

New Foundation

Showa Shell Sekiyu K.K.
ANNUAL REPORT 2006



Profile

Showa Shell Sekiyu K.K. was formed in 1985 through a merger between Showa Oil Co., Ltd., established in 1931, and Shell Sekiyu K.K., a subsidiary of Royal Dutch Shell, which had been operating in Japan for more than one hundred years. In the ensuing years, Showa Shell has continued to foster a hybrid corporate culture that incorporates the best of both Japanese and Western management practices, pursuing cutting-edge innovations.

In 2004, Saudi Arabian Oil Company (Saudi Aramco), the national oil company of Saudi Arabia, which is the world's largest oil exporter, became a new partner to Showa Shell through capital participation. Since then, we have been working to foster a receptive corporate culture that can easily accommodate the diversity resulting from the amalgamation of the management styles of the Shell Group and Saudi Aramco, as well as Japanese business practices.

At the start of 2005, to mark the 20th anniversary of the aforementioned merger, we introduced our New Foundation philosophy, to create a solid base for operational expansion as we usher in a new era. We have also drafted a new corporate message, reflecting our aim of creating enduring ties with our customers and stakeholders, and expressing our hope that these relationships will be mutually beneficial for all those involved.

Currently, we not only undertake petroleum refining and sales, but also offer an extensive lineup of energy options, which include solar energy. We maintain a close relationship with our customers in the Japanese market, and are working to meet the expectations of our stakeholders.

Showa Shell Sekiyu has been reborn. We will not disappoint you.

Long-term rating

Rating and Investment Information Inc. (R&I)A

Japan Credit Rating Agency Ltd.A+p

Short-term (CP) rating

Rating and Investment Information Inc. (R&I) ...a-1

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すべては、あなたに信頼される企業であるために。



私たちは約束したい。
エネルギーとともにある未来を。人間らしい豊かさのある未来を。
そのために、これまでなかった商品や、
提案あるサービスを次々と生み出していくことを。

私たちは約束したい。
生活を、社会全体を活性化するエネルギーに責任を持つことを。
人の気持ちを前へ、前へと進めるエネルギーをお届けすることを。

私たちには、その力がある。
永年培った安定供給の足跡と、信頼。
環境と性能を両立させる、次世代エネルギーの研究。
お客様のことを考え抜く姿勢と、サービス品質。

そして、
私たちは約束したい。
お客様のために、誰よりエネルギーにあふれる会社になることを。
あなたとともに、未来へと走り続ける会社であることを。

ずっと走ろう。シェルと走ろう。
昭和シェル石油



Corporate Message

This corporate message reflects our aim of creating enduring ties with our customers and stakeholders through our daily activities, and our aspiration to become their company of choice in the future. It also expresses the hope that this relationship will be mutually beneficial for all those involved.

[http://www.showa-shell.co.jp/
profile/corp_message.html](http://www.showa-shell.co.jp/profile/corp_message.html)

For more information, visit our website:

<http://www.showa-shell.co.jp/>

Note about forward-looking statements and forecasts

Statements made in this annual report with respect to current plans, estimates, strategies and beliefs and other statements of Showa Shell Sekiyu K.K. that are not historical facts are forward-looking statements about the future performance of Showa Shell Sekiyu. These statements are based on management's current assumptions and beliefs in light of the information currently available to it and involve known and unknown risks and uncertainties. Actual results may materially differ from those contained in the forward-looking statements as a result of various factors. Important factors that might cause such a material difference include, but are not limited to, currency exchange rate fluctuations, changes in market conditions and in general economic conditions.

Our Roadmap

Achieving sustainable growth

Creating added value

Reducing cost and enhancing financial position

To become a leading company

2005= 20th anniversary of the merger

+ M&As

+ New businesses

Commercial production of CIS photovoltaic modules

Organic growth

Wakamatsu Gas

AOCHD

Seibu MX Plant

Toyotsu Sekiyu Hanbai

Saudi Aramco (Shareholder, supplier)

Marubeni Energy

Strategic partnerships

1996~

First stage of corporate reforms

2002~

Second stage of corporate reforms

2005~

New Foundation

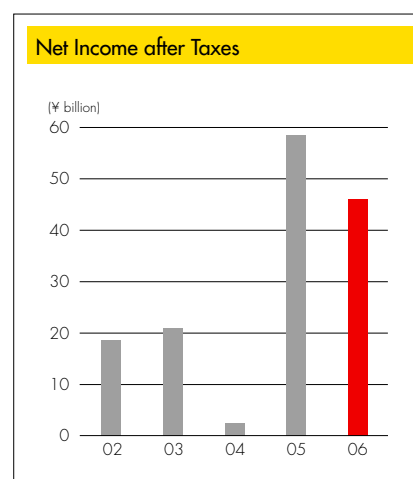
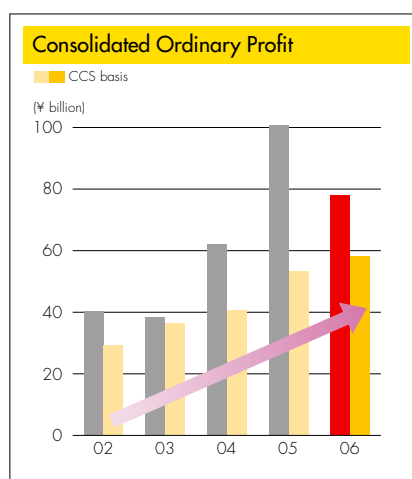
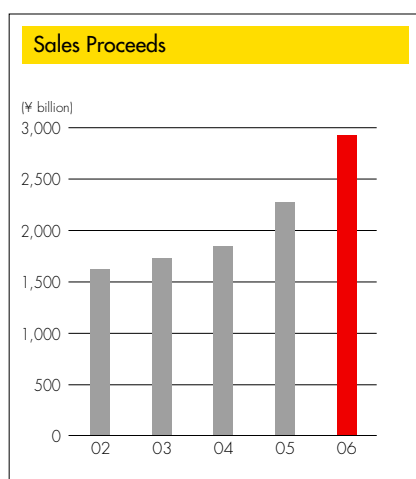
Consolidated Financial Highlights

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
Years ended December 31

	Millions of yen 2006	Percent change	Millions of yen 2005
For the year:			
Sales proceeds	¥2,921,287	+28.8	¥2,268,488
Operating profit.....	74,301	-24.5	98,381
Ordinary profit*	77,675	-22.7	100,497
	(58,074)	(+9.0)	(53,279)
Net income after taxes.....	46,249	-20.8	58,370
At year end:			
Total shareholders' equity	330,956	+20.2	275,232
Total assets.....	1,195,015	+4.4	1,145,191
Interest-bearing debt	190,526	-0.7	191,830
Yen			
Per share data:			
Net income after taxes per share.....	¥122.95	-32.36	¥155.31
Cash dividends	36.00	+1.0	35.00
Shareholders' equity per share	822.20	+90.12	732.08
Ratios:			
Return on equity (ROE) (%).....	15.8	-7.4	23.2
Return on average capital employed (ROACE) (%)	9.6	-5.2	14.6
Gearing ratio** (%).....	38.5	-4.6	41.1

*Figures in parentheses are calculated on a current cost of supply (CCS) 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).

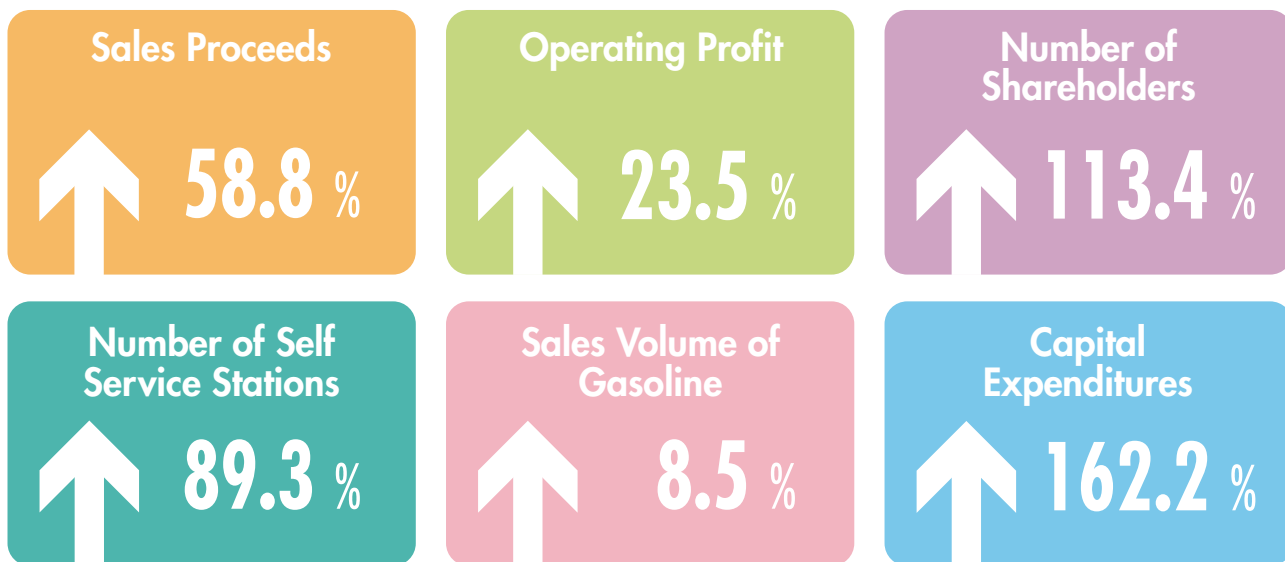
**Gearing ratio is interest-bearing debt/Average capital employed (shareholders' equity plus interest-bearing debt)



Making Progress with “New Foundation”

Trying to build a new business model

Achievements in 2 years



New Foundation Philosophy

Expanding the scale of our core businesses

Increasing the value of our core businesses

Developing new and peripheral businesses

The New Foundation programme was launched in 2005 to accomplish our goals of increasing the value and expanding the scale of our core business, and of developing new and peripheral businesses. Initiatives implemented under this programme have produced significant results in terms of both financial position and the scope of business. Shown here are the achievements under the New Foundation programme. The following is a comparison of changes in key indicators for the business terms ended in December 2004 and 2006.

We adopted impairment accounting from 2004. On the assumption that no impairment losses had been recognized, the sales and operating income for the subsequent two years would still have indicated a steady improvement in our financial position. As for the expansion of operations, we have been increasing the number of self-service filling stations, and have also achieved a steady rise in gasoline

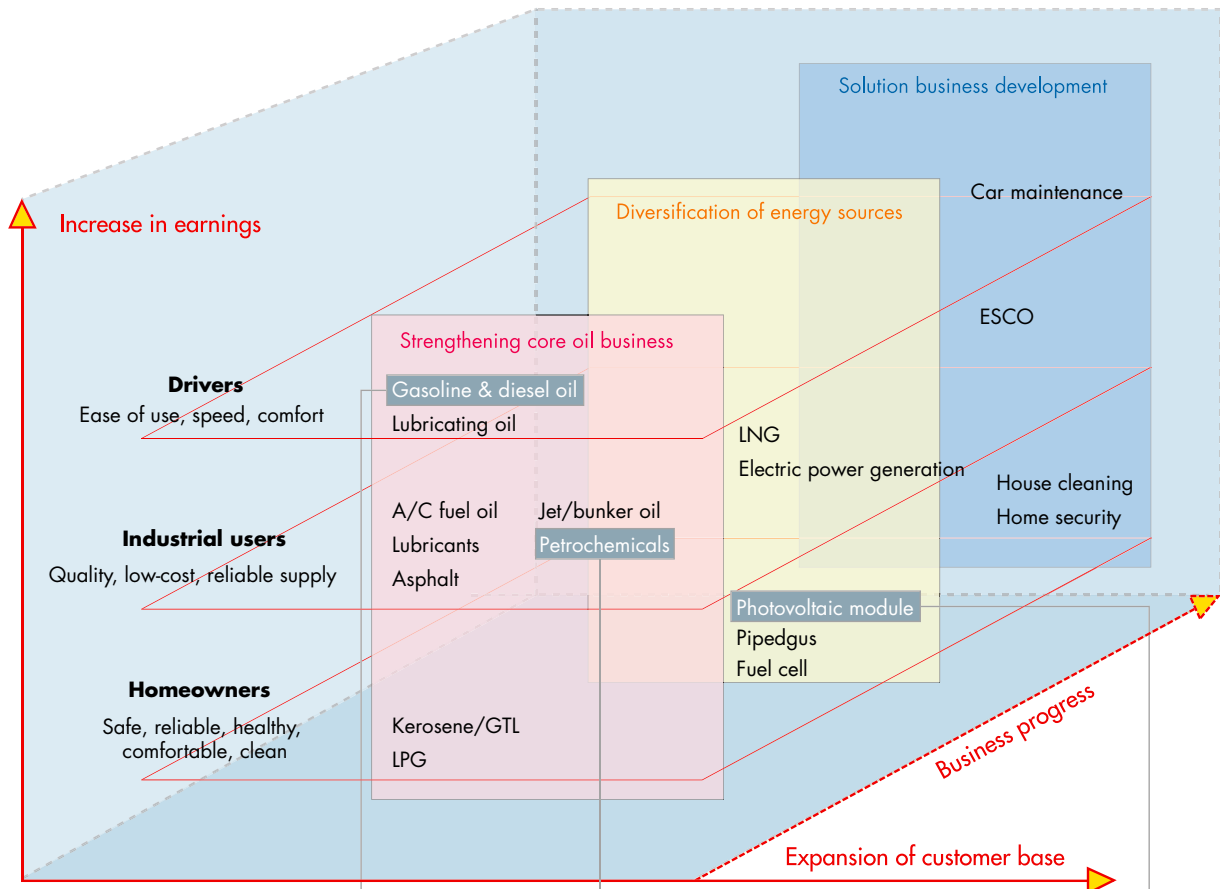
sales on a volume basis, despite the challenging operating environment posed by surging gasoline prices. We also saw rapid growth in sales of our new and peripheral businesses. In this way, we have succeeded in expanding the scope of our businesses, thereby reducing our dependence on the oil business.

Regarding the Company's shareholder composition, the sale of shares to individual shareholders resulted in a doubling in the number of shareholders. Thanks to the support of these numerous shareholders, we have been able to strengthen our foothold in the Japanese market, and also in Japanese society.

Building on the significant achievements of the past two years, we have devised a variety of initiatives, which are indicated on the following pages, by which we aim to meet the needs of the next generation of customers.

Growth Strategy Framework

We are expanding our lineup of energy options beyond our core business of petroleum refining and sales, to include natural gas, solar-powered batteries, and fuel cell batteries. We have further diversified operations through the expansion of our solutions business, which has no direct connection with our core energy supply business. We aim to provide useful solutions to diverse customer segments, ranging from drivers and industrial users to home owners.



Gasoline & diesel oil

Regarding our popular self-service stations, our network has grown to 580 stations at the end of 2006. In addition, our new brand Fantasista has been built into a shopping complex, in a new type of store format. We are making our filling stations easier to use, by training employees to enhance their skills, and introducing a postpaid settlement service, among other things. In these ways, we are working to further expand our sales channels.



Petrochemical

Our core businesses consist mainly of petroleum refining and the sale of petrochemicals for industrial users. At Seibu Oil's Yamaguchi Refinery, we began production and shipments of mixed xylene, a high-value-added petrochemical product for industrial users. At the same refinery, we intend to construct a continuous regeneration-type catalytic reformer by the end of 2009, and further increase production of mixed xylene.

Photovoltaic modules

Solar batteries are an extremely clean form of energy which we expect to supplement our petroleum energy business in the future. To achieve sustainable growth in the long term regardless of changes in the state of energy supply conditions in the future, the Company has adopted the policy of nurturing this business as a second core business. We have completed construction of the world's first commercial production plant for CIS (copper, indium and selenium) thin-film photovoltaic modules in Miyazaki City in Kyushu.



■ To Our Shareholders



Looking back on the business term ended December 2006

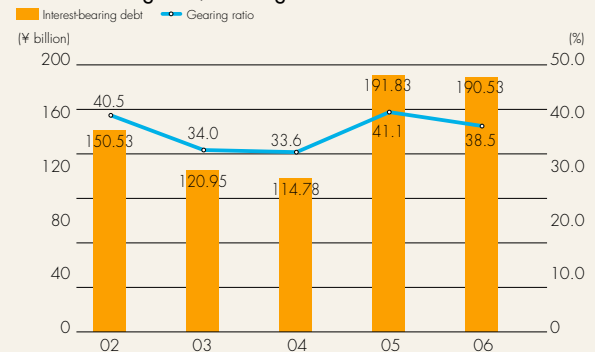
At the start of 2005, to mark the 20th anniversary of the merger of Showa Oil Co., Ltd. and Shell Sekiyu K.K. we introduced our New Foundation philosophy. Under this vision, we have been vigorously managing the Company toward our goal of operational expansion.

In 2006, our second year of business operations under the New Foundation programme. During the year, we achieved substantial progress in bolstering our business base as a prerequisite to corporate growth further down the road, in line with the policies set out in the programme.

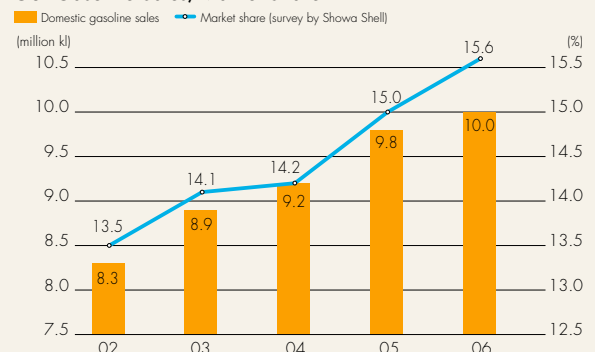
We recorded growth during the reporting period in our core business—the refining and sale of petroleum products. Sales of gasoline were particularly strong, in spite of a general year-on-year decline in demand over the whole country, and we believe this is primarily attributable to the increased efficiency of our service stations owing to the conversion of many service stations to the self-service format during the term under review. Also contributing to our success was the adoption of a new business model based on the deployment of the new *Fantasia* brand of service station, which are characterized by being built-in as part of existing shopping centers. In addition, the development of new shopping centers incorporating *Fantasia* service stations is also being pursued. We believe that our favorable performance was the result of the increased popularity of our service stations. Moreover, further significant progress was seen in the development of core-related peripheral businesses and completely new business lines, which is one of the strategic linchpins of our New Foundation programme.

In our solar battery business, which we hope to grow into our second core business, we completed construction of a plant in Miyazaki Prefecture in Kyushu for the manufacture of CIS (copper-indium-selenium) photovoltaic modules. The plant will have an annual production capacity of modules with a total

Interest-bearing debt/Gearing ratio



Our Gasoline Sales/Market Share



combined power output of 20 megawatts, and we are currently pushing ahead aggressively with initial sales plans for these products.

We have set up new services in the fields of home security and housework, and we expect these new businesses to give us greater marketing access to individual home owners, who will be a new customer demographic for us. This is just one part of our wide-reaching efforts to profitably leverage our know-how in retail services.

Turning to the Company's shareholder relations, in December 2006 we offered 9 million shares for sale on the secondary market, and as a result, our shareholders now number more than 52,000, including both institutional investors and individuals. This is more than twice the number of shareholders at the end of 2004, just prior to the commencement of the New Foundation programme. Showa Shell Sekiyu values very highly the relationships of trust it enjoys with its customers and with market participants, and we believe that this increase reflects growing trust on the part of market participants in our willingness to implement an adequate return to our shareholders. In our opinion, the increased number of shareholders will, in its turn, help to increase the number of our customers, which is crucial for a company that sells its products primarily in the domestic market.

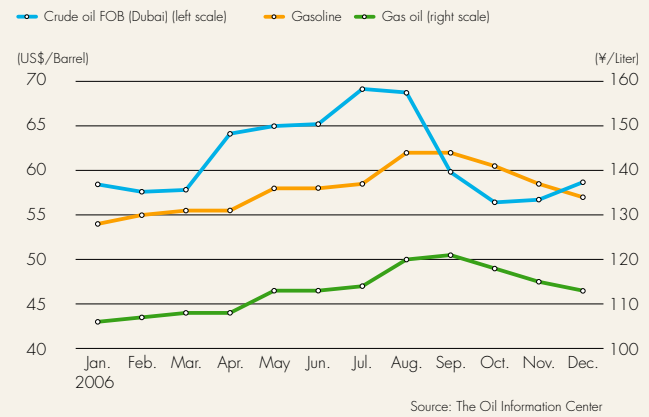
As a combined result of the sales price hikes that we implemented—in response to the steep rise in the price of crude oil—and the growth in the volume of our sales of gasoline and diesel oil in the reporting period, sales for 2006 on a consolidated basis posted a year-on-year increase of 28.8% to ¥2,921.2 trillion. On the other hand, increased costs caused gross profit to decline to ¥193.1 billion from ¥212.5 billion for the previous year, and the gross profit margin to fall 2.8 percentage points to 6.6%.

Although we were unable to pass on the increase in crude oil costs to our customers in its entirety, the efforts we have made to reduce costs over the past several years helped to hold down sales and administrative expenses for 2006 to ¥118.8 billion, for a year-on-year growth of only 4.1%. Similarly, sales and administrative expenses as a percentage of sales for 2006 stood at 4.1%, an improvement of 0.9 percentage point from the previous business year. In line with a fall in the market price of crude oil from the latter half of the third quarter of 2006, the Company recorded valuation gains on inventories in a smaller amount than for the previous year. As a result, the margin of decline in the cost of sales was substantially lower than that of the previous year. Consequently, operating profit on a consolidated basis came to ¥74.3 billion (down 24.5% from the previous term), ordinary profit came to ¥77.6 billion (down 22.7%), and net income was ¥46.2 billion (down 20.8%). Ordinary profit calculated on a current cost of supply (CCS) basis (see p. 1), which excludes inventory valuation effects and therefore constitutes a more realistic yardstick for assessing profits/losses, would amount to ¥58.0 billion, for a year-on-year increase of 9.0%.

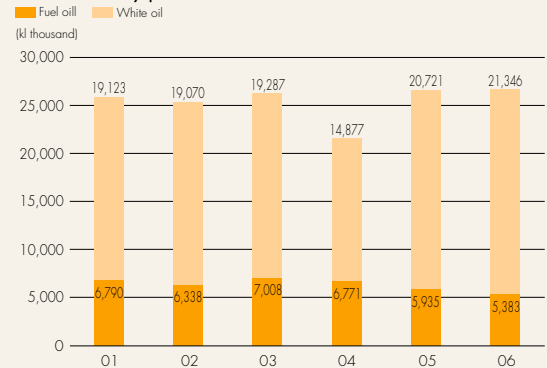
Total assets at term-end stood at ¥1.195 trillion, an increase of ¥49.8 billion over the previous term-end. This reflects that there were: 1) the sharp growth in the book value of inventory assets in line with the rising price of crude oil; 2) an increase in the book value of assets as a result of new investments in the Company's petroleum refining facilities in the form of regular repairs and overhauls; and 3) aggressive investment in our solar battery business and in our service station network.

Regarding cash flow, operating activities resulted in a net cash inflow of ¥29.3 billion; investing activities resulted in a net cash outflow of ¥28.8 billion; and financing activities also resulted in a net cash outflow, in the amount of ¥13.7 billion. As a result of the foregoing, cash and cash equivalents as of the term-end registered a decrease of ¥12.8 billion from the previous term-end.

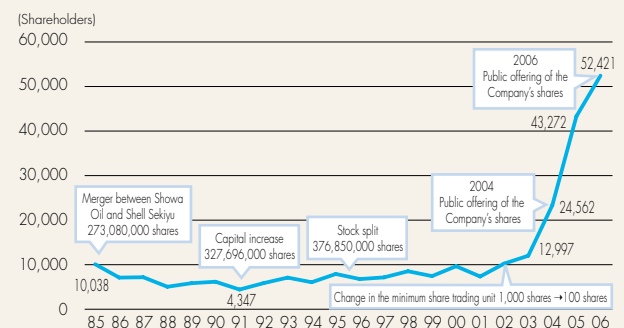
Crude Oil Costs and Retail Oil Prices in 2006



Sales volume by product



Number of Shareholders



Further progress in developing new value-added products and services

Steps taken to strengthen our core petroleum operations

The management of Showa Shell continues to work to further improve the attractiveness of the Company's products and services in its core business—the refining and sale of petroleum products—and to develop profitable new business models, all with the goal of expanding the scale of its operations. The increase seen in 2006 in demand for crude oil on a world-wide scale, combined with a further heightening of political tension in the Middle East, caused the price of Dubai crude to top the \$70/barrel mark in July, but a subsequent relaxation of the tension, and an easing of the previously very tight supply situation, allowed crude prices to fall back to around the \$55/barrel level by the end of the year. The business performance of Showa Shell could inevitably be impacted by such violent fluctuations in the crude oil market, and the historically high level of crude oil prices was also reflected in the retail market. As a result, demand for petroleum products was sluggish in Japan. In particular, the sales volume of gasoline fell below the previous year's level for the first time in 32 years.

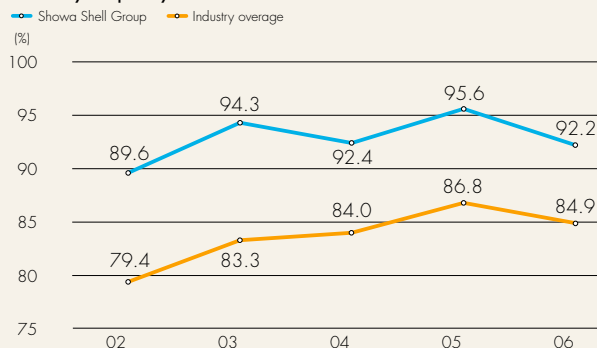
Despite these adverse circumstances, Showa Shell's gasoline sales volume exceeded the previous year's figure. In May 2006 we established a new subsidiary (under the name of Showa Shell Network Development K.K.) dedicated to the discovery and development of promising sites for new service stations, enabling us to further reinforce our sales network and supply system. As of the end of December 2006 the number of our self-service stations stood at 583.

Turning to our products, in April we expanded the geographical area of sale of our popular *Shell Pura* brand of high-octane gasoline to include an area of Hokkaido centered on the city of Sapporo. We also developed a GTL (gas-to-liquids) technology for transforming natural gas into a low-odor form of kerosene with a very low carbon footprint. This has been sold on a limited basis under the name *Shell Eco Toyu* since the previous period, and is just one example of the wide range of superior products that Showa Shell supplies.

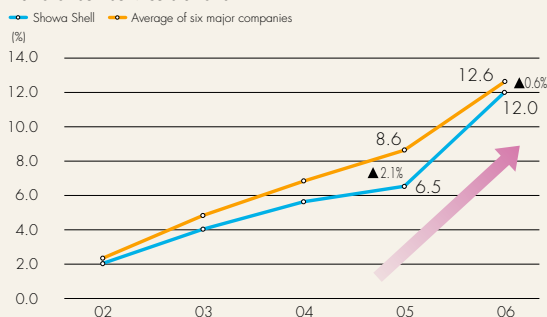
With regard to our selling strategies, since June 2006 we have been gradually introducing, at selected service stations, a new payment system called *Visa Touch (Smart Plus)*. This enables our customers to employ a contactless card (in fact, a card with additional value-added features) at our self-service stations. We are drawing up plans to build a network of service stations within shopping centers under the new brand name *Fantasista*. (The first *Fantasista* outlet was opened in late 2006.) We are also considering building service stations combined convenience stores as part of our larger strategy for attracting more customers.

At the Yamaguchi Refinery operated by our subsidiary Seibu Oil Co., Ltd., a mixed xylene production facility has been in operation since February 2006, and its products are sold to industrial users in the petrochemicals sector. Seibu Oil, our group company, has decided to construct a facility for continuous catalytic reformer, with the start of operation scheduled for the end of 2009. This is just one of the measures being taken by the Showa Shell Group to expand its production volume of high-value-added products.

Refinery Capacity Utilization Rate



Ratio of self service stations



Miyazaki Plant for commercial production of CIS photovoltaic modules

The possibilities of CIS photovoltaic modules Free from constraints on mainstream type of solar batteries

Against the backdrop of the recent steep rise in oil prices and the growing worldwide concern over the preservation of the environment, photovoltaic modules (also referred to as "solar power batteries") are just the sort of non-oil-dependent, eco-friendly energy sources that society needs, and the long-term possibilities for such energy sources appear limitless. Up to now, however, the mainstream type of solar power battery has been made of crystalline silicon: the production and popularization of such batteries has thus been held back by the tightness of silicon supply. By contrast, the CIS (copper, indium, selenium) thin-film photovoltaic modules commercialized by Showa Shell have broken free from these constraints, and could potentially open the way to a tremendous expansion in the use and popularity of solar power batteries (see Page 11 for details).

Expanding the range of energy sources handled

The Earth's reserves of crude oil will be exhausted eventually, and at Showa Shell we recognize the necessity to discover and exploit the possibilities of new sources of energy if we are to continue fulfilling our corporate mission of providing our customers with a reliable supply of energy. The development of cleaner forms of energy, which help in the fight against environmental degradation, is also essential to the Company's continued existence and prosperity.

Since 1978 Showa Shell has been putting effort into research, development and popularization of solar energy, one of the leading candidates in the field of clean energy. The Company has taken part in a large number of overseas assistance projects organized by the New Energy and Industrial Technology Development Organization (NEDO), a public organization. These projects are aimed at bringing electric power within reach of populations in remote areas of developing countries. Showa Shell also possesses a strong track record in this field thanks to its installation of solar power generation systems in public facilities as well as the offices and factories of private-sector corporations.

Against this background, in 2005 NEDO commissioned the Company to undertake an R&D project on the commercialization of a solar power battery employing thin-film CIS compounds. In October of 2005 we completed construction of a plant for commercial production at Miyazaki. Although two of the raw materials required to make CIS photovoltaic modules—indium and selenium—are rare, this disadvantage is offset by the various advantages, among which is the fact that such modules can utilize a wider range of the light spectrum than is the case for conventional solar cells. Under the name of "solacis," Showa Shell has already launched on the market a home-use power generation system employing CIS photovoltaic modules, and we believe we have excellent chances of developing a large market for this product.

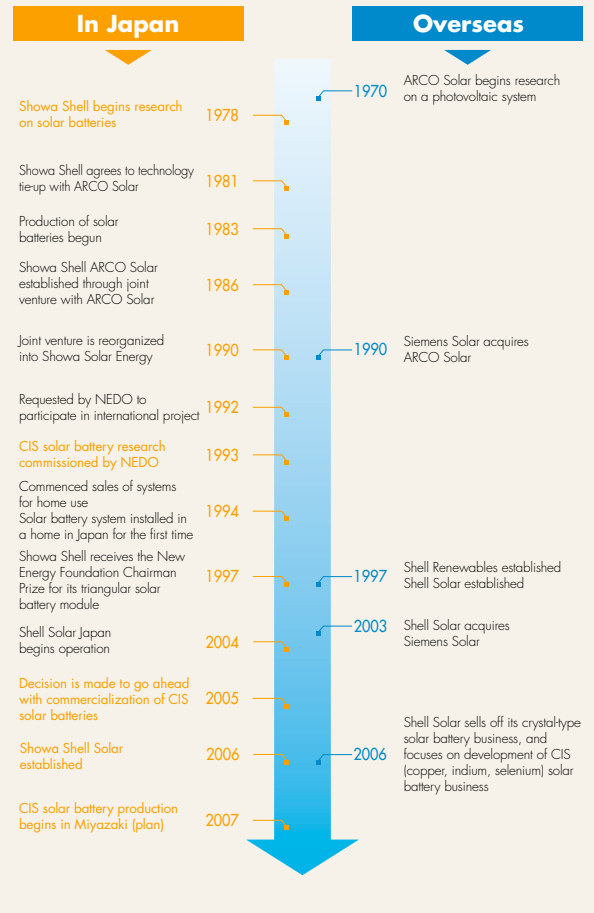
In addition to solar power, we are also actively pursuing the possibilities of other petroleum-alternative energy sources, such as natural gas and hydrogen. We have plans to construct power generation plants burning natural gas with the aim of entering the IPP (independent power producer) field. To this end, we have jointly established Ogishima Power Co., Ltd. with Tokyo Gas Co., Ltd., and the company is scheduled to begin operations in 2010.

Deploying solutions services

In 2006 Showa Shell also entered a new business field not directly related to its core energy operations. This is a "home solutions" business, offering such services as residential security, and housework like cleaning and washing. Our home security service operates under the name Shell HomeGuard. It is principally handled by an existing Showa Shell Group member engaged in the sale of liquefied petroleum gas, which it supplies (in cylinders) to households not connected up to the gas pipeline network, and thus possesses a large "book" of existing regular customers. The security service consists mainly of the fitting of various anti-burglary sensors and fire-alarm sensors. These sensors are connected to the local police and fire stations.

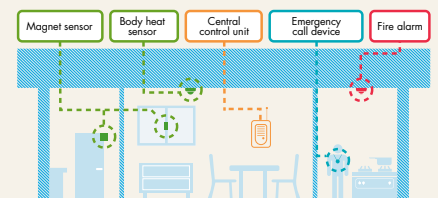
Regarding the housework service, in September 2006 we set up a joint venture (under the name of Michell Home Service Co., Ltd.) with Cleaty Service Co., Ltd. one of Japan's leading housework agencies. The joint venture started operation in October, offering housework services (principally cleaning) in the Kanto, Kansai, and Chubu regions, the three most densely-populated parts of Japan. In the near future, we plan to widen the scope of our housework services to include babysitting, cooking, and others.

Our Development of Solar Batteries



Staff of Michell Home Service offering housework services

Shell HomeGuard



Our Shell HomeGuard sensors and other devices help protect you in your own home

Compared with our existing business model, whereby customers come to us (our service stations), these new home-oriented solutions businesses involve our staff visiting our customers' premises. Using the word "retail" in its widest sense, the successful pursuit of such new types of business will require our staff to cultivate considerable retail business know-how.

Fuel costs account only for a relatively small proportion of the average household's total monthly expenditure, and there is thus a limit to the corporate growth we can expect solely from pursuing our existing core business. By cultivating these new business lines, we aim to diversify our revenue sources and open up the possibility of growth by identifying and catering to the multifarious needs of a large number of individuals. Only in this way, we believe, can we ensure sustainable growth for Showa Shell over the long term.

Apart from such new home-oriented solutions services, we already offer services at our filling stations. As well as normal repairs, we offer extra incentives for customers who come up for their mandatory automobile inspections (carried out by qualified staff). These extras include special, value-added services such as emergency "while-you-wait" repairs, towing services for vehicles that have broken down, and troubleshooting services at distant locations performed through collaboration with other enterprises. All these additional services are free of charge.

For our industrial users, we have started operations as an ESCO (Energy Service Company), offering energy conservation and cost-reduction assessments and solution proposals, tailored to the unique situations of each customer. We are confident of our ability to provide accurate advice to any customer, thanks to the know-how we have acquired in the operation of our distributed power source business. From individuals at our service stations to industrial users who conclude energy conservation contracts with us, Showa Shell's customers are able to choose from a wide range of energy conservation support services, and to find just the one that meets their needs.

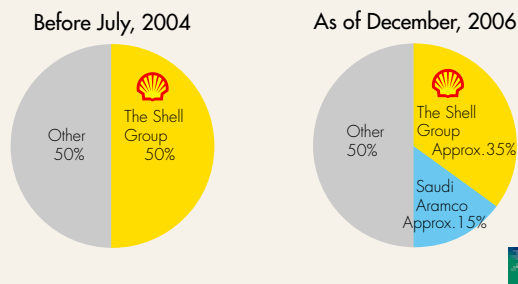
Compliance and Corporate Social Responsibility

With the aim of raising both the transparency and the efficiency of the Company's management, we are currently designing an internal control system that will incorporate an independent checking function. The new Corporation Law, which includes provisions mandating stronger internal control, went into effect in May 2006, and in response to this Showa Shell set up a working committee to supervise the creation of an effective internal control system. At the same time, we also drew up the Basic Policies Governing Internal Control, which lay down the rules that will govern the organization of the Company's internal control system and rules for the management of sensitive information.

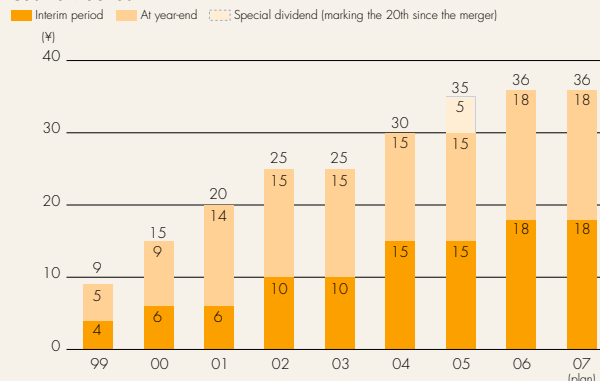
In spite of these efforts, however, it was discovered—in two separate cases in September and October 2006—that two of our service stations had for many years been selling the wrong types of gasoline due to mistaken connections of the fuel supply pipes. The management of Showa Shell regards such occurrences as very serious matters that could have a substantial negative impact on the Company's reputation for reliability. All service stations under the control of the Company or its affiliates were immediately ordered to implement thorough checks to confirm that no similar mistakes had been made. Fortunately, all other service stations came through these checks with a clean sheet.

Changes in shareholder composition

Prior to 2004, the Shell Group held 50% of the shares of Showa Shell Sekiyu K.K., but in that year approximately 15% of total shares were transferred by the Shell Group to Saudi Aramco, the national oil company of Saudi Arabia, the world's No. 1 oil exporter. The current shareholder composition has remained unchanged since July 2005: i.e. the Shell Group holds 35%, Saudi Aramco holds 15%, and the remaining 50% is held by a large number of other shareholders, including both institutional investors and individuals. The investment input into Showa Shell by Saudi Aramco has smoothed the way to acquisition of crude oil from Saudi Arabia, and has also contributed to the rationalization of our oil transportation methods, enabling us to realize a more efficient supply system.



Cash dividends



Quality First 2007

Showa Shell has dedicated the entire year starting January 1, 2007 to the materialization of higher standards of product quality, and has initiated a Company-wide quality improvement initiative under the slogan "Quality First 2007."

Learning from our experience in 2006, when we discovered that two of our service stations had been unknowingly selling the wrong types of gasoline, we are working to revamp our product quality assurance system across the entire Showa Shell Group, including affiliated companies and dealerships, to prevent the recurrence of such a mishap. Specifically, we have set up working groups responsible for fuels and special products, and charged them with the task of identifying and dealing with all the risks that could affect the quality of all our products. We are also holding courses aimed at raising awareness of product quality issues for all our staff—in back-office departments as well as frontline sales departments—as a means of preventing the future recurrence of such issues.

For the duration of the Quality First 2007 campaign, all employees will wear badges inscribed with the words "Quality First," as a permanent reminder of the importance of the campaign. Questionnaires will be distributed to all staff twice during the campaign period to help us assess its effectiveness.



Not only will we ensure that there are no such mishaps in the future, we have also instituted in 2007 a radical overhaul of our systems of product quality assurance and safety management. We are currently pursuing a companywide quality assurance campaign under the slogan: Quality First 2007.

It would be no exaggeration to say that in today's society, companies that do not fulfill their social responsibilities will not continue in existence for very long. Showa Shell places corporate social responsibility and HSSE (health, safety, security and environment) matters at the top of its list of management priorities. For this reason, we are not content simply with fulfilling our primary social mission of ensuring a steady and reliable supply of energy; we are also actively engaged in activities that directly contribute to the good of society. For example, the Shell Art Award has for 51 years been one of the most important events in the calendar for the Japanese art world, and the Company's institution and continuation of this award has been highly praised as proof of Showa Shell's lasting commitment to social contribution.

Another new event is being held this year for the second time—the Showa Shell Environment Photo Contest. In this unique event, contestants are invited to submit photos of attractive and historically valuable buildings and so on in the neighborhoods where they live, which they believe should be preserved, as well as pictures of ugly scenes that they want to be beautified. This year's contest has received 1,727 entries.

Jointly with the Integrated Research System for Sustainability Science, Showa Shell established an industry-academia collaborative organization to find and develop strategies for the use of renewable forms of energy. This body particularly concentrates on investigations into practical renewable energy technologies and systems that would help to retard global warming. When its conclusions have been finalized, the organization will present its recommendations to the relevant governmental policy-making bodies.

In other contributions to environmental improvement, Showa Shell is constantly expanding its lineup of eco-friendly products and services, including energy conservation-type kerosene, the CIS photovoltaic modules described above, sulfur-free gasoline and diesel oil, and a new, low-odor type of asphalt under the name New Mellowphalt, which comes in attractive light colors.

Enhancing shareholder value

Showa Shell's fundamental policy with regard to shareholder return is to pay a stable and attractively high dividend, taking into due consideration the Company's financial position, trends in the financial markets, and other such factors. In line with this policy, we have been increasing the per-share dividend since 1999, when it stood at ¥9. For the business term ended December 31, 2006, we have decided to make payments of ¥18 per ordinary share of common stock for both the interim and term-end dividends, giving a total annual per-share dividend of ¥36, for an increase of ¥1 over the previous term.

Forecast for fiscal 2007, and future tasks

The historically high levels reached by crude oil prices in 2006 once again highlighted Japan's overdependence on oil. Although the oil price has fallen back to a more reasonable level, this does not mean we can simply breathe a sigh of relief and forget about the issue. Oil reserves will run out one day, and it is incumbent upon us to take another, close look at the environmental problems we face on a global scale, and to start drawing up plans for our future growth that do not depend on oil.

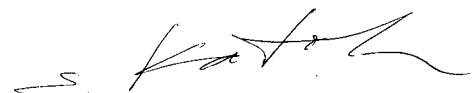
In 2007, which is the third year under Showa Shell's New Foundation programme, we will be maintaining our pursuit of growth opportunities by taking steps to further improve the quality of our petroleum products and services, and by expanding our network of service stations and introducing new systems to ensure improved efficiency. At the same time, we plan to optimally leverage our existing marketing network to sell new products such as CIS photovoltaic modules and raw materials for the petrochemical industry. We aim to expand the total scale of our business operations by offering a larger menu of forms of energy, as well as a wide-ranging solutions business for households. Additionally, we will be making the growth-oriented investments that are required to build a strong business base.

We will also be paying great attention to staff training, as a company's employees constitute its primary driving force. We hope to implement a training system that will encourage every single employee of Showa Shell not only to perform his or her duties diligently and honestly, but also to constantly be on the lookout for opportunities to increase the added value of the Company's products and services. The basic message that we aim to get across to our staff is that the success of the organization as a whole is only possible through collaboration among all its members.

As we pursue the goals outlined above, the management of the Showa Shell Group looks forward to the continued support and encouragement of the Group's shareholders.



Haruyuki Niimi
Chairman, Representative Director



Shigeya Kato
Vice Chairman, Representative
Director



Yasuo Murayama
President, Representative Director

■ Overview of Business Operations



Service Stations

Our service station network encompasses approximately 4,600 stations nationwide, which sell gasoline, diesel oil, kerosene, and automotive lubricants. Along with our affiliated dealers, we provide services that meet specific customer requirements to ensure a high level of customer satisfaction. We plan to increase the number of self-service filling stations, which are popular, and will further enhance our services through such initiatives as the introduction of the "Visa Touch" postpaid settlement system, to make our services even more user-friendly. We have established a certification program for employees, called the Showa Shell Royal Manager (SRM) program. In addition, certification is offered in two categories: Showa Shell Oil Meisters and Showa Shell Car Life Advisors. These are just some examples to illustrate the priority we put on the training of our service station staff.



Distribution System

The Company operates a fleet of approximately 1,000 large tankers and tank trucks, delivering petroleum products to service stations nationwide. Our top priority is to ensure a steady and safe supply of quality products to our customers. To this end, we are steadily expanding our equipment for preventing the accidental mixing of petroleum products, as well as the over-filling of tankers. We are taking steps to enhance communication between the managers of service stations and our tank truck drivers, and have improved safety through the introduction of a variety of reform measures.

Simultaneously, we have introduced a computer-controlled delivery system to optimize truck utilization rates, thereby raising the efficiency of transport operations and reducing distribution costs.



Liquefied Petroleum Gas (LPG)

Showa Shell handles four kinds of LPG: 1) Clean Propane, used in homes and at restaurants; 2) Clean Auto used in taxis; 3) Clean Butane for industrial and consumer gas applications, as well as basic materials for chemical products; and 4) Clean Mix, a mix of propane and butane. These gases can be stored in easy-to-carry, environmentally friendly dispensers, which make LPG easy to handle. Nationwide, there are currently 26 million households that use LPG for cooking, water heating, air conditioning, and commercial use. In the future, we anticipate the use of LPG in fuel batteries, serving as one of the fuels in a diversified power system. The Showa Shell Group's liquefied petroleum gas sales subsidiaries are also responsible for handling the home security service business.



Jet and Bunker Oil

Showa Shell sells fuel oil and lubricants for jets and tankers. The Shell Group supplies fuel to jets starting with their very first tankful. Today, the Shell Group supplies fuel to over 800 airports, in more than 80 countries. The Group also supplies tanker fuel and lubricants, servicing over 1,400 ports worldwide. Leveraging its global network, the Shell Group is expanding its sales activities in Japan and overseas. With regard to lubricants, the Shell Group markets a common brand for both jets and tankers.



Refining and Supply of Petroleum

In addition to the combined capacity of the Group's three refineries—the Yokkaichi Refinery of Showa Yokkaichi Sekiyu, the Keihin Refinery of Toa Oil, and the Yamaguchi Refinery of Seibu Oil—the Company has acquired equity stakes in AOC Holdings, thereby buying petroleum products from Fuji Oil's Sodegaura Refinery and substantially increasing its supply capacity in the Tokyo area and northern Japan, where demand is especially strong. We actively invested in technology for saving energy and limiting sulfur content in gasoline for automotive fuel to 10 ppm or less (sulfur-free). Through the pioneering of such sophisticated technologies, we will continue to undertake oil refining while proactively responding to customer needs. At the Yamaguchi Refinery of Seibu Oil, we began production and shipments of mixed xylene, a high-value-added petrochemical raw material, in February 2006.



Fuel for Industrial Uses

Showa Shell produces fuels for industrial use and sells these fuels directly to customers in the manufacturing, transport, and electric power industries, and also the agricultural, forestry and fisheries sectors, as well as the government and other public offices. As all industrial sectors in Japan work to resolve environmental issues, typified by recent efforts to reduce CO₂ emissions, their fuel needs will grow increasingly diverse. Showa Shell aims to face this challenge as a solution provider.



Lubricants, Grease, and Asphalt

Showa Shell, in collaboration with other members of the Shell Group, has developed over 1,000 varieties of lubricants and grease products, for a wide product lineup designed to meet customers' needs, which change from day to day. We have gained a substantial lead over our competitors thanks to our development of high-performance, environmentally friendly lubricants such as the synthetic fuel XHVI™, made from natural gas.

Thanks to our extensive efforts in research and new product development, we are now able to supply asphalt that imposes a smaller environmental burden. In civil engineering work, we offer not only asphalt for use as a road paving material but also supply SL compounds that protect pilings from friction caused by land subsidence. This proprietary technology, which played a role in the Hanshin Earthquake in preventing damage from soil liquefaction, has won Showa Shell considerable praise from the public.



CIS Photovoltaic Modules "Solacis"



Showa Shell will begin full-scale commercial production of solar batteries in 2007. The Company will begin selling CIS (copper, indium and selenium) thin-film photovoltaic modules, which are approximately one hundredth the thickness of conventional crystal silicon solar batteries and require much fewer resources and energy to produce. In addition, the solar batteries are able to continue generating power even if partially in the shade. The module itself is black in color, and will fit any kind of roof.

Our Solacis power generation system, which uses CIS solar batteries, is able to reduce electricity costs by about 70%*. This system has no special requirements in terms of operations or maintenance, enabling users to make a smooth transition to an eco-friendly lifestyle.

*This figure is true for a 3kW system. (Source: Survey by the New Energy and Industrial Technology Development Organization.)

■ Research and Development

The Shell Group is a pioneer in environmentally friendly countermeasures and new energy development. Our Central Research Laboratory—our primary research organization—works closely with the Shell Group’s worldwide R&D bases, undertaking research on a wide range of themes. The solar battery business mentioned above is just one aspect of the new energy business we expect to grow into a second core business.

Hydrogen Fuel

Hydrogen fuel promises to be an extremely clean source of energy. Fuel cells produce electricity through a chemical reaction of hydrogen with the oxygen from the air. We are working to commercialize this technology for principally automotive and home-use applications, and are making progress in our research. Since June 2003, Showa Shell has been operating the JHFC Ariake Hydrogen Station in Tokyo’s Koto Ward, in collaboration with Iwatani Industries Co. as part of the Japan Hydrogen & Fuel Cell Demonstration Project. By January 18, 2007, the station had refueled a total of 2,000 vehicles, which is the largest figure among Japan’s independent hydrogen stations.

Regarding fuel cells for home use, we are participating in a project to demonstrate their feasibility, and undertaking experiments with the aim of commercialization. Fuel cells for home use not only produce electricity, but also simultaneously generate heat through a co-generation system. Approximately 80% of generated energy can effectively be used. This system is expected to become widespread in the future, as it realizes energy conservation and a reduction in carbon dioxide emissions, as well as contributing to lower heating and lighting costs.



Dispersed Power Source Business

We began cogeneration utilizing the TES (Total Energy System) in 1974. Since then, we have realized significant achievements in the dispersed power source business. We have been able to

more efficiently supply electricity than the existing electric power companies, thereby contributing to the reduction of carbon dioxide. In addition to large-scale facilities, we will also begin offering efficient and reliable cogeneration power systems for home-use and use by small businesses.



GTL (Gas to Liquids)

GTL is a process in which the carbon and hydrogen contained in natural gas are combined to create synthetic liquid petroleum products. GTL fuel is clean and environmentally friendly, as it contains almost no sulfur, and has virtually no odor. The

Shell Group operates a GTL plant in Malaysia (the world’s first commercial facility of this kind; see photo), which supplies GTL products to over 20 countries. Moreover, the Shell Group has announced plans to build a large-scale GTL plant in Qatar, slated for completion in 2009, which will further cement its lead in both GTL technology and GTL fuel supply. Trial sales of *Shell Eco Toyu* (see p.6) made with the GTL process commenced in 2002, and have gone very well.



Natural Gas-Based Power Generation

From the viewpoint of environment protection, it is necessary to further improve energy consumption efficiency and promote energy conservation while helping retard global warming. Out of consideration for these requirements, we have established Ogishima Power

K.K. in collaboration with Tokyo Gas to explore ways to effectively and economically supply electricity from locations in close proximity to users. The authorities finished their environmental assessment process in 2006. The project is proceeding smoothly, and is scheduled to begin operation in 2009.



Soil Remediation Business

The Company employs the NERA (Network Environment Risk Assessment) system, developed by the Shell Group, to assess environmental risks and manage soil contamination risks at service stations. Our subsidiary Shoseki

Engineering & Construction Co., Ltd. is registered as a specified assessment organization with regard to soil reclamation countermeasures. Another subsidiary, K.K. SVC Tokyo, which is authorized to undertake verification of environmental measurements, is working to develop a business as a highly reliable environmental risk assessment company.

■ CSR Initiatives

We undertake management of the Showa Shell Group always keeping in mind our corporate responsibility as a member of society. Our social responsibilities range from the stable supply of energy to more direct corporate social responsibility initiatives. In particular, we focus on environmental issues and undertake a variety of activities in an effort to accelerate the realization of a society that gives priority to sustainable environmental protection.

Management Philosophy and Basic Policies

Showa Shell recognizes that the sustainable growth of the Company not only depends upon economic factors such as earnings and dividends, but also requires a management approach that shows due care for the environment and community. By maintaining an open line of communication with stakeholders including shareholders, consumers, customers, business partners, employees and the community, Showa Shell is committed to affirming its responsibilities as a corporation and reflecting the input of stakeholders in management decisions, as well as to boosting its corporate value.

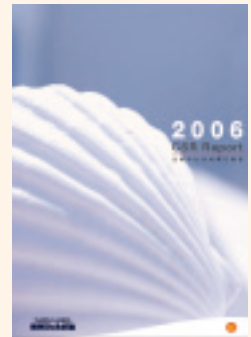
The Company also recognizes that no company can raise its enterprise value without possessing a sound earnings structure.

Showa Shell's approach to achieving sustainable growth is outlined in its Management Philosophy and Corporate Goals, while its business activities are guided by the Code of Conduct in existence since 1997. (For more information, see p. 34.)

CSR Report

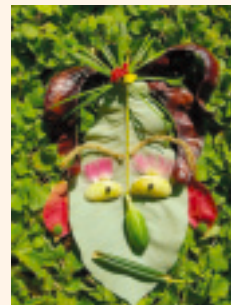
To further raise the recognition of the Company's CSR initiatives among stakeholders, Showa Shell published its first *CSR Report* in 2005, which incorporates two additional elements, "Society" and "Economy," into *Moderate*, the Company's environmental report published since 1993. For more information on our CSR initiatives, please read the *CSR Report 2006*, on our website.

<http://www.showa-shell.co.jp/society/csr/index.html>



Environment Photo Contest

From 2005, we launched the "Environment Photo Contest." This requires the submission of photos showing local scenery that have a visual effect in raising consciousness with regard to environmental preservation. Our hope is that this event will serve as a first step toward the creation of a nationwide grassroots movement aimed at the resolution of environmental issues, realized through the planning and initiative of individuals. The second such photo contest was held in 2006, drawing a total of 1,727 submissions. The contest was divided into two categories (a junior participants' division, and a general citizens' division), with a total of 68 winners. The award ceremony was held on October 29, 2006. The photo contest will be held again this year.



Winner in the Junior Participants' Division in the Second Environmental Photo Contest: Haruka Anbai (Hokkaido) for the photo entitled "Indigenous Species and Foreign Species."

Shell Art Award

The Shell Art Award has long been a springboard for Japan's young artists, and is widely known in the art world. Since its establishment in 1956, the prize has been awarded 35 times. The system relies entirely on public submissions, with the aim of discovering young artists who are likely to be outstanding figures among the next generation.

In 2006, the grand-prize winner was Hiroki Tanaka's "Spring Thunder" (see photo), and 42 winners of lesser awards from 1,357 works entered.

We plan to continue offering philanthropic support in the arts in Japan through the sponsorship of the Shell Art Award, with the aim of contributing to the discovery of new talent.

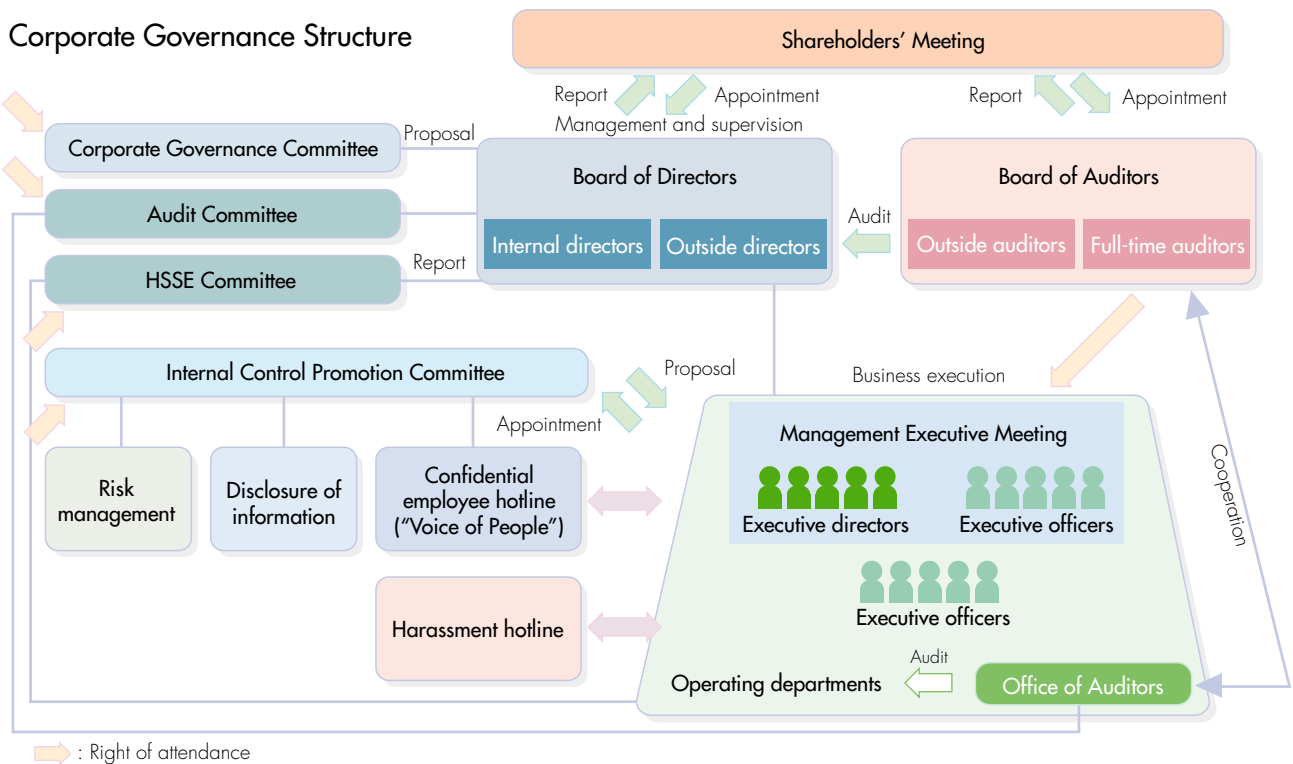


■ Corporate Governance

Showa Shell's goal is to increase enterprise value while delivering stable earnings and continuous growth. To achieve this goal, the Company has reduced the number of board members, introduced an executive officer system, and enhanced the participation of outside board members while giving them greater authority. Through such management reforms, the Company has effectively separated its management oversight and business execution functions. In 2004, Showa Shell established a Corporate Governance Committee as an advisory organization to the Board of Directors, as part of its measures to improve its corporate governance system.

Our Basic Stance on Corporate Governance

1. To accelerate decision-making and clarify accountability through the separation of management and execution functions
2. To reflect the objectives of external parties to management and improve transparency through voluntary disclosure of information
3. To establish monitoring functions and improve them as necessary in order to thoroughly ensure compliance and risk management
4. To respect consensus-based decision-making that reflects a diversity of opinions, ensures rational decisions and fosters management teamwork, a strength of Showa Shell's corporate culture
5. To ensure the rights and benefits of all shareholders, including minority shareholders, and show particular consideration for shareholder equality in light of the Company's unique shareholder composition



Improving Compliance

Our standards for compliance can be found in Article 4 of our Code of Conduct (see p. 34). The Company demands honesty, integrity, and high ethical standards in all aspects of business operations. The offer, payment, solicitation, and acceptance of bribes in any form constitutes unacceptable business practice. Employees must avoid conflicts of interest between their private financial interests and the conduct of company duty.

In terms of actual systems in place, we have introduced a consultation service, dubbed the "Voice of the People" (VOP), as well as a sexual harassment hotline. The All-Employees' Committee addresses the issues that have been raised, and comes up with appropriate responses.

Internal Control

In response to recent changes which include enactment of Japan's Corporate Law and the Financial Products Transaction Law, we drafted our "Basic Policy on Internal Control System." In line with this policy, we have established the Internal Control Promotion Committee, headed by the Chairman of the Board, and the Internal Control Promotion Department, which is responsible for actual implementation. The Internal Control Promotion Committee is intended to effectively integrate the internal control function for the entire group, by working with representatives from each department. This framework makes possible the development of a flexible system of internal controls. The management of Showa Shell has positioned the two-year period through 2008 as a phase during which particular focus will be put on strengthening internal controls. This will be achieved by reforming and strengthening our internal control structure.

■ Board of Directors and Corporate Auditors



Directors

Chairman, Representative Director

Haruyuki Niimi

Vice Chairman, Representative Director

Shigeya Kato

President, Representative Director

Yasuo Murayama

Vice President, Director

Richard A. Carruth

Managing Directors

Hitoshi Sato
Jun Arai

Directors

Yoshihiko Miyauchi
Chong-Meng Tan
Khalid H. Al-Dabbagh
Tomoyuki Egami
Atsuhiko Hirano

Full-Time Auditors

Hisao Nozaki
Kanji Yamamoto

Auditors

Akio Kioi
Midori Miyazaki

Executive Officers

Senior Managing Executive Officers

Jun Yui
Yukimichi Ikemura
Shigeaki Kameda

Managing Executive Officers

Kazunori Yamamoto
Hiroto Tamai

Executive Officers

Kazuo Murakami
Naoto Komatsu
Kiyotaka Yamada
Tsuyoshi Kameoka
Katsuhiro Nakagawa
David J. Kinder
Yukihiro Hoshito
Misao Hamamoto
Tomoaki Ito

(From left, the first row):

*Shigeya Kato,
Haruyuki Niimi,
Yasuo Murayama*

(From left, the second row):

*Midori Miyazaki,
Chong-Meng Tan,
Hitoshi Sato,
Yoshihiko Miyauchi,
Khalid H. Al-Dabbagh,*

Akio Kioi

(From left, the third row):

*Hisao Nozaki,
Atsuhiko Hirano,
Tomoyuki Egami,
Jun Arai,
Richard A. Carruth,
Kanji Yamamoto*

(As of March 29, 2007)

■ Network, Major Subsidiaries and Affiliates

Head Office	Daiba Frontier Bldg., 2-3-2, Daiba, Minato-ku, Tokyo 135-8074	Tel: (03) 5531-5591
Ishioka Training Centre	3-21-11, Minamidai, Ishioka, Ibaraki 315-0035	Tel: (0299) 26-9611
Central Research Laboratory	4052-2, Nakatsu, Aikawa-machi, Aiko-gun, Kanagawa 243-0303	Tel: (046) 285-0564
Branches		
Hokkaido	Nishi 1-1-2, Kita 7 jo, Kita-ku, Sapporo, Hokkaido 060-0807	Tel: (011) 738-2070
Tohoku	4-1-1, Ichiban-cho, Aoba-ku, Sendai, Miyagi 980-0811	Tel: (022) 263-1216
Tokyo Metropolitan District	1-6-1, Otemachi, Chiyoda-ku, Tokyo 100-0004	Tel: (03) 3214-8518
Kanto	1-6-1, Otemachi, Chiyoda-ku, Tokyo 100-0004	Tel: (03) 3214-8581
Niigata	21, Heiwa-cho, Niigata-shi, Niigata 950-8515	Tel: (025) 274-5511
Shizuoka	3-11, Otemachi, Aoi-ku, Shizuoka-shi, Shizuoka 420-0853	Tel: (054) 255-5381
Chubu	3-25-9, Meieki, Nakamura-ku, Nagoya, Aichi 450-0002	Tel: (052) 582-6611
Hokuriku	1-5-2, Honmachi, Kanazawa, Ishikawa 920-0853	Tel: (076) 233-5151
Kinki	2-5-8, Minami-senba, Chuo-ku, Osaka-shi, Osaka 542-0081	Tel: (06) 6271-9825
Chugoku	2-7-10, Otemachi, Naka-ku, Hiroshima-shi, Hiroshima 730-0051	Tel: (082) 249-4424
Shikoku	1-3-1, Kotobuki-cho, Takamatsu, Kagawa 760-0023	Tel: (087) 851-7934
Kyushu	3-11-1, Tenjin, Chuo-ku, Fukuoka-shi, Fukuoka 810-0001	Tel: (092) 752-5313
Petroleum Import Terminal		
Niigata	21, Heiwa-cho, Niigata-shi, Niigata 950-8723	Tel: (025) 274-4141
Lubricant Blending Plants		
Yokohama	2-4, Anzen-cho, Tsurumi-ku, Yokohama, Kanagawa 230-0035	Tel: (045) 505-8201
Kobe	6-1-17, Namimatsu-cho, Nagata-ku, Kobe, Hyogo 653-0055	Tel: (078) 731-2035
Management Terminals		
Management Terminal (Tokyo)	1-6-1, Otemachi, Chiyoda-ku, Tokyo 100-0004	Tel: (03) 3214-8531
Management Terminal (Osaka)	2-5-8, Minami-senba, Chuo-ku, Osaka-shi, Osaka 542-0081	Tel: (06) 6271-2411
Management Terminal (Yokkaichi)	1, Shiohama-cho, Yokkaichi, Mie 510-0851	Tel: (0593) 46-2418
Management Terminal (Seibu)	5, Oaza-Nishioki, Onoda, Yamaguchi 756-0885	Tel: (0836) 88-0622

Affiliates

<i>Company name</i>	<i>Equity ownership (%)</i>	<i>Major businesses</i>
Showa Yokkaichi Sekiyu Co., Ltd.	75.0	Petroleum refining
Toa Oil Co., Ltd.	50.1	Petroleum refining
Seibu Oil Co., Ltd.	38.0	Petroleum refining
Showa Shell Sempaku K.K.	100.0	Domestic and international shipping
Heiwa Kisen Kaisha, Ltd.	100.0	On-site services at refineries and oil fields, shipping agent
Japan Oil Network Co., Ltd.	49.0	Petroleum storage, contracts for receipts and payments, leasing of petroleum storage facilities
JLS Corporation	50.0	Receipt of orders for transport, allocation of vehicles and delivery of petroleum products
Niigata Joint Oil Stockpiling Co., Ltd.	29.0	Petroleum storage
East Ogishima Oil Terminal K.K.	76.0	Petroleum storage
Hokkaido Joint Oil Stockpiling Co., Ltd.	10.0	Petroleum storage
Oita L.P.G. Joint Stockpiling Co., Ltd.	15.0	Liquefied natural gas storage
Shoseki Overseas Oil Development Co., Ltd.	100.0	Mining, development, production and sales of petroleum and natural gas
Shoseki Engineering & Construction Co., Ltd.	100.0	Design and construction of industrial facilities, particularly those used in the petroleum industry
Red and Yellow Co., Ltd.	100.0	Import and sales of lubricating oil
Nippon Grease Co., Ltd.	99.3	Manufacturing and sales of grease and lubricating oil
Rekisei Kagaku K.K.	100.0	Processing of specialized asphalt products
Showa Shell Solar K.K.	100.0	Manufacturing and sales of solar batteries, development of photovoltaic modules and systems
K.K. SVC Tokyo	100.0	Performance testing and analysis of petroleum products, solutions to prevent oil from polluting the soil, engine testing
Shoseki Kako K.K.	100.0	Manufacturing, sales and execution of materials used for waterproofing buildings, and manufacturing and sales of petroleum products and asphalt pavement
Shoseki Gas K.K.	100.0	Sales of liquefied natural gas, high-pressure gas and other petroleum related engineering works, and sales of household appliances and office automation equipment
K.K. Rising Sun	100.0	Sales of petroleum and automotive products, indemnity agent, leasing, uniform rental
Kyoto Sky Parking K.K.	100.0	Operation of parking facilities, real estate agent
K.K. Creco	100.0	Building maintenance services, travel agent
K.K. On Site Power	64.0	Supply of heat and electricity
K.K. Ogishima Power	25.0	Environmental assessment, technological study, and business profitability study on electric power plant construction
Wakamatsu Gas K.K.	100.0	Sales of petroleum products and city gas business
Showa Shell Network Development K.K.	100.0	Development of locations for building service stations

(As of April 2007)

Management's Analysis of Financial Position and Operating Results

The Japan's Economy and the Operating Environment

Although the pace of growth of consumer spending in Japan slowed down in the latter half of 2006, corporate earnings continued to improve and private-sector capital investment continued to expand. In view of these factors, the economy can be judged to have maintained its recovery trend.

Crude oil prices started off the year at a historically high level, with Dubai crude selling at around \$55 dollars per barrel, and the price subsequently went even higher due to the twin factors of increased demand, particularly in the United States and the principal oil-consuming nations of Asia, and the perception of rising geopolitical risks in the Middle East. By mid-summer, the price of crude oil had topped \$70 per barrel for a short while, setting an all-time high. Thereafter, however, the geopolitical risk factors appeared to recede, and with futures prices declining and the balance of supply and demand becoming easier, the price of Dubai crude finally ended the year back around the \$55 level.

On the foreign exchange markets, meanwhile, the Japanese currency started off the year at nearly ¥116 to the dollar and fluctuated in the fairly narrow range of 113-119 to the dollar up to mid-April, against the backdrop of the market's inability to confidently forecast the fiscal policies of the U.S. and Japanese financial authorities. Subsequently, the yen began to climb at a sharp pace, reaching ¥109-110 by the middle of May. In the latter half of the year, however, the yen gradually weakened against the dollar as a result of the U.S.-Japan interest rate disparity, sinking back to around ¥119/\$1 by the yearend.

Amid this business environment, the Showa Shell Group decided to take to the next level its efforts—which it has been pursuing for a number of years—to strengthen its cost competitiveness and build a strong financial position. Under the banner of "New Foundation," the management decided to pursue a new growth strategy in the Group's core business of the refining and sale of petroleum products, by expanding its network of filling stations and introducing new items to its product lineup that would clearly set

the Group apart from its rivals. At the same time, the Group will continue to invest management resources in the development of peripheral businesses, as well as completely new business lines unconnected with its oil operations.

Operating Results

Sales for 2006 on a consolidated basis came to ¥2,921.2 billion, an increase of 28.8% over the preceding business year. This is attributable to the record-high levels attained by crude oil prices.

At the profit level, the surge in crude oil prices cut back the Group's gross profit on sales to ¥193.1 billion, for a year-on-year decline of ¥19.3 billion. Turning to operating income on a consolidated basis, despite our efforts to cut costs, as evidenced by the 0.9 percentage point year-on-year decline in the ratio of SG&A expenses to sales, the fall in crude oil prices from the latter half of the third quarter led to a much smaller decline in the cost of sales than in the previous year, in line with a decrease in the book value of crude oil inventory. As a result, operating income registered a year-on-year fall of ¥24 billion to ¥74.3 billion.

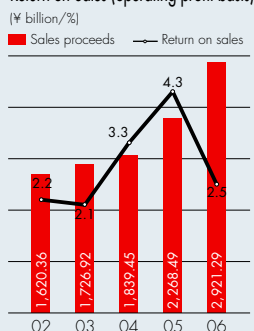
In non-operating profits and expenses, gains/losses on foreign exchange translation improved by ¥4.1 billion over the previous year, but ordinary profit registered a year-on-year decline of ¥22.8 billion to ¥77.6 billion.

For the reporting term, the Showa Shell Group recognized net special losses amounting to ¥400 million (an improvement of ¥800 million year-on-year) in the form of losses on disposal of fixed assets (involving the selloff of idle assets and the scrapping of superannuated facilities to enable replacement with up-to-date facilities), as well as losses resulting from a fire at the Keihin Refinery operated by consolidated subsidiary Toa Oil Co., Ltd.

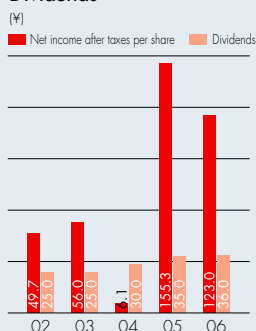
As a result of the above, net income on a consolidated basis for the reporting term came to ¥46.2 billion, down by ¥12.1 billion from the previous year.

Earnings per share for fiscal 2006 stood at ¥122.88 and net assets per share came to ¥822.20.

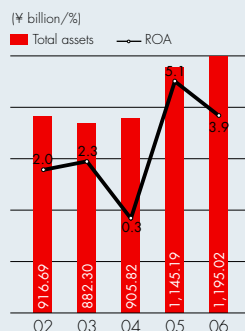
Sales Proceeds/
Return on Sales (operating profit basis)



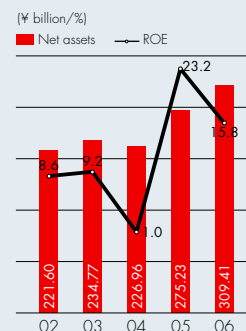
Net Income after Taxes per Share/
Dividends



Total Assets/ROA



Net Assets/ROE



Twelve-Year Summary of Selected Financial Data

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
Years ended December 31

	2006	2005	2004	2003	2002
Sales proceeds.....	¥2,921,287	¥2,268,488	¥1,839,445	¥1,726,917	¥1,620,359
Cost of sales.....	2,728,137	2,056,023	1,665,978	1,570,155	1,460,458
Gross profit.....	193,149	212,465	173,466	156,761	159,901
Sales and administrative expenses.....	118,847	114,084	113,280	120,787	123,500
Operating profit.....	74,301	98,381	60,185	35,974	36,400
Ordinary profit.....	77,675	100,497	61,927	38,188	40,101
Net income after taxes.....	46,249	58,370	2,362	21,000	18,665
Total assets.....	1,195,015	1,145,191	905,823	882,299	916,690
Total shareholders' equity*1.....	309,411	275,232	226,955	234,773	221,604
Net income after taxes per share (yen).....	¥122.95	¥155.31	¥6.14	¥55.96	¥49.69
Shareholders' equity per share (yen).....	822.20	732.08	605.25	627.07	592.18
Return on sales (operating profit basis) (%).....	2.5	4.3	3.3	2.1	2.2
Return on sales (net income basis) (%).....	1.6	2.6	0.1	1.2	1.2
Return on assets (%).....	3.9	5.1	0.3	2.3	2.0
Return on equity (%)*1.....	15.8	23.2	1.0	9.2	8.6
Equity ratio (%)*1.....	25.9	24.0	25.1	26.6	24.2
Number of shares outstanding at end of term (thousand shares) *2,3.....	376,323	375,863	374,868	374,303	374,125

*1 The definition of "shareholders' equity" was revised under the new Corporation Law in 2006, and "shareholders' equity" under the new law excludes minority interests. Please note referred numbers above are based on new definition of "shareholders' equity," NOT including minority interests. "Return on equity" and "equity ratio" are also calculated quoting these numbers.

*2 Treasury stock is excluded.

*3 The amount of treasury stock includes Showa Shell Sekiyu stock held by affiliates accounted for by the equity method.

On a current cost of supply basis (i.e., excluding the effects of inventory appraisal), ordinary profit on a consolidated basis would have come to ¥58 billion, for a ¥4.7 billion increase over the previous year.

Regarding the term-end dividend, the management of Showa Shell has recognized steady improvements in its cost competitiveness and financial position. Consequently, we decided to pay a term-end dividend of ¥18 per share. Combined with the ¥18 per share interim dividend, this brings the annual dividend per share to ¥36.

Segment Information

Oil Business

Demand for oil and its derivatives in the Japanese market weakened in 2006 against the background of rising oil prices and the effects of the growing energy conservation movement, as a result of which the gasoline sales volume fell below the previous year's level for the first time in 36 years. In spite of this, the total volume of Showa Shell's sales of petroleum fuels such as gasoline and diesel oil (excluding kerosene, sales of which fell below the previous year's level owing to the relatively warm winter) posted a 5.6% year-on-year growth.

Turning to petroleum product prices, these climbed sharply from the start of the year up to the summer, owing to the steep rise in the price of crude oil. However, as demand was following a downward trend, we were not able to adjust our selling prices at our filling stations or for fuel sold to industrial customers by a margin sufficient to match the rise in crude oil procurement costs.

As a result of the foregoing factors, the Company's petroleum segment recorded increases both in selling prices and in the volume of gasoline and diesel oil sold in the Japanese market, and the segment's sales on a consolidated basis thus rose 28.1% over the previous year, to ¥2,883.4 billion. Earnings, however, were lower than the previous term's level. This was due to the fact that

the price of crude oil entered a downward phase in the latter half of the third quarter, leading to a rise in the cost of sales, and the Company was unable to pass on the increase in costs to its customers to a sufficient extent. Consequently, operating income for the petroleum segment on a consolidated basis amounted to ¥69.9 billion, a decline of ¥24.8 billion from the previous year.

Property Business

In the office building rental business, despite a geographical expansion in the growth trend of demand—against the backdrop of a fullscale recovery in corporate earnings—revenues from the real estate segment of the Showa Shell Group stayed flat on a year-on-year comparison, at ¥4.2 billion. On the bright side, operating income rose 2.6% over the previous term, to ¥2.7 billion, thanks to our various measures to reduce expenses involved in outsourcing our building management services, among other cost reductions.

Other Businesses

In the Group's leasing business, the start-up of a back-office transaction computer system leasing business from the previous term contributed to an increase in total revenues. In the Group's construction and engineering business, revenues were pushed up by an increase in orders for soil purification work and a number of contract completions in the field of work related to our TES (Total Energy System) cogeneration system.

In new businesses, the Group's gas utility business, commenced in 2005, was joined by an IPP (independent power producer) business and a dispersed power source business. Sales on a consolidated basis for the Miscellaneous Business Segment amounted to ¥33.5 billion, a sharp increase of 137.4% over the previous year, while the segment's operating income came to ¥1.6 billion for a year-on-year increase of ¥700 million.

Financial Position

Assets, Liabilities, and Owners' Equity

Total assets on a consolidated basis for the end of the term under

Millions of yen

2001	2000	1999	1998	1997	1996	1995
¥1,664,954	¥1,639,475	¥1,365,478	¥1,324,752	¥1,588,067	¥1,600,067	¥1,441,176
1,513,626	1,477,361	1,218,732	1,171,788	1,408,789	1,404,723	1,225,954
151,328	162,113	146,746	152,964	179,278	195,344	215,222
123,274	124,442	133,692	144,446	164,434	174,646	186,383
28,053	37,670	13,054	8,518	14,844	20,698	28,839
29,052	38,913	12,191	7,223	12,901	15,225	21,993
2,610	12,499	1,828	1,999	6,387	6,054	13,802
909,902	1,002,146	974,916	992,282	1,049,931	1,071,464	1,001,676
212,168	216,349	197,562	199,711	201,479	198,536	195,926
¥6.95	¥33.19	¥4.85	¥5.31	¥16.95	¥16.06	¥39.94
565.36	574.77	524.25	529.95	534.64	526.84	519.93
1.7	2.3	1.0	0.6	0.9	1.3	2.0
0.2	0.8	0.1	0.2	0.4	0.4	1.0
0.3	1.2	0.2	0.2	0.6	0.6	1.5
1.2	6.0	0.9	1.0	3.2	3.1	7.3
23.3	21.6	20.3	20.1	19.2	18.5	19.6
375,281	376,409	376,850	376,850	376,850	376,850	376,850

review stood at ¥1,195 billion, for an increase of ¥49.8 billion compared with the previous term-end. This increase is primarily attributable to growth in the value of current assets. Crude oil prices followed a consistent upward trend from the end of the previous year, pushing up the value of inventory assets by a large margin. In addition, in line with the growth in sales, an increase in trade notes and accounts receivable (trade receivables) led to an increase in accounts receivable. The increase in fixed assets is largely attributable to: a) the upgrading (scrapping and replacement) of the Group's oil refining facilities; b) investments in the construction of a manufacturing plant for solar cells (photovoltaic modules), one of our new business lines; c) investment in the construction of additional filling stations; and d) the expansion of the scope of consolidation.

Liabilities at term-end increased by ¥12.9 billion to ¥864 billion. This is principally attributable to the fact that the increase in trade payables—stemming from the rise in crude oil prices—greatly exceeded the decrease (combined total of income taxes paid and reversal of allowance for the regularly-scheduled refurbishment of refining facilities). In addition, interest-bearing liabilities fell only slightly, to stand at ¥190.5 billion. However, the gearing ratio fell by 2.9 percentage points from the previous term, to 38.5%.

Owners' equity on a consolidated basis came to ¥303.9 billion, an increase of ¥34.1 billion over the previous year. This was principally due to an increase in retained earnings made possible by the posting of net income. As a result of the foregoing, the term-end equity ratio stood at 25.9% and the ROE was 15.8%.

Cash Flows

Net cash provided by operating activities amounted to ¥29.3 billion, due to the fact that the combined amount of increases in income before income taxes and in depreciation expenses exceeded the amount of income taxes paid.

Net cash used in investing activities amounted to ¥28.8 billion. The main factor behind this was the acquisition of new fixed assets

as part of the regularly scheduled refurbishment of the Group's oil refining facilities.

Net cash used in financing activities came to ¥13.7 billion. This is largely attributable to the fact that, despite fund procurement through the issuance of corporate bonds in the amount of ¥15 billion, this amount was exceeded by the combined total of ¥5.6 billion in payments of term-end dividends for the previous business year, ¥6.7 billion in interim dividend payments for the reporting term, and ¥16.3 billion in repayments of long-term debt and short-term bank borrowings.

As a result of the above, cash and cash equivalents at term-end came to ¥16.5 billion, representing a decrease of ¥12.8 billion from the previous term-end, despite an increase due to the wider scope of consolidation. The free cash flow (cash flow provided by operating activities minus cash flow used in investment activities) came to ¥400 million.

Outlook for 2007

For the fiscal year ending December 2007, as crude oil prices are virtually certain to remain high, we project business performance as follows: sales at ¥2,860 billion on a consolidated basis and ¥2,750 on a non-consolidated basis; ordinary profit at ¥60 billion (consolidated) and ¥53 billion (non-consolidated); and net income at ¥35 billion (consolidated) and ¥31 billion (non-consolidated).

On a current cost of supply basis, ordinary profit (consolidated) is forecast at ¥60 billion.

These forecasts are based on the assumption of an average crude oil price for the entire term of \$55 per barrel (\$53.5/barrel for the first half; \$56.5/barrel for the second half), and on an assumed average exchange rate of ¥120 to the dollar.

Operational Risks

The Showa Shell Group has created a system to monitor and manage business risk, and endeavors to mitigate the risks associated with its business operations. Among such risks, the following are considered important categories related to the businesses of the Showa Shell Group and its financial and accounting position that could have a material effect on the decisions of investors.

The risks described below are those risks evaluated to be material by the Showa Shell Group (on a consolidated basis) at the end of the fiscal year under review. This list is not meant to be, and should be not construed as, a comprehensive list of every risk affecting the Group. Furthermore, the matters discussed here concerning future circumstances are those matters evaluated by the Showa Shell Group at the end of the fiscal year under review.

1. The effects of energy demand and market conditions for petroleum products

Domestic demand for petroleum products is affected by, and changes with, factors such as the economic situation in Japan and domestic energy supply and demand.

Moreover, Japan's domestic petroleum products market is affected by factors such as fluctuations in demand, price competition with other companies in the industry, overseas prices for petroleum products, and price competition with other forms of energy. These fluctuating factors also exert an influence on the quantities and prices of petroleum products that the Showa Shell Group sells, and cause changes to the Group's earnings.

2. Changes in crude oil prices and exchange rate market prices

a. Effect on sales margin

Because the cost of sales of the petroleum products sold by the Showa Shell Group is affected by changes in crude oil prices and the foreign exchange market, the Company's basic policy is to reflect these influences in its sales prices. When it is difficult to reflect the changes in cost of sales, which result from factors such as the domestic market environment, in the Company's sales prices, however, these changes will cause fluctuations in the Group's earnings.

In addition, there is a possibility that the amount of working capital the Group requires will increase because of a rise in crude oil prices or a rapid depreciation of the yen.

b. Effect of inventory valuation

The Showa Shell Group uses the weighted-average method to value crude oil inventory. When crude oil prices have declined, the Group's cost of sales will be increased by the effect of inventory that is relatively expensive at the beginning of the period, which will be a negative factor for earnings. When crude oil prices have risen, on the other hand, the Group's cost of sales will be reduced by the effect of inventory that is relatively inexpensive at the beginning of the period, which will be a positive factor for earnings. As this illustrates, there is a possibility that changes in crude oil prices will affect the Group's operating results.

3. Risks related to sources of crude oil procurement

The Showa Shell Group procures all of its crude oil from countries in the Middle East. There is a possibility that the financial position and operating results of the Showa Shell Group would be seriously affected in the event that obstacles arose to its procurement of crude oil, for reasons such as changes in the political climate in oil-producing countries, and assuming that an appropriate alternative supply source could not be found.

4. Environmental regulations and introduction of environmental taxes on the Group's business operations

Stricter regulations have been introduced limiting the sulfur content of gas oil to 10 ppm or less (de facto sulfur-free), and these restrictions will be extended to gasoline from the start of 2008. The Showa Shell Group is making investments to respond to this change. There is a possibility that the Group's additional capital investment or expense burden will increase if environmental taxes or quantity restrictions on parties that emit carbon dioxide, or on consumption of fossil fuels or other new environmental regulations, are introduced in Japan in the future, which would affect the Group's financial position and operating results.

5. Termination or restriction of active conduct of business as the result of a disaster, accident, etc.

The Showa Shell Group has enacted a basic policy concerning health, safety, security and the environment (HSSE) based on its own management rules, and strives to ensure safe operations and minimize disaster risk through the use of appropriate insurance, including property and casualty insurance. There is a possibility, however, that each office and facility of the Showa Shell Group, including its refineries, could face obstacles to its operations if struck by a natural disaster such as a large typhoon or earthquake, or if the area of business operations of the Company was hit by a large-scale epidemic of a serious infectious disease such as avian influenza, either of which would affect the Group's financial position and operating results. There is also a possibility of being similarly affected by the termination or restriction of active conduct of its business as the result of an occurrence such as a serious industrial injury or equipment accident.

6. Risks related to intellectual property rights

In addition to competition for technological development, as intellectual property rights strategies become more important, there is a risk that disputes will occur over issues such as the violation of intellectual property rights if the Group's steps to strengthen its intellectual property rights management system or defensive measures are inadequate.

7. Control of personal data

The Showa Shell Group obtains and uses personal data, including information on its customers, in relation to its businesses such as oil sales, and has created in-house management systems for the administration of this data.

The Group strives to protect such information with great care, but there is a possibility the Showa Shell Group brand image will be damaged, and the business performance of the Group negatively affected, if for some reason such data is disclosed outside the group and misused.

8. Risk concerning retirement benefits

The Showa Shell Group's estimated pension benefit obligations and costs are calculated according to mathematical valuation principles, and basic rates such as the discount rate and the expected rate of return on pension plan assets have been set as calculation assumptions. In the event the actual numerical values concerning the basic rate differ from these assumptions, or in the event the assumptions are revised, these changes would affect the amount of the pension benefit obligation and the costs recognized in the future because the effects would be cumulative and would be recognized regularly in future periods.

Consolidated Balance Sheet

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
As of 31 December 2006

Million Yen

	2006	2005
Assets		
Current assets:		
Cash and deposits.....	¥ 16,645	¥ 29,651
Notes and accounts receivable (Note 14)	326,121	309,633
Inventories	276,298	236,686
Deferred tax assets (Note 7)	7,611	8,049
Others	24,748	20,956
Provisions for doubtful debts	(401)	(417)
Total current assets.....	651,025	604,560
Fixed assets (Notes 6, 11 and 12):		
Tangible fixed assets		
Buildings and structures.....	116,967	118,750
Tanks.....	10,768	11,636
Machineries and equipments	125,855	123,771
Lands.....	162,162	160,512
Construction in progress.....	5,795	5,106
Others	5,313	5,308
Total tangible fixed assets.....	426,862	425,085
Intangible fixed assets		
Goodwill.....	1,629	2,064
Leasehold	3,692	3,683
Software	5,084	6,066
Others	1,051	1,393
Total intangible fixed assets	11,458	13,207
Investments		
Investment securities (Note 4)	54,509	51,377
Long-term loans	997	1,206
Deferred tax assets (Note 7)	25,362	25,900
Others	25,988	24,688
Provisions for doubtful debts	(1,189)	(835)
Total investments.....	105,669	102,338
Total fixed assets	543,990	540,630
Total assets	¥1,195,015	¥1,145,191
Liabilities		
Current liabilities:		
Notes and accounts payable (Trade) (Note 14)	¥ 291,289	¥ 247,565
Short-term debts (Notes 5 and 13).....	51,254	41,901
Accounts payable (Other) (Notes 12 and 14)	201,769	204,174
Income taxes payable.....	9,032	26,952
Unpaid expenses.....	11,666	11,265
Provisions for employees' bonuses.....	2,142	2,069
Provisions for directors' bonuses.....	62	—
Commercial papers (Note 5)	68,000	86,000
Others (Note 14).....	43,789	44,451
Total current liabilities	679,006	664,379
Long-term liabilities:		
Bonds (Note 5)	30,000	15,000
Long-term debts (Notes 5 and 12)	41,272	48,929
Deferred tax liabilities (Note 7)	7,418	3,886
Provisions for retirement benefits (Note 8).....	78,554	79,677
Provisions for special maintenance	11,353	17,227
Others	16,453	21,998
Total long-term liabilities	185,052	186,719
Total liabilities	864,058	851,099
Net assets		
Share capital:		
Authorised 440,000,000 shares		
Issued shares 376,850,400 shares.....	34,197	34,197
Capital surplus.....	22,111	22,106
Retained earnings	248,108	214,346
Treasury shares:		
527,370 shares as of 31 December 2006 and 986,620 shares as of 31 December 2005	(422)	(781)
Total shareholders' equity	303,995	269,869
Valuation and translation gains/losses		
Unrealised gains/losses of investment securities	5,416	5,362
Minority interests	21,544	18,859
Total net assets	330,956	294,091
Total liabilities and net assets	¥1,195,015	¥1,145,191

Fractions below 1 million yen are rounded off.

Consolidated Statement of Income

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
Year ended 31 December 2006

Million Yen

	2006	2005
Sales proceeds (Notes 14 and 15).....	¥2,921,287	¥2,268,488
Cost of sales (Notes 14 and 15).....	2,728,137	2,056,023
Gross profit.....	193,149	212,465
Sales, administrative and general expenses (Notes 6, 8, 10, 14 and 15).....	118,847	114,084
Operating income.....	74,301	98,381
Non-operating profit		
Interest income.....	130	64
Dividends income.....	535	455
Foreign exchange gains.....	1,324	—
Amortisation of negative goodwill.....	468	2,951
Income from equity-method affiliates.....	1,803	1,668
Income from investment in anonymous association.....	1,465	785
Others.....	2,191	2,351
	7,919	8,276
Non-operating expenses		
Interest expenses.....	1,702	1,103
Sales discount.....	2,026	1,516
Foreign exchange losses.....	—	2,831
Others.....	816	708
	4,546	6,160
Ordinary income.....	77,675	100,497
Extraordinary profit		
Profit from sales of fixed assets.....	5,119	1,824
Profit from sales of investment securities (Note 4).....	725	91
Write back of provisions for special maintenance.....	972	81
Others.....	632	707
	7,450	2,704
Extraordinary loss		
Loss from disposal of fixed assets.....	3,869	1,663
Loss from sales of investment securities.....	0	0
Valuation losses on investment securities.....	114	9
Early retirement premium.....	28	82
Valuation losses on golf membership.....	3	34
Impairment losses (Note 11).....	2,462	1,894
Others.....	1,455	398
	7,934	4,083
Net income before taxes.....	77,190	99,119
Taxes.....	28,861	40,439
Tax adjustments.....	1,003	(53)
Minority interests.....	1,077	363
Net income after taxes.....	¥ 46,249	¥ 58,370
		Yen
Per share data:		
Net income after taxes.....	¥122.95	¥155.31
Diluted net income after taxes.....	122.88	155.13
Dividend.....	36.00	35.00
Net assets.....	822.20	732.08

Fractions below 1 million yen are rounded off.

Consolidated Statement of Changes in Net Assets

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
Year ended 31 December 2006

Million Yen								
2006								
	Shareholders' equity					Valuation & translation gains/losses	Minority interests	Total net assets
	Capital	Capital surplus	Retained earnings	Treasury shares	Total shareholders' equity	Unrealised gains/losses of investment securities		
Opening balance	¥34,197	¥22,106	¥214,346	¥(781)	¥269,869	¥5,362	¥18,859	¥294,091
Changes in the period								
Dividend from surplus			(12,412)		(12,412)			(12,412)
Directors' bonuses			(74)		(74)			(74)
Net income after taxes			46,249		46,249			46,249
Acquisition of treasury shares				(9)	(9)			(9)
Disposal of treasury shares		4		368	373			373
Net changes in items except shareholders' equity						(53)	2,685	2,739
Total changes in the period		4	33,762	359	34,125	(53)	2,685	36,865
Closing balance	¥34,197	¥22,111	¥248,108	¥(422)	¥303,995	¥5,416	¥21,544	¥330,956

Fractions below 1 million yen are rounded off.

Million Yen								
2005								
	Shareholders' equity					Valuation & translation gains/losses	Minority interests	Total net assets
	Capital	Capital surplus	Retained earnings	Treasury shares	Total shareholders' equity	Unrealized gains/losses of investment securities		
Opening balance	¥34,197	¥22,095	¥169,113	¥(1,537)	¥223,869	¥3,085	¥3,807	¥230,763
Changes in the period								
Dividend from surplus			(13,125)		(13,125)			(13,125)
Directors' bonuses			(62)		(62)			(62)
Net income after taxes			58,370		58,370			58,370
Acquisition of treasury stock				(9)	(9)			(9)
Disposal of treasury stock		11		764	775			775
Change in scope of consolidation			50		50			50
Net changes in items except shareholders' equity						2,277	15,051	17,329
Total changes in the period		11	45,233	754	45,998	2,277	15,051	63,328
Closing balance	¥34,197	¥22,106	¥214,346	¥(781)	¥269,869	¥5,362	¥18,859	¥294,091

Fractions below 1 million yen are rounded off.

Consolidated Statement of Cash Flows

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
Year ended 31 December 2006

Million Yen

	2006	2005
Cash flows from operating activities		
Net income before taxes	¥77,190	¥99,119
Depreciation	27,329	23,979
Impairment losses	2,462	1,894
Loss from disposal of fixed assets	3,869	1,663
Profit from sales of fixed assets	(5,119)	(1,824)
Valuation losses on investment securities	118	43
Change in provisions for doubtful debts	330	(473)
Change in provisions for directors' bonuses	62	—
Change in provisions for retirement benefits	(1,131)	(1,041)
Interest and dividend income	(665)	(520)
Interest expense	3,729	2,620
Change in accounts receivable	(14,923)	(69,675)
Change in inventories	(39,271)	(58,678)
Change in accounts payable	44,809	50,812
Others	(18,893)	16,781
Subtotal	79,896	64,700
Interests and dividends received	701	896
Interests paid	(3,912)	(2,986)
Corporate taxes paid	(47,373)	(36,803)
Cash flow from operating activities	29,312	25,806
Cash flows from investing activities		
Payments for purchase of fixed assets	(32,540)	(17,442)
Proceeds from sales of fixed assets	6,485	3,347
Payments for purchase of investment securities	(1,559)	(10,420)
Proceeds from sales of investment securities	1,064	471
Change in short-term loans	(919)	415
Payments for long-term loans	(97)	(117)
Proceeds from collection of long-term loans	67	12
Payments for additional acquisition of consolidated subsidiary shares	—	(949)
Others	(1,385)	(3,866)
Cash flow from investing activities	(28,883)	(28,548)
Cash flows from financing activities		
Change in short-term debts	13,053	(14,292)
Change in commercial papers	(18,000)	63,000
Proceeds from long-term debts	—	9,500
Repayments of long-term debts	(11,367)	(10,012)
Proceeds from bond issues	15,000	—
Payments for redemptions of bonds	—	(15,000)
Payments for purchase of treasury shares	(9)	(9)
Dividends paid	(12,412)	(13,133)
Dividend paid to minority interests	(349)	(101)
Others	373	775
Cash flow from financing activities	(13,712)	20,725
Change in cash and cash equivalents	(13,282)	17,982
Opening balance in cash and cash equivalents	29,354	8,313
Increase in cash and cash equivalents from newly consolidated subsidiaries	469	3,057
Increase in cash and cash equivalents due to merger of consolidated subsidiaries	—	1
Closing balance in cash and cash equivalents	¥16,541	¥29,354

Relation between cash and cash equivalents at year-end and cash in hand and at bank on the balance sheets

Million Yen

	2006	2005
Cash and deposits on the balance sheets	¥16,645	¥29,651
Time deposits exceeding three months	(104)	(296)
Cash and cash equivalents	¥16,541	¥29,354

Fractions below 1 million yen are rounded off.

Notes to the Consolidated Financial Statements

1. Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Securities and Exchange Law of Japan and its related accounting regulations, and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects from the application and disclosure requirements of International Financial Reporting Standards.

As permitted by the Security Exchange Law, fractions below one million yen are rounded off. It causes the totals in the financial statements are not equivalent to the sums of each item.

2. Summary of Significant Accounting Principles

(1) Principles of Consolidation

a) Consolidated subsidiaries as of 31 December 2006: (26 companies)

Showa Yokkaichi Sekiyu Co., Ltd.	Shoseki Overseas Oil Development Co., Ltd.	Shoseki Home Gas K.K.
Toa Oil Co., Ltd.	Petro Star Kansai K.K.	K.K. Shinyo Sekiyu
East Ogishima Oil Terminal Co., Ltd	Chuo Shell Sekiyu Hanbai K.K.	K.K. Marushin
Showa Shell Sempaku K.K.	Kanto Koyu Energy Co., Ltd	K.K. Rising Sun
Shoseki Gas K.K.	Nakagawa Oil Co., Ltd.	Shoseki Engineering & Construction Co., Ltd.
Nippon Grease Co., Ltd.	Tokyo Shell Pack K.K.	Wakamatsu Gas K.K.
Shoseki Kako K.K.	Petro Star Kanto Co., Ltd.	Genex Co., Ltd.
Heiwa Kisen Kaisha, Ltd.	K.K. Sun Road	On-Site Power Co., Ltd.(*1)
Central Energy K.K.(*2)	Nissho Koyu K.K.(*3)	

(*1) On-Site Power Co., Ltd. has become a consolidated subsidiary from this financial year due to additional acquisition of shares.

(*2) Central Energy K.K., which used to be an equity-method affiliate, has become a consolidated subsidiary from this financial year due to additional acquisition of shares.

(*3) Nissho Koyu K.K., which used to be an equity-method affiliate, has become a consolidated subsidiary from this financial year due to additional acquisition of shares.

Companies, such as K.K. Hayawa are excluded from consolidation because their influence is immaterial to the consolidated financial statements.

b) Account closing dates

	Toa Oil Co., Ltd. and Genex Co., Ltd. change their account closing date from 31 March to 31 December from this financial year.
	Central Energy K.K. change its account closing date from 31 December to 30 September.
30 September	Petro Star Kansai K.K., Petro Star Kanto Co., Ltd., Nakagawa Oil Co., Ltd., K.K. Sun Road, K.K. Sinyo Sekiyu, Shoseki Home Gas K.K., and K.K. Marushin.
31 October	Tokyo Shell Pack K.K.

The consolidated financial statements incorporated the accounts of the above companies with adjustments for significant transactions arising after their accounts closed.

(2) Equity-method Affiliates

Equity-method affiliates as of 31 December 2006: (11 companies)

Seibu Oil Co., Ltd.	Toyotsu Petrotex Co.	Niigata Joint Oil Stockpiling Co., Ltd.
Japan Oil Network Co., Ltd.	Joyo Shell Sekiyu Hanbai K.K.	Marubeni Energy Corporation
Central Sekiyu Gas Co., Ltd.	Mieseki Shoji K.K.	Shell Sekiyu Osaka Hatsubaisho K.K.
Shell Tokuhatsu K.K.	DaiaShoseki K.K.	

Central Energy K.K. and Nissho Koyu K.K. are excluded from the scope of equity-method affiliates as of this financial year for the reason mentioned above.

(3) Valuation Methods for Major Assets

a) Securities:

Securities with market value are stated at market value. Net unrealised gains or losses on these securities are reported as a component of the net assets in after-tax amount. Cost of securities sold is calculated primarily by the moving average method.

Securities with no market value are valued at historical cost, based on the moving average method.

b) Derivatives:

Derivatives are stated at market value.

c) Inventories:

Inventories are stated at historical cost, mainly based on the weighted average method.

(4) Depreciation and Amortisation of Major Assets

a) Tangible fixed assets:

Straight-line method is adopted. The same standard as stipulated in the Corporate Tax Law is applied to the useful economic lives and the residual values. The main refining facilities at the Ogimachi Factory of the Keihin Refinery of Showa Shell Sekiyu K.K. and the Yokkaichi Refinery of Showa Yokkaichi Sekiyu Co., Ltd. are depreciated with estimated useful economic lives of 20 years.

b) Intangible fixed assets:

Straight-line method is adopted. Software for in-house use is amortised based on the straight-line method over the expected useful economic life of 5 years.

(5) Basis of Provisions

a) Provisions for doubtful debts:

For doubtful debts, provisions are calculated individually based on the estimated uncollectible amounts. For other debts, provisions are calculated based on the actual ratio of the past doubtful debt losses.

b) Provisions for employees' bonuses:

Accrued bonuses for the current financial year are provided based on the estimated bonuses to be paid in the following year.

c) Provisions for Directors' bonuses:

For directors' bonuses, provisions are calculated based on the estimated bonuses to be paid in the following year.

d) Provisions for retirement benefits:

Accrued retirement benefits for the current financial year are provided based on the estimated PBO and pension assets as at the current financial year end. Actuarial differences are amortised evenly within the following 13-14 years, which is the average remaining service years of employees. The past service liabilities are amortised evenly within 14 years, which was the average number of remaining service years of employees at occurrences. Differences at the accounting standards change are amortised evenly over the following 15 years, which used to be the average remaining service years of employees at that time.

e) Provisions for special maintenances:

Estimated accrued expenses on inspections and maintenances on refining machineries and oil tanks are provided. Periodical inspections on oil tanks are required under the Fire Defence Law.

(6) Accounting for Leases

Finance leases, in which ownership of the leased assets is not transferred to the lessees, are treated in the same way as operating leases.

(7) Hedge Accounting

Hedge accounting is not adopted.

(8) Consumption Tax

Consumption tax is imposed at the flat rate of 5% on all domestic consumption of goods and services (with certain exemptions). The consumption tax withheld upon sale and consumption tax paid by the Companies on their purchases of goods and services is not included in revenue and cost or expense items respectively in the accompanying consolidated statements of income.

(9) Valuation Method for Assets and Liabilities of Subsidiaries

Assets and liabilities of the subsidiaries are measured at the fair values when consolidated.

(10) Amortisation of Goodwill and Negative Goodwill

Goodwill and negative goodwill is amortised evenly over a period not exceeding 20 years, which is determined in consideration of its causes. Goodwill is expensed in the year it arises when it is immaterial.

(11) Appropriation of retained earnings

Under the corporation law of Japan, the appropriation of retained earnings on the current financial year is determined by resolution of shareholders meeting held after the financial year-end. Therefore the appropriation of the retained earnings for the current financial year is not reflected in the accounts of the current financial year.

(12) Cash and Cash Equivalents

Cash and cash equivalents in the consolidated cash flow statements consists of cash in hand, deposits, readily convertible into cash, and short-term investments with low risk of price fluctuations and with a maturity of 3 months or less at the time of acquisition.

(13) Comparatives

Certain accounts in consolidated financial statements for the year ended 31 December 2005 have been reclassified to conform to the 2006 presentation.

3. Accounting Change

a) Accounting standard for directors' bonuses

"Accounting Standard for Directors' Bonuses" (ASBJ Statement No. 4, issued on 29 November 2005) has been adopted effective for the current financial year. Due to the adoption of this new accounting standard, the directors' bonuses are expensed when incurred, although it had been accounted for an appropriation of retained earnings upon resolution of shareholders' meeting. As a result, operating income, ordinary income and net income before taxes are decreased by 92 million yen compared with those would have been reported under the previous accounting policy.

b) Accounting standard for presentation of net assets on the balance sheet

"Accounting Standard for Presentation of Net Assets on the Balance Sheet" (ASBJ Statement No. 5, issued on 9 December 2005) and its Implementation Guidance (ASBJ Guidance No. 8, issued on 9 December 2005) have been adopted effective for the current financial year.

In addition, preparation of a consolidated statement of changes in net assets has been required instead of a consolidated statement of shareholders' equity.

In order to conform to the 2006 presentation, the consolidated balance sheet as of 31 December 2005 and the consolidated statement of shareholders' equity for the year ended December 2005 have been restated.

4. Securities

a) Investment securities

	Million Yen	
	2006	2005
Securities	¥26,098	¥27,489
Securities of non-consolidated subsidiaries and affiliates	28,410	23,887
	¥54,509	¥51,377

b) Securities with market value

	Million Yen		
	2006		
	Historical cost	Fair market value	Unrealised gain (loss)
Securities with unrealised gains:			
Shares	¥12,172	¥20,465	¥8,292
Securities with unrealised losses:			
Shares	4	4	(0)

	Million Yen		
	2005		
	Historical cost	Fair market value	Unrealised gain (loss)
Securities with unrealised gains:			
Shares	¥12,426	¥21,616	¥9,189
Securities with unrealised losses:			
Shares	0	0	0

c) Securities sold

	Million Yen	
	2006	2005
Amount of sold during the year	¥1,064	¥471
Realised gains	725	91
Realised losses	0	0

d) Securities with no market value

	Million Yen	
	2006	2005
Securities		
Unlisted shares	¥5,614	¥5,858
Unlisted bonds	15	15
	¥5,629	¥5,873

5. Short-term and Long-term Debts

a) Short-term debts

	Million Yen	
	2006	2005
Short-term debts	¥ 43,589	¥ 30,535
Commercial papers	68,000	86,000
	¥111,589	¥116,535

Note: The weighted average interest rates on short-term debts outstanding at the year-end were as follows:

	%	
	2006	2005
Short-term debts	0.18	0.19
Commercial papers	0.44	0.03

b) Long-term debts

	Million Yen	
	2006	2005
Loans from banks, other financial institutions, etc.		
Due from 2007 to 2015	¥48,937	¥ —
Due from 2006 to 2015	—	60,295
0.71 per cent unsecured straight bond due in 2010	15,000	15,000
1.66 per cent unsecured straight bond due in 2013	15,000	—
	78,937	75,295
Less: due within one year	7,665	11,366
	¥71,272	¥63,929

Note: The weighted average interest rate on long-term debts (excluding the one due in 1 year) from banks outstanding as of 31 December 2006 and 2005 were 1.74% and 1.68%, respectively.

Annual maturities of bonds

	Million Yen	
	2006	
Within one year	¥ —	—
More than one year less than two years	—	—
More than two years less than three years	—	—
More than three years less than four years	15,000	—
More than four years less than five years	—	—
More than five years	15,000	—
	¥30,000	—

Annual maturities of long-term debts, (excl. bonds)

	Million Yen	
	2006	
Within one year	¥ 7,665	—
More than one year less than two years	678	—
More than two years less than three years	10,160	—
More than three years less than four years	9,042	—
More than four years less than five years	500	—
More than five years	20,892	—
	¥48,937	—

c) Commitment-line contracts

The company concludes a revolving credit contract available up to 60 billion yen with a banking syndicate and overdraft contract up to 10 billion yen with Mizuho Corporate Bank Ltd.

There was 4,135 million yen balance as at 31 December 2006 under the contract with Mizuho Corporate Bank Ltd.

6. Lease Transactions

(1) Lessee

a) Finance leases

Finance leases, excluding those for which the ownership of the leased assets is considered to be transferred to the lessee, as of, and for the years ended 31 December 2006 and 2005.

Million Yen				
2006				
	Acquisition Costs	Accumulated Depreciation	Accumulated Impairment Losses	Balance
Buildings, structures and tanks.....	¥ 312	¥ 216	¥ —	¥ 95
Machineries and equipments.....	17,545	5,937	91	11,517
Tools, implements and fixtures.....	1,141	364	—	776
Intangible fixed assets.....	18	14	—	3
	¥19,018	¥6,533	¥91	¥12,393

Million Yen			
2005			
	Acquisition Costs	Accumulated Depreciation	Balance
Buildings, structures and tanks.....	¥ 312	¥ 180	¥ 132
Machineries and equipments.....	1,189	614	575
Tools, implements and fixtures.....	3,316	1,870	1,445
Intangible fixed assets.....	12	6	5
	¥4,830	¥2,672	¥2,157

Lease rental payments and depreciation for the years ended 31 December 2006 and 2005 amounted to 2,037 million yen and 852 million yen respectively. Depreciation is calculated by the straight-line method over the lease term of the leased assets assuming no residual value.

Scheduled maturities of future lease rental payments of finance leases as of 31 December 2006 and 2005

Million Yen		
	2006	2005
Due within one year	¥ 3,384	¥2,261
Due over one year	14,156	4,510
	¥17,540	¥6,771

b) Operating Leases

Million Yen		
	2006	2005
Due within one year	¥ 90	¥101
Due over one year	125	182
	¥215	¥284

(2) Lessor

Finance leases

Scheduled maturities of future lease rental payments of finance leases as of 31 December 2006 and 2005

Million Yen		
	2006	2005
Due within one year	¥1,422	¥1,421
Due over one year	3,724	3,191
	¥5,146	¥4,613

Note: They are sublease transactions.

7. Income Taxes

(1) Temporary differences that compose deferred tax assets and liabilities

	Million Yen	
	2006	2005
Deferred tax assets:		
Provisions for retirement benefits	¥31,887	¥31,508
Impairment losses of fixed assets.....	14,287	14,496
Valuation losses on investment securities.....	900	1,014
Provisions for doubtful debts.....	219	310
Others.....	16,139	16,475
Sub-total	63,435	63,805
Valuation reserve.....	(14,742)	(15,090)
Total deferred tax assets	¥48,693	¥48,715
Deferred tax liabilities:		
Reserve for advanced depreciation fixed assets transactions	¥ (9,688)	¥ (9,038)
Unrealised gains on investment securities	(3,377)	(3,740)
Others.....	(10,134)	(5,873)
Total deferred tax liabilities.....	(23,200)	(18,652)
Net deferred tax assets / (liabilities).....	¥25,492	¥30,063

(2) Reconciliation between the statutory tax rate and the effective tax rate

Information on 2006 and 2005 accounts is omitted because there was no significant difference between the normal effective statutory tax and the effective income tax rates.

8. Provisions for Retirement Benefits

The Companies operate various kinds of retirement benefit plans, such as contributory pension plan, qualified pension plan and severance payment plan.

(1) Provisions for retirement benefits

	Million Yen	
	2006	2005
Retirement benefit obligations	¥(105,977)	¥(106,240)
Pension assets	17,326	15,212
Unfunded retirements benefit obligations.....	(88,650)	(91,027)
Unrecognised actuarial differences	9,695	10,889
Unrecognised past service cost (reduction in obligations)	(567)	(624)
Unrecognised transition differences due to accounting changes	967	1,085
	¥ (78,554)	¥ (79,677)

Notes: 1. A past service obligation (decrease in obligations) arose because a consolidated subsidiary using the general accounting method changed its plan by reducing the benefit level in its lump-sum retirement scheme.

2. SSSKK's retirement benefit scheme includes three consolidated subsidiaries.

3. The simple method is used for calculating retirement benefit obligations, except at SSSKK and two of the consolidated subsidiaries.

4. In-house pension schemes are mainly those in which employees retiring at retirement age or voluntarily at above the age of 55 contribute 50% of their retirement benefits to their company, which then pays it out over 180 months or until the death of the pensioners.

5. SSSKK has introduced a new retirement benefit system in which employees choose from a scheme for advance cash payment or retirement allowance and pension (full payment of retirement allowance and pension equivalent amount included in salary), and a lump-sum retirement benefit scheme; the benefit obligations of employees choosing the lump-sum scheme are also included.

(2) The net periodic pension expense related to the retirement benefits

	Million Yen	
	2006	2005
Service cost	¥2,315	¥2,132
Interest cost	2,535	2,496
Expected return on pension assets	(924)	(56)
Amortisation of unrecognised actuarial differences.....	1,171	1,268
Amortisation of unrecognised post service costs	(57)	(57)
Amortisation of unrecognised transition differences due to accounting changes	117	29
	¥5,158	¥5,812

Note: The retirement benefit costs of consolidated subsidiaries that use a simple method are included in "Service cost."

(3) Assumptions used in calculation of the above information

	As of 31 December 2006	As of 31 December 2005
Allocation method for retirement benefits expense	Periodical straight line	Periodical straight line
Discount rate	2.5%	2.5%
Expected rate of return.....	6.5%	0.5%
Period for amortisation of past service cost	14 years	14 years
Period for amortisation of actuarial differences	13-14 years	13-15 years
Period for amortisation of transition differences due to accounting changes.....	15 years	15 years

9. Derivatives

(1) Conditions of transactions

In the normal course of business, the Companies use derivatives to manage their exposures to market risks in compliance with their internal policies. The Companies do not use derivatives for speculative purposes. These instruments include foreign exchange contracts, foreign currency options, interest rate swaps, futures, forward contracts and options of crude oil, oil products and tanker freight.

All such derivatives involve risks, including the credit risk of non-performance by counter-parties. However, in order to minimise the credit risk of non-performance by counter-parties, the Companies deals these derivatives with major financial institutions and trading companies with a high credit rating.

(2) Current Value of Derivatives

	Million Yen		
	31 December 2006		
	Notional Amount	Fair Value	Unrealised Gain (Loss)
Foreign currency contracts (US\$)			
To buy	¥53,532	¥54,243	¥ 710
To sell	1,780	1,785	(5)
			¥ 705
Foreign currency contracts (US\$)			
To buy	19,006	29,945	10,941
To sell	17,010	16,569	441
			¥11,382

	Million Yen		
	31 December 2005		
	Notional Amount	Fair Value	Unrealised Gain (Loss)
Foreign currency contracts (US\$)			
To buy	¥35,944	¥35,899	¥ (45)
To sell	5,535	5,549	(14)
			¥ (59)
Commodity-related transactions			
To buy	63,853	74,351	10,500
To sell	69,201	80,058	(10,856)
			¥ (356)

Interest rate swaps, which meet specific matching criteria are not measured at fair value although the net amount to be paid or received under the swap contracts is recognised and included in interest expenses or income. The above information is presented excluding these interest rate swaps.

10. Sales, Administrative and General Expenses

Major elements of sales, administrative and general expenses for the years ended 31 December 2006 and 2005

	Million Yen	
	2006	2005
Transportation	¥ 44,649	¥ 41,468
Salaries.....	29,746	29,478
Rents	4,843	4,843
Depreciation	5,173	5,498
Research and development expenses	1,866	2,030
Others	32,569	30,765
	¥118,847	¥114,084

11. Impairment Loss of Fixed Assets

As a minimum unit for generating cash flows, service stations were assessed individually, and other fixed assets were grouped by segments of management accounting. Assets used for rent and non-performing assets were assessed individually in principle.

Recoverable value was assessed comparing net selling price and value in use. Net selling price was mainly adopted for non-performing assets and value in use for other assets. Net selling prices, if material, were assessed according to the property appraisal standards. To calculate value in use, the future cash flows were discounted at 6.5%.

An impairment loss was recorded at the amount by which the carrying amount of each group of assets exceeded its recoverable value. For the year ended 31 December 2006, the Companies recognised impairment losses of 2,462 million yen on 57 groups of impaired fixed assets, which were accounted for as a special loss. They were primarily related to the significant decrease in the market value of the Companies' land as well as to the overall deterioration of their business environment. They consisted of the following:

	Million Yen		
	2006		
	Land	Others	Total
Service stations (21 groups)	¥819	¥457	¥1,277
Idle assets (36 groups)	363	822	1,185
			¥2,462

	Million Yen		
	2005		
	Land	Others	Total
Service stations (26 groups)	¥638	¥132	¥ 770
Assets for property business (2 groups)	15	5	20
Idle assets (30 groups)	112	989	1,102
			¥1,894

12. Collateral Assets

As of 31 December 2006, 172,358 million yen assets were mortgaged for certain liabilities of the Companies (86,853 million yen).

13. Contingent Liabilities

The Companies had the following contingent liabilities as of 31 December 2006 and 2005:

	Million Yen	
	2006	2005
Guarantees for:		
Non-consolidated subsidiaries, affiliates and other companies	¥6,227	¥6,507
Employees (housing loan).....	1,355	1,514
Discounts of notes receivable.....	121	19
	¥7,703	¥8,040

14. Related Third Party Transactions

When transactions of the Company with its related third parties are more than 10% of the consolidated sales proceeds, or 10% of the total amount of the consolidated cost of sales, or 10% of the consolidated sales, administrative and general expenses, excluding transactions with consolidated subsidiaries, for the years ended 31 December 2006 and 2005 are disclosed by each item.

The Company discloses material balances and transactions with related third parties where such balances and transactions represent more than 1 per cent of the consolidated total assets, excluding transactions with consolidated subsidiaries.

(1) Related third parties – Corporation

For the year ended 31 December 2006

Name	Capital (Million Yen)	Voting right share owing (share owned)	Million Yen	
			Transactions	Closing balances
Saudi Arabian Oil Co., Ltd	—	(Indirect 15.0%)	Purchase of crude oil and oil products	¥761,084 Accounts payable (trade) ¥61,195
Seibu Oil Co., Ltd.	8,000	Direct 38.0%	Purchase of oil products	326,090 Accounts payable (trade) 38,565
Marubeni Energy Corporation	2,350	Direct 33.4%	Sale of oil products	154,402 Accounts receivable (trade) 17,846
Shell Chemicals Japan	250	NA	Purchase of petrochemicals	96,926 Accounts receivable (trade) 12,259
Shell Eastern Trading (P.T.E.) Limited	714	NA	Sales and purchase of crude and oil products	294,586 Accounts payable (trade) 23,251

For the year ended 31 December 2005

Name	Capital (Million Yen)	Voting right share owing (share owned)	Million Yen	
			Transactions	Closing balances
Saudi Arabian Oil Co., Ltd	—	(Indirect 15.0%)	Purchase of crude oil and oil products	¥586,763 Accounts payable (trade) ¥47,872
Seibu Oil Co., Ltd.	8,000	Direct 38.0%	Purchase of oil products	222,602 Accounts payable (trade) 38,244
Toa Oil Co., Ltd.	4,961	Direct 37.5%	Refining on commission	14,561 Other current liabilities 2,082
			Payment of gasoline tax	90,800 Accounts payable (other) 24,477
Marubeni Energy Corporation	2,350	Direct 33.4%	Sale of oil products	131,340 Accounts receivable (trade) 19,174

(2) Related third parties – Individuals

Material transactions and balances of the Company with related individuals, including shareholders and directors, representing more than 1 million yen for the years ended 31 December 2006 and 2005 are as follows.

For the year ended 31 December 2006

Name	Post	Voting right share owing (share owned)	Million Yen	
			Transactions	Closing balances
Haruyuki Niimi	Chairman of SSSKK, Head Director of Showa Shell Sekiyu, Foundation for Promotion of Environmental Research	—	Donation	¥38 — —

For the year ended 31 December 2005

Name	Post	Voting right share owing (share owned)	Million Yen	
			Transactions	Closing balances
Haruyuki Niimi	Chairman of SSSKK, Head Director of Showa Shell Sekiyu, Foundation for Promotion of Environmental Research	—	Donation	¥38 — —

15. Segment Information

(1) Business Segment Information

For the year ended 31 December 2006

	Million Yen					
	Oil business	Property business	Other businesses	Sub-total	Internal trade	Total
I. Total sales and operating income						
Total sales						
(1) Sales to customers	¥2,883,480	¥ 4,283	¥33,523	¥2,921,287	¥ —	¥2,921,287
(2) Inter-segment sales and transfers	5,799	126	15,293	21,220	(21,220)	—
Total sales	2,889,279	4,410	48,817	2,942,507	(21,220)	2,921,287
Operating expenses	2,819,298	1,648	47,184	2,868,131	(21,146)	2,846,985
Operating income	¥ 69,980	¥ 2,761	¥ 1,633	¥ 74,375	¥ (73)	¥ 74,301
II. Assets, depreciation, impairment and capital expenditures						
Assets	¥1,165,149	¥31,361	¥28,818	¥1,225,329	¥(30,314)	¥1,195,015
Depreciation	24,021	907	2,400	27,329	—	27,329
Impairment losses	2,462	—	—	2,462	—	2,462
Capital expenditures	30,057	125	3,812	33,995	—	33,995

For the year ended 31 December 2005

	Million Yen					
	Oil business	Property business	Other businesses	Sub-total	Internal trade	Total
I. Total sales and operating income						
Total sales						
(1) Sales to customers	¥2,250,088	¥ 4,281	¥14,119	¥2,268,488	¥ —	¥2,268,488
(2) Inter-segment sales and transfers	728	128	8,540	9,398	(9,398)	—
Total sales	2,250,817	4,410	22,659	2,277,887	(9,398)	2,268,488
Operating expenses	2,156,018	1,719	21,774	2,179,511	(9,404)	2,170,107
Operating income	¥ 94,798	¥ 2,691	¥ 885	¥ 98,375	¥ 5	¥ 98,381
II. Assets, depreciation, impairment and capital expenditures						
Assets	¥1,091,570	¥32,729	¥38,573	¥1,162,873	¥(17,682)	¥1,145,191
Depreciation	22,197	926	854	23,979	—	23,979
Impairment losses	1,873	20	—	1,894	—	1,894
Capital expenditures	17,697	42	3,552	21,292	—	21,292

Notes: 1. Businesses are classified based on the companies' internal definition.

2. Main products and businesses by each segment

(1) Oil business: Gasoline, naphtha, kerosene, diesel oil, fuel oil, lubricating oil, LPG, asphalt, petrochemical products

(2) Property business: Leasing and administration of properties

(3) Other businesses: Engineering, sale and lease of automobile accessories, city gas business, electric power supply business and distributed power supply, etc.

3. "Internal trade" did not include any operating expenses that could not be allocated.

4. Corporate assets are fully allocated to each segment and not included in assets in "Internal trade."

5. Long-term prepaid expenses and their depreciation are included in depreciation and impairment losses and capital expenditures.

(2) Geographic Segment Information

For the years ended 31 December 2006 and 2005, geographic segment information has been omitted as the Companies have no consolidated subsidiaries or branches domiciled in countries or regions other than Japan.

(3) Overseas Sales

For the year ended 31 December 2006

	Million Yen		
	Asia	Others	Total
Overseas sales	¥212,113	¥127,463	¥ 339,576
Consolidated sales proceeds			2,921,287
Overseas sales as a percentage of total consolidated sales proceeds	7.3%	4.4%	11.6%

For the year ended 31 December 2005

	Million Yen		
	Asia	Others	Total
Overseas sales	¥125,583	¥92,901	¥ 218,484
Consolidated sales proceeds			2,268,488
Overseas sales as a percentage of total consolidated sales proceeds	5.5%	4.1%	9.6%

Notes: 1. Countries and regions are classified on the basis of geographic proximity.

2. Main countries included in each geographic segment are as follows;

(1) AsiaSingapore, Republic of Korea, Hong Kong

(2) Others...U.A.E., U.S.A., United Kingdom, Belize

3. Overseas sales are sales of the Company and its consolidated subsidiaries outside Japan.

Report of Independent Auditors

To the Board of Directors
SHOWA SHELL SEKIYU K.K.

We have audited the accompanying consolidated balance sheet of SHOWA SHELL SEKIYU K.K. ("the Company") and its subsidiaries as of 31 December 2006, and the related consolidated statement of income, changes in net assets and cash flows for the year then ended, all expressed in Japanese yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of 31 December 2006, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in Japan.

PricewaterhouseCoopers Aarata

Tokyo, Japan
29 March 2007

■ Code of Conduct

1. Objectives

The objectives of the Company are to engage responsibly and efficiently in profitable businesses in the fields of refining and sales of oil and related fields.

The Company seeks a high standard of performance and aims to maintain a long-term position in competitive environments.

2. Responsibilities

The Company recognizes the following responsibilities:

1) Responsibility to shareholders

To protect shareholders' investment, and provide an acceptable return.

2) Responsibility to customers

To win and retain customers by developing and providing products and services that offer value in terms of price, quality, safety and environmental impact, and which are supported by technological, environmental and commercial expertise.

3) Responsibility to employees

To respect the worth and individuality of employees, and provide them with a safe work environment and good working conditions; to promote the development and best use of human resources; and to encourage the involvement of employees in the implementation of business and in the application of these principles within the Company.

4) Responsibility to business partners

To seek mutually beneficial relationships with business partners, including joint venture partners, and to promote the application of these principles in these relationships; to consider the ability and performance of these companies to conform with these principles in the decision to enter into or remain in such relationships.

5) Responsibility to society

To conduct business as a responsible corporate member of society, to observe laws, to express support for fundamental human rights, and to give proper regard to health, safety and environment consistent with the commitment to contribute to sustainable development.

3. Economic Principles

Profitability is essential to discharging these responsibilities and remaining a going concern. It is a measure both of efficiency and of customer satisfaction with the Company's products and services. It is also essential to the future allocation of corporate resources and to the continuing investment required to ensure a stable supply of energy to meet consumer needs. Without profits and a strong financial foundation, it is not possible to fulfil the responsibilities outlined above.

Criteria for investment decisions are not exclusively economic in nature but also take into account social and environmental effects.

4. Business Integrity

The Company has established a corporate code of conduct and insists on honesty and fairness in all aspects of its business, and expects the same in its relationships with all entities with which it does business.

The direct or indirect offering, payment, solicitation or acceptance of bribes in any form are unacceptable practices. Employees must avoid conflicts of interest between their private financial activities and their conduct on behalf of the Company.

All business transactions on behalf of the Company must be reflected accurately and fairly in the accounts of the Company in accordance with established procedures and be subject to audit.

5. Political Activities

The Company acts in a socially responsible manner within the law in pursuit of its legitimate commercial objectives.

The Company does not make payments to political parties, organizations or their representatives or take any part in party politics. However, the Company has the right and the responsibility to make its position known on any matter that affects the interests of itself, its employees, its customers and its shareholders.

6. Health, Safety and Environment

Consistent with its commitment to contribute to sustainable development, the Company adopts a continuous and systematic approach to health, safety and environmental management.

To this end, the Company manages these matters as it does all other critical business activities, sets targets for improvement, and measures, appraises and reports on performance.

7. Local Community

The Company is actively involved in contributing to society as a responsible member thereof. The most important contribution that the Company can make to the local community is in performing its core business as efficiently as possible.

8. Competition

The Company seeks to compete freely and fairly within the framework of applicable competition laws.

9. Communications

The Company recognizes that open communication is essential in view of the importance of the activities in which it is engaged and their impact on national economies and individuals. The Company therefore provides relevant information about its activities in a timely and appropriate manner.

10. Companies of the Showa Shell Sekiyu Group

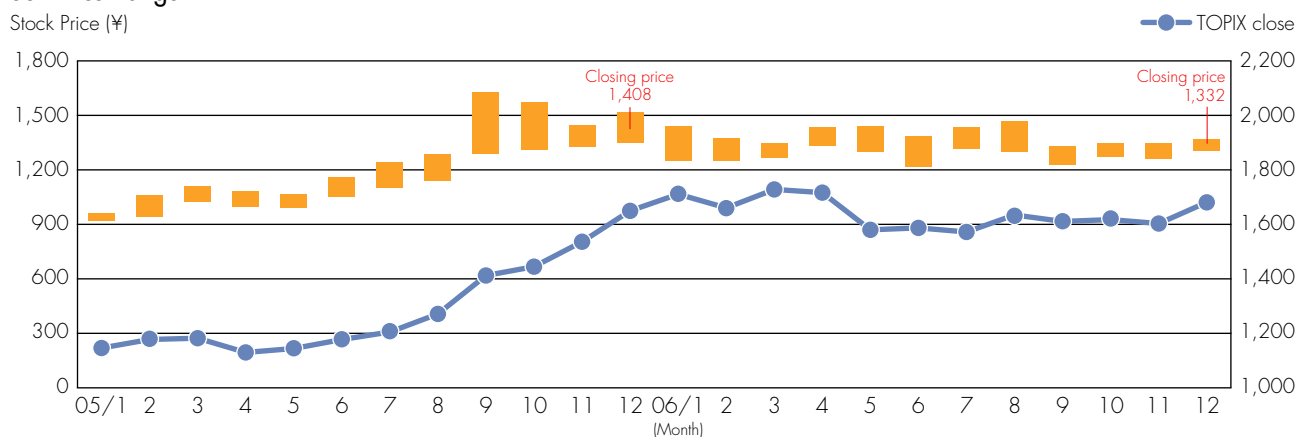
The Company encourages these companies to adopt and abide by its Code of Conduct.

Investor Information

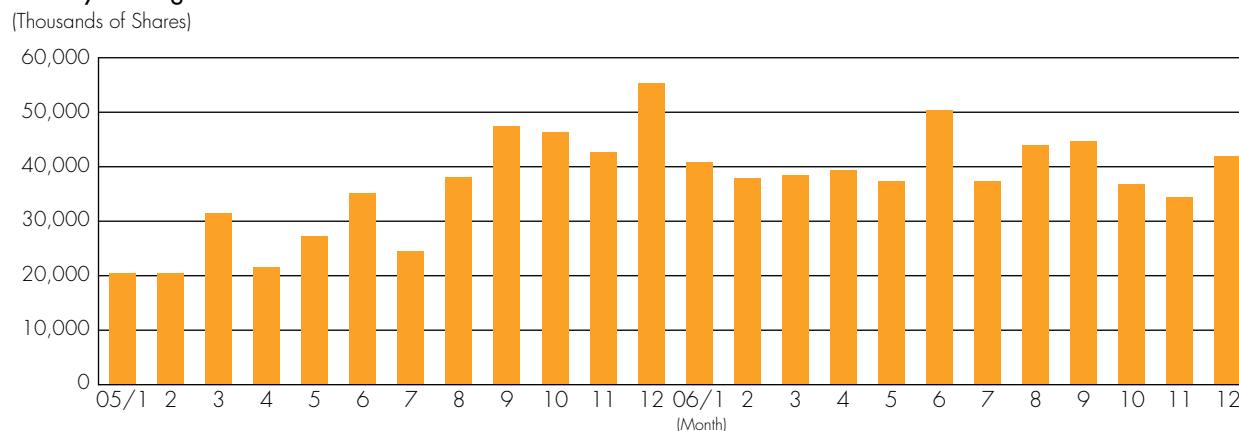
Date of Establishment:	January 1, 1985
Authorized Number of Shares:	440,000,000 shares
Number of Shares Issued:	376,850,400 shares
Paid-in Capital:	¥34,197,585,900
Number of Employees:	1,036
Total Number of Service Stations:	4,575
Number of Shareholders:	52,421
Securities Listings:	Tokyo
Ticker Code:	5002
Transfer Agent:	Mizuho Trust & Banking Co., Ltd. 1-2-1, Yaesu, Chuo-ku, Tokyo 103-0028, Japan
Independent Auditors:	PricewaterhouseCoopers Aarata
General Shareholders' Meeting:	March

Major Shareholders	Shares owned (Thousand shares)	Percentage of total common shares outstanding
The Shell Petroleum Co., Ltd.	125,261.2	33.24%
Aramco Japan Holdings Company B.V.	56,380.0	14.96
The Master Trust Bank of Japan, Ltd. (Trust Account)	20,499.4	5.44
Japan Trustee Services Bank, Ltd.	18,184.7	4.83
Trust & Custody Services Bank, Ltd.	8,993.2	2.39
The Anglo-Saxon Petroleum Co., Ltd.	6,784.0	1.80
Kochi Shinkin Bank	3,562.4	0.95
Kawasaki Kisen Kaisha, Ltd.	3,503.7	0.93
BNP Paribas Securities (Japan) Ltd.	3,251.3	0.86
Investors Bank	2,769.6	0.73
Total	249,189.5	66.12

Stock Price Range



Monthly Trading Volume



Showa Shell Sekiyu K.K.

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