese oil industry. However, recognizing the need to avoid complacency based on past success, we have adopted the "New Foundation" philosophy, aimed at securing an even brighter future for Showa Shell.

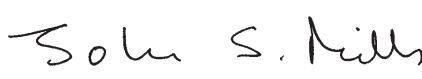
This philosophy encapsulates three major approaches for Showa Shell. The first approach is to break away from our past, in a good sense. This approach enables us to examine long-cultivated strengths to identify which strengths are necessary to achieve future growth, without unduly focusing on past success. The second approach is our decision to set out on a path of growth in an effort to increase profits driven by revenue growth, in addition to the previous focus on securing profits through efficiency improvements and cost reduction. Finally, the "New Foundation" philosophy symbolizes the beginning of a new era for Showa Shell, with the change in shareholder composition.

The "New Foundation" philosophy is also indicative of an even greater recognition by management of the need to fulfill Showa Shell's responsibilities to its shareholders. Due to changes in the composition of the Company's major shareholders, individual and institutional investors now comprise Showa Shell's largest group of shareholders. The management at Showa Shell is fully committed to ensuring that the Company meets the expectations of its individual and institutional investors.

We look forward to our shareholders' continued understanding of and support for the Showa Shell Group.



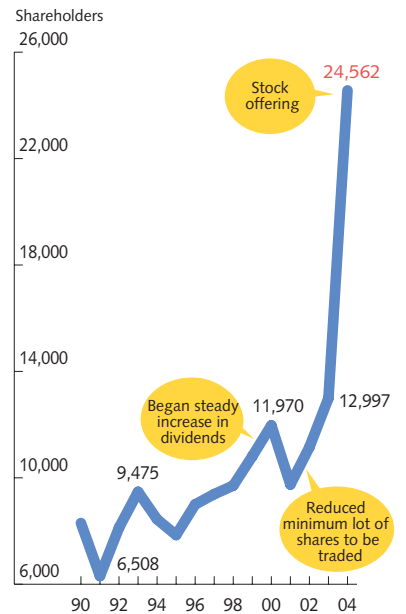
**Haruyuki Niimi**  
Chairman, Representative Director



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

**Number of Shareholders**

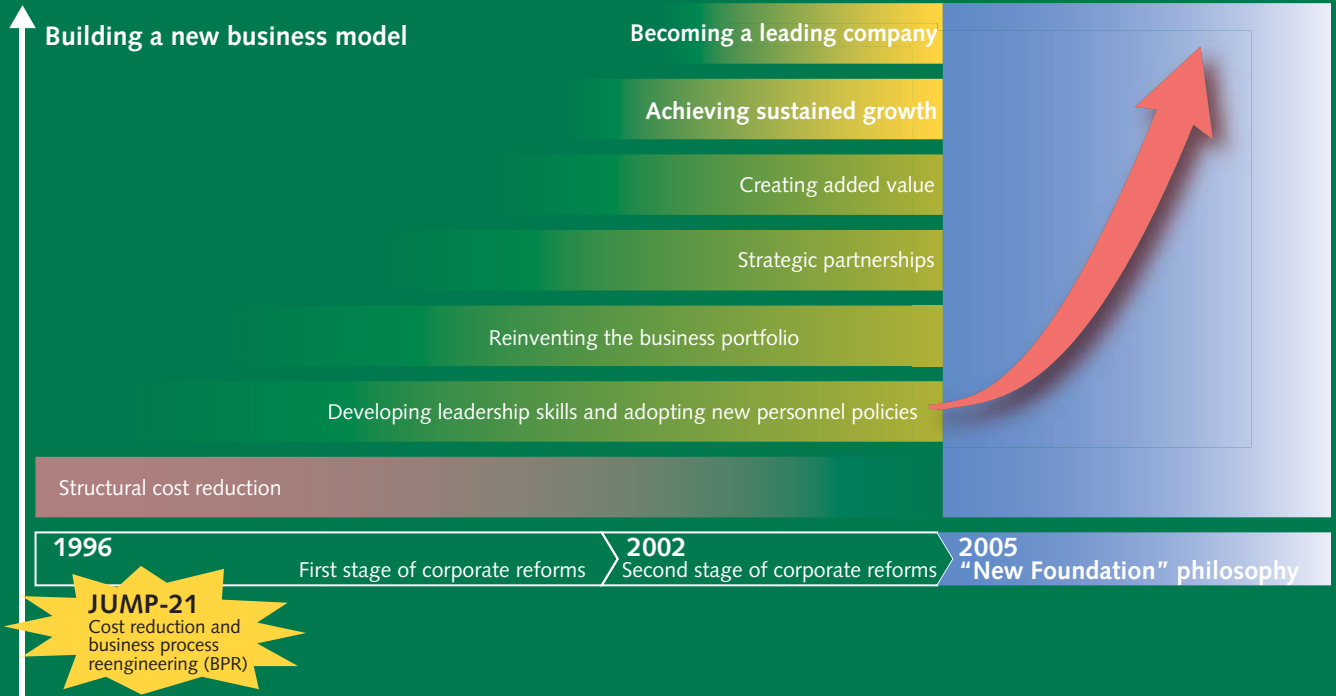
(1990–2004 Figures are before computer-aided name identification)



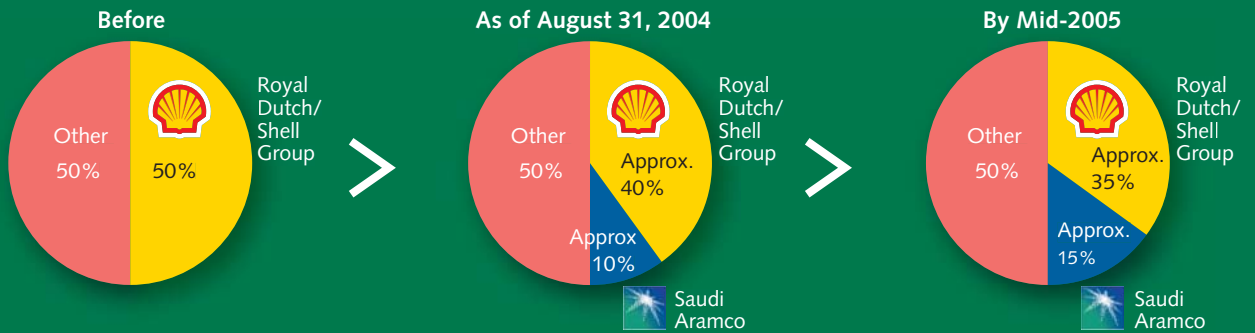
The number of individual shareholders has increased significantly as a result of a two-pronged strategy to boost the number of shareholders and improve stock liquidity. In October 2002, Showa Shell changed the minimum lot of shares to be traded from 1,000 to 100, and in December 2004 executed a stock offering of ten million shares.

# In its 20th year, Showa Shell makes a new commitment to its shareholders: Build a "New Foundation"

## Corporate Reform Program and New Foundation Program



## Stock Transfer from Shell to Saudi Aramco



Signing Ceremony for Equity Transfer  
(From left): Rob Routs, Managing Director and Executive Director of Royal Dutch Petroleum Company; Haruyuki Niimi, Chairman and Representative Director of Showa Shell Sekiyu K.K.; Abdallah S. Jum'ah, President and Chief Executive Officer of Saudi Aramco; and Abdulaziz F. Al-Khayyal, Senior Vice President of Refining, Marketing & International of Saudi Aramco.

Senior executives of the three companies