

To Our Shareholders

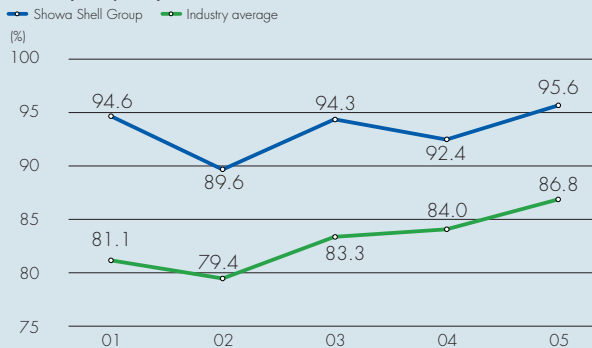


A review of the first year of our New Foundation programme

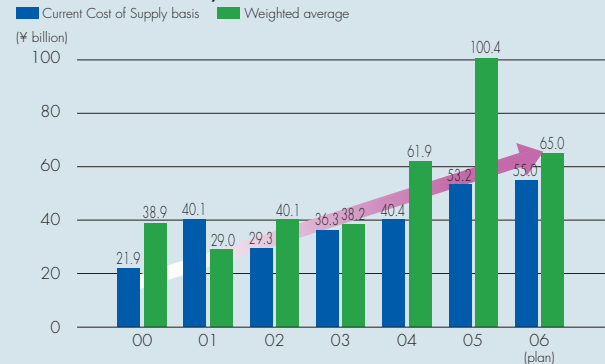
The term that ended December 2005 marked the 20th anniversary of the merger of Showa Oil Co., Ltd. and Shell Sekiyu K.K. To acknowledge this turning point in our 20-year history, we introduced our New Foundation management vision and have achieved dramatic results. The vision incorporates three resolutions. Firstly, we will move forward by separating ourselves from

the past, in a positive sense, to enable us to tackle the new challenges facing us. Secondly, we will firmly establish Showa Shell on a growth track through adherence to a well-defined strategy. Thirdly, we will respond to the changes in shareholder composition, and increase autonomy to ensure that Showa Shell can, indeed, achieve the fresh start to which it aspires as a reborn company.

Refinery Capacity Utilization Rate



Consolidated Ordinary Profit



The well-defined strategy referred to in the second item consists of expanding our core businesses, enhancing the value of core businesses, and developing new and peripheral businesses. At Showa Shell, we took the opportunity in 2005 to make a departure from the corporate innovation activities that had been in effect since 1996. We have introduced widespread initiatives that firmly target growth as their objective. We have been raising our product selling prices in response to increases in crude oil prices since 2004. At the same time, we made aggressive efforts to expand sales. As a result, on a consolidated basis, sales proceeds for fiscal 2005 increased by 23.3% year-on-year to ¥2,268.4 billion, gross profit amounted to ¥212.4 billion, and the gross profit margin on sales was unchanged from the previous term, at 9.4%.

At the profit level, as a result of an improvement in our profit margin on the sale of fuel oil and various cost reductions, as well as a substantial increase in gains on valuation of inventories, in line with the continued upward trend of crude oil prices compared with the previous fiscal year. As a result, operating profit on a consolidated basis came to ¥98.3 billion, for a year-on-year increase of 63.5%, and ordinary profit rose 62.3% to ¥100.4 billion. Ordinary profit calculated on a current cost of supply (CCS*) basis, i.e. excluding gains on the valuation of inventory assets, came to ¥53.2 billion, for a year-on-year growth of 31.8%.

Sales and administrative expenses edged up by 0.7% to ¥114 billion, and sales and administrative expenses as a percentage of sales declined to 5.0% from 6.1% for the previous term. As a result of these factors, net income after taxes for the reporting period soared to ¥58.3 billion, or 24.7 times the figure for the previous term.

Total assets at term-end increased by ¥239.3 billion over the previous term-end, to ¥1,145.1 billion. This was due

mainly to: 1) an increase in the book value of inventories resulting from the high level of crude oil prices, 2) additional investment in the petroleum refining and independent power producer (IPP) businesses, 3) the establishment of new consolidated subsidiaries, mainly to engage in the gas utility business (supply of natural gas via pipeline networks), and 4) an increase in total investment resulting from the purchase of equity securities as part of strategic investments in various companies.

Regarding cash flows, operating activities resulted in a net cash inflow of ¥25.8 billion, investing activities resulted in a net cash outflow of ¥28.5 billion, and financing activities resulted in a net cash inflow of ¥20.7 billion. As a result of the foregoing, and including the increase resulting from the inclusion of 3 additional companies in the scope of consolidation, cash and cash equivalents as of the term-end registered an increase of ¥21 billion over the previous term-end.

Stable supply is prerequisite for enhancing enterprise value and higher profits

In August 2004, through a transfer of shares from the Shell Group, Saudi Aramco, the national oil company of Saudi Arabia, the world's largest oil producing nation, became a participant in the Company's management. The inclusion of Saudi Aramco among our shareholders rounds out the Company's Saudi Arabian procurement network, and has enabled Showa Shell to streamline the transport process and create a more steady and efficient supply system.

Meanwhile, this has resulted in a reduction in the Shell Group's equity stake, which had been 50% until then. We must become more autonomous in our decision-making and reconsider how we intend to proceed as a Japan-based petroleum company. Needless to say, there will be no change in the solid business partnership we maintain with the Shell

CCS* Basis (Current Cost of Supply basis)

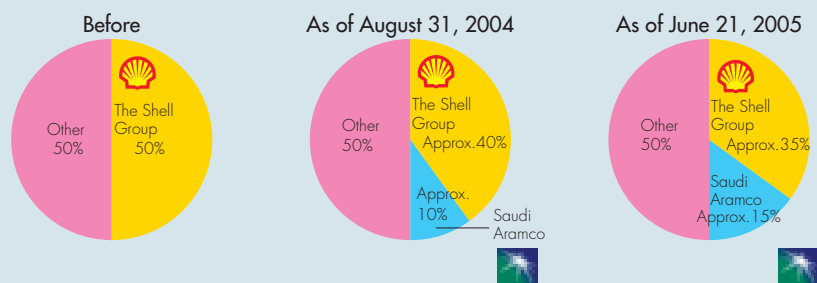
Inventories are stated at historical cost, mainly based on the weighted average method. Cost of sales is calculated using the weighted average of the cost of inventory purchased during the reporting term (current cost) and the cost of inventory at the start of the term (previous term-end inventory). Consequently, during periods when the price of crude oil is rising, the inclusion of the relatively inexpensive start-of-term inventory serves to bring down the cost of sales recognized in the accounts below the actual level of inventory costs during the reporting term (current cost). Conversely, during periods when crude oil prices are on a downward trend, the start-of-term inventory price is higher per unit than that for inventory purchased during the term, and the cost of sales is higher than actual inventory purchase costs for the term (current cost).

As a result, the Company's cost of sales for fiscal 2005 was lower by ¥47.2 billion than that on a current cost of supply basis. Conversely, operating income was pushed up in the same

amount. At Showa Shell, to enable a system of earnings management and monitoring that reflects the actual state of affairs by excluding this kind of effect from inventory valuation, in addition to the posting of profits and losses using the conventional method (described above) for calculating cost of sales (weighted average basis), we also calculate and disclose profits and losses on the basis of the current cost of supplies (CCS basis).

Changes in Shareholder Composition

In accordance with the initial contract, an additional 5% of the Company's equity shares were transferred from the Shell Group to Saudi Aramco in June 2005. Thus, the current shareholder composition is as follows: Shell Group (35.04%), Saudi Aramco (14.96%), and general shareholders (50%). With the acceptance of equity participation by Aramco, oil imports from Saudi Arabia have risen above 60%. We can also vary production of petroleum products as the occasion demands, which gives us a considerable advantage.



Group. This aspect is underscored by the third priority task included in our New Foundation programme: to respond to the changes in shareholder composition, and increase autonomy to ensure that Showa Shell can, indeed, realize the fresh start to which it aspires as a reborn company.

Showa Shell, the number of whose general shareholders has been rapidly increasing since its secondary offering of the Company's shares to Japanese investors in 2004, is expected to fulfil its responsibilities to its general shareholders in addition to the major shareholders. Moreover, with Japan as its primary business market, its priority is to adequately fulfil its mission of ensuring a stable supply of petroleum products.

To meet the requests of its customers requiring petroleum, the Company functions at a high level of competency, engaging primarily in the import, refining and distribution of petroleum products. At the same time, to remain competitive in the current operating climate, only those companies that implement environmental policies and fulfil their corporate social responsibilities will survive. In addition to the super major Shell Group, our partnership with Aramco will help us to meet these criteria and contribute significantly to this all-important task of ensuring a stable supply of oil.

Concentrating on our core business, developing high-value-added products

From 1996 through 2004, our top priority has been the strengthening of our financial position. We have made utmost efforts to transform operations in order to become a lean, muscular organization. In addition, our management resources—which have been dispersed through the diversification process—are now being redirected to our core business. Previously, there had been concerns that a diminishing of business scale would result due to the strong emphasis placed on

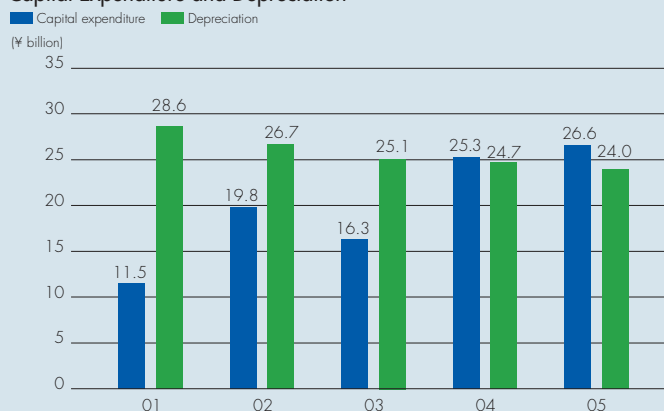
the bolstering of our financial position, the raising of overall efficiency, and the pursuit of more economical operations. However, from 2005, with the adoption of the New Foundation initiative, we have dramatically changed direction, and now emphasize an expansion of operations.

The centrepiece of this programme is, of course, our core business. We are creating a network through which we will provide high-quality products suited to the Japanese market, which demands a level of quality on par with global standards. While working to raise the value—and profitability—of our businesses, we will simultaneously undertake new investments to expand the scale of business operations.

A perfect example of our high quality, high-value-added products is *Shell Pura*. The more this gasoline is used, the cleaner the engine becomes. This, in turn, leads to improved acceleration capabilities and dramatic reductions in emissions of harmful gases, such as carbon monoxide. Launched in April 2005 in the area surrounding the city of Sendai, in Miyagi Prefecture, *Shell Pura* is now being sold nationwide in 25 prefectures, and has become a very popular product. Our other high-value-added products and services include the engine oil *Shell Helix*, developed by leveraging know-how acquired through F1 racing, and a credit card that precisely meets customers' needs, as indicated by responses to very detailed customer surveys.

In addition, we have been undertaking investments to expand the scale of our operations. For example, in October 2005, we undertook equity participation in AOC Holdings Inc., the joint venture holding company of Fuji Oil Co., Ltd. established with Arabian Oil Co., Ltd. (AOC), which engages in oil exploration and development in the Middle East (see below). This equity participation aims to ensure a long-term stable supply of petroleum product transactions with Fuji Oil. In

Capital Expenditure and Depreciation



Capital participation in AOC Holdings Inc.

Showa Shell owns an equity stake of 6.58% (with voting rights of 6.84%) in AOC Holdings; the holding company of Fuji Oil Co., Ltd. Affiliate Fuji Oil operates a refinery in Sodegaura, Chiba Prefecture, which produces 192,000 barrels per day. This refinery is expected to serve as an important supplier of petroleum products for customers in the Tohoku region, as well as the Tokyo area, where demand is strong. With the Group's existing refineries located at a distance, this move will help to ensure a stable supply of petroleum products.

the same month, the Showa Shell Group made Toa Oil Co., Ltd. into a specified subsidiary (see p. 7). Through these various initiatives, in addition to measures implemented under business tie-up agreements with Japan Energy Corporation, we were able to dramatically increase our oil supply capabilities.

On the sales front, in April 2005, Showa Shell invested in equity shares of Toyotsu Sekiyu Hanbai K.K., a wholly owned subsidiary of Toyota Tsusho K.K. The company operates both directly-owned and franchised service station chains centred in Aichi Prefecture. Through this move, we were able to strengthen our petroleum retail base in the Chukyo area (42 cities, 37 towns and 2 villages in Aichi, Gifu and Mie prefectures), our core market in Japan. In addition, we implemented a reorganization of affiliated dealers in which we have invested, and strengthened our grip on influential dealers.

We intend to take every opportunity to make strategic investments of this kind in the future.

Aggressive development of core-related peripheral businesses

As the Company commences the second year of the New Foundation initiative, Showa Shell must focus on pursuing further growth of its core businesses, as well as gaining a foothold in new and peripheral businesses. Specifically, we must improve the profitability of existing core business areas and strengthen cost competitiveness, while simultaneously developing a new business model that targets sustained business growth.

With regard to the core business and closely related peripheral businesses, in July 2005 the Company entered into a new business field as a supplier of gases to end-users through pipelines. The Company acquired parts of businesses from Wakamatsu Gas K.K., a gas supplier based in Fukushima Prefecture, transferring the goodwill and business assets of

Wakamatsu Gas K.K. and Wakamatsu Gas Nenryo Kiki K.K. on behalf of the Company's wholly owned subsidiary. As a new downstream development, we are hoping this will lead to an expansion in the scale of our core businesses. By securing diverse energy sources, we intend to expand the scope of downstream products and create a system to respond to wide-ranging customer requirements.

In the area of new businesses, we are creating the world's first commercial production base for CIS (copper, indium, and selenide) solar batteries in Miyazaki Prefecture, and have decided to construct a new plant with a capacity of 20 megawatts per annum. Commercial production and sales are targeted for 2007. In addition, we have launched a new business encompassing home security, house cleaning, and other home solutions, and have begun test sales of GTL (gas-to-liquids) kerosene, with the hope that these new ventures will grow into promising businesses in the future.

Our existing business model for our core business requires a passive stance whereby we wait for customers to come to our service stations. In the future, however, we need to develop a more proactive model, in which we anticipate customers' latent needs, and then reach out to them and meet those needs. Our entrance into the gas business is one such example of the way in which we are working to proactively meet customer needs. Through the diversification of the types of energy we supply, and also through the development of a home solutions business, we aim to become a company that can respond more closely to end-user needs.

Brand Strategy

Showa Shell has put down strong roots in the Japanese market, and is making strenuous efforts to become the petroleum company of choice among customers in this market. The

Toa Oil Co., Ltd. made a specified subsidiary

The main businesses of Toa Oil and its subsidiaries are petroleum refining and wholesale of electricity. The company became a specified subsidiary of Showa Shell at the end of October 2005, upon receipt of the new shares through a private placement of shares issued by Toa Oil Co., Ltd.

Capital participation in Toyotsu Sekiyu Hanbai K.K.

Showa Shell Sekiyu acquired an equity stake in Toyotsu Sekiyu Hanbai through a private placement of shares. Following the investment in Toyotsu Sekiyu Hanbai, the equity stake composition became Toyota Tsusho K.K. (65.3%) and Showa Shell Sekiyu (34.7%). Capital participation in Toyotsu Sekiyu Hanbai is part of a business alliance between Showa Shell and Toyota Tsusho K.K. Both parties will work together to strengthen the competitiveness of Toyotsu Sekiyu Hanbai.

Acquisition of gas business of Wakamatsu Gas K.K. and Wakamatsu Gas Nenryo Kiki K.K.

Wakamatsu Gas K.K. and Wakamatsu Gas Nenryo Kiki K.K. have their headquarters in Aizu-Wakamatsu City, in Fukushima Prefecture, and are developing their gas business in Aizu-Wakamatsu and Fukushima cities. At the request of the Wakamatsu Gas Group, Showa Shell has provided support through a transfer of goodwill. Through this move, Showa Shell aims to make a major contribution to the local region by ensuring the continuation of the local gas business, which is matter of great interest to the public.

Company's goal is to capture an overwhelming share of the market, and thereby achieve sustained growth. To this end, we must make proactive efforts to reach out to our customers, identify their latent needs, develop new services and products to meet those needs, and create a new business model.

In addition, by taking a proactive stance, reaching out to customers, we hope to cultivate customer loyalty for the Showa Shell Sekiyu brand. We have drafted our corporate message with the objective of promoting the understanding of customers and stakeholders about the measures we are implementing for corporate revitalization and the creation of new value through our New Foundation initiatives (p. 3). Our corporate message conveys Showa Shell Sekiyu's strong desire to grow along with its customers and stakeholders.

Compliance and CSR Activities

As the Company's management gains a greater level of autonomy, the role of corporate governance as "safe counsel" becomes increasingly important. Showa Shell has established the Corporate Governance Committee as a permanent body to advise the Board of Directors. The committee is designed to enable the Board of Directors to incorporate the views of outside experts, to enhance the transparency and objectivity of management.

In a very regrettable development, we were convicted of violating the Antitrust Law relating to tendering practices for the sale of jet fuel to the Self Defense Agency during the term under review. We at Showa Shell will make utmost efforts to prevent the recurrence of such an incident by more strictly enforcing compliance with laws and regulations. Particularly in view of the recent tightening of antitrust regulations, we intend to take an even stricter and more uncompromising stance on involvement in cartels, and on the elimination of other illegal

tendering practices. We will carefully monitor every minute aspect of our operations in tackling this issue. We also make the enforcement of our basic policy concerning health, safety, security and environmental preservation, based on HSSE management rules, into our highest priority.

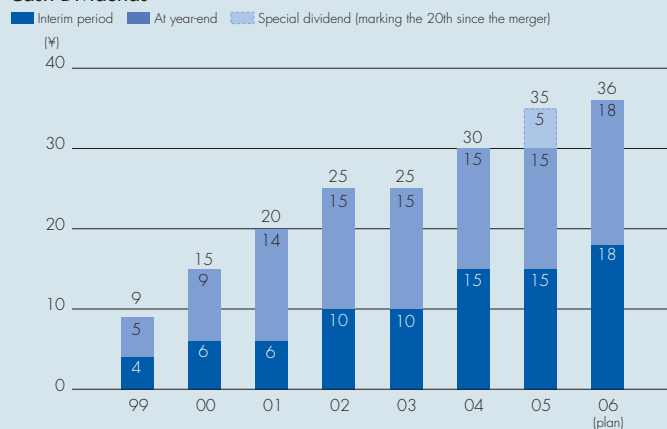
Showa Shell fulfils its corporate social responsibilities through its involvement in a wide variety of activities. In 2004, we set up a CSR working team, and our previously published environmental report *Moderate* has become our CSR Report. In addition to issuing a report, we also introduced various rules, regulations, and policies. In this way, we have systematically commenced CSR activities. In 2005, the second year of this initiative, we held "The First Showa Shell Environment Photo Contest." Our aim is to raise awareness about the natural environment through the photographing of local scenery, and encourage individuals to take the initiative in seeking solutions to environmental issues from a new perspective. From the 1,175 submissions received, we can conclude that the event generated a high level of interest in environmental issues. We intend to hold this contest every year.

In the future, we intend to place greater priority on the provision of "sulfur-free" gasoline and diesel oil and other environmentally friendly products and services.

Successive Dividend Hikes and 20th Anniversary Dividend Payment

Showa Shell's basic policy concerning the distribution of earnings is to pay a stable and attractive dividend to shareholders while taking into consideration factors such as the Company's operations, financial position and trends in the financial markets. In accordance with this policy, the Company has continuously increased its annual dividend payment, which was ¥9.00 in 1999. For the fiscal year ended in December 2005,

Cash Dividends



the Company paid a dividend of ¥5.00 per share at the interim term-end to commemorate the 20th anniversary of the merger between Showa Oil and Shell Sekiyu. In addition, a ¥15.00 dividend was paid at both the interim term-end and annual term-end, on par with the dividend paid in the previous term. Consequently, the total amount of dividends for the full-year period came to ¥20.00 for the first-half period, ¥15.00 for the second-half period, and ¥35.00 per share for the year. We estimate a dividend payment of ¥36.00 for fiscal 2006.

Forecast for Fiscal 2006 and Future Tasks

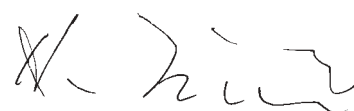
In fiscal 2006, the second year of our New Foundation plan, we will continue working to become a leading company with the goal of achieving sustained growth, and in the current year we will redouble our efforts to realize this goal. In 2006, the Japanese economy is forecast to show a favorable performance, overall. However, we anticipate a further acceleration in the pace of change in our management environment. Among our foremost concerns is the oil situation. Given the limited supply of this natural resource and global environmental concerns, it is unclear how long we will be able to continue using oil as a fuel source, and this question is stirring much debate. Against this backdrop, the economic development of China and the other BRICs countries is rapidly speeding up the consumption of oil, causing oil prices to surge to record levels.

In the domestic market, the combination of an improvement in automobile fuel efficiency and a switchover from heavy oil to natural gas for plant operations suggests that demand for crude oil will be flat in the future even under the most optimistic scenario. Given this situation, the time has come for the Company to seriously reformulate policies for achieving sustainable growth.

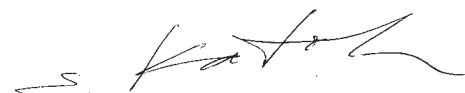
In 2006, we will once again return to a customer-focused

approach, with the aim of becoming a company that closely meets local market needs. Although Japan is a country of limited land area, local market needs are quite diversified. We will do our best to respond to the requirements of our customers in each local area, by emphasizing the creation of a network of affiliated dealers and other affiliated companies. By focusing on the preferences of customers and the characteristics of the local market, we aim to identify latent demand and discover a path toward sustained growth.

We at the Showa Shell Group would like to express our great appreciation to all our shareholders, for their continued support and understanding.



Haruyuki Niimi
Chairman, Representative Director



Shigeya Kato
Vice Chairman, Representative Director



Yasuo Murayama
President, Representative Director

Commenced commercial production of a next-generation CIS solar battery

As a project commissioned by The New Energy and Industrial Technology Development Organization (NEDO), the independent administrative organization, Showa Shell has undertaken development of CIS (copper, indium and diselenide) thin-film photovoltaic modules, which are cadmium-free and thus environmentally friendly, for more than 10 years. The production process of CIS modules involves a production process that is completely different from that of existing crystalline silicon, and is drawing attention worldwide. The Company began construction of the world's first commercial production plant in Miyazaki City in Kyushu after determining photovoltaic modules to be cost-competitive with strong potential for future commercialization. We will continue working to introduce clean energies that offer possibilities for recycling, thereby contributing to the resolution of environmental issues while supplying sustainable sources of energy.

GTL fuel supplied at Aichi Expo

Accompanying our sponsorship of the Expo 2005 Aichi Japan (also known as Aichi Expo 2005), we supplied GTL (gas-to-liquids) fuel for a shuttle bus for use at the expo site. This was the first time that GTL fuel had been used in the hybrid diesel electric vehicles of a public transport organization in Japan. The GTL fuel was produced by the Shell Group's plant in Bintulu, Malaysia, using its proprietary technology.

Corporate Message

Our employees, including the younger generation, have been discussing the future direction for Showa Shell, and out of these discussions has come the Company's new corporate message. The emphasis is not simply on what Shell will do on its own account, but rather on what Shell will do for and with its customers. In the development of this slogan, we have endeavored to incorporate the customer's perspective, and sincerely hope that this slogan will be used by Showa Shell for years to come.