

Showa Shell Sekiyu K.K.

ANNUAL REPORT 2007



SUSTAINABLE GROWTH THROUGH ENERGY CHALLENGE



CONSOLIDATED FINANCIAL HIGHLIGHTS

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

	Yen Million	Percent change	Yen Million
	2007		2006
For the year:			
Net sales	3,082,641	+5.5	2,921,287
Operating income	88,813	+19.5	74,301
Ordinary income	92,709	+19.4	77,675
CCS ordinary income* ¹	44,271	-23.8	58,074
Net income	43,729	-5.4	46,249
At year end:			
Total shareholders' equity* ²	338,933	+9.5	309,411
Total assets	1,339,114	+12.1	1,195,015
Interest-bearing debt (excluding cash and deposits)	166,655	-4.2	173,881
Per share data:			
		Difference (Yen)	
Net income after taxes per share (Yen)	116.12	-6.83	122.95
Cash dividends (Yen)	36.00	0.00	36.00
Shareholders' equity per share (Yen)	899.90	+77.70	822.20
Ratios:			
		Percent change	
Return on equity (ROE) (%) * ³	13.5	-2.3	15.8
Return on average capital employed (ROACE) (%) * ⁴	8.8	-1.0	9.8
Gearing ratio (%) * ⁵	33.0	-3.0	36.0

* 1 CCS ordinary income (ordinary income on Current Cost of Supply basis); ordinary income based on costs excluding inventory valuation effects.

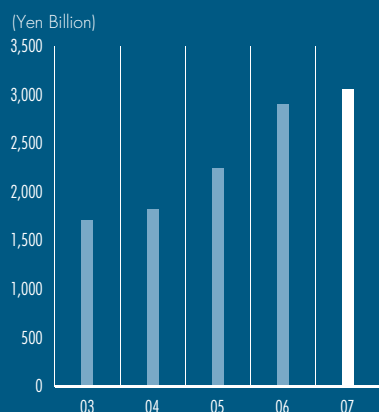
* 2 Total shareholders' equity=Net assets-Minority interests

* 3 ROE=Net income/Average total shareholders' equity

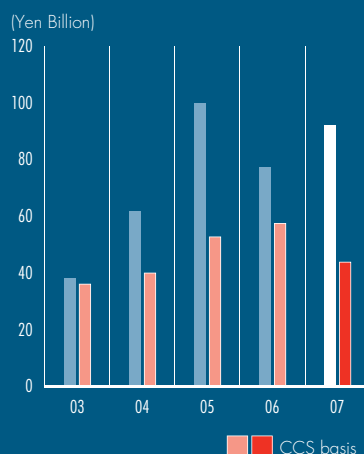
* 4 ROACE=Net income before interest paid (after interest received) after tax/Average capital employed

* 5 Gearing ratio=(Total debts-cash and deposits)/(Capital employed-cash and deposits)

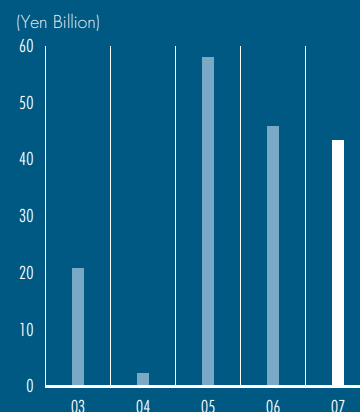
Consolidated Sales Proceeds



Consolidated Ordinary Income



Consolidated Net Income after Taxes



■ CCS basis

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Shigeya Kato
*Vice Chairman
and Representative Director*

Haruyuki Niimi
*Chairman
and Representative Director*

Yasuo Murayama
*President
and Representative Director*

MANAGEMENT PHILOSOPHY

Showa Shell Sekiyu K.K. can only achieve a further leap and perpetual growth by constantly making its contribution to society, while securing reasonable profits and constructing a strong management base and sound corporate constitution. With this in mind, we set our corporate creed as follows:

1. We will always endeavor for a break-through or technological innovation with a spirit of customer first and for continual growth of the company, discharging our social responsibilities including environmental preservation, a stable supply of energy and operation safety.
2. We will implement Japanese-style management adaptable to changes at our own discretion and on our own responsibility, while maintaining close relationships with Shell group companies and cultivating our international business sense.
3. We will aim to achieve our corporate goals and form a group of positive people full of vitality associated with each other through a noble ideal and trust.
4. We will endeavor to improve productivity through an effort calling for everybody's participation for thinking and sweating together and construct an affluent future on the base of the company's unshakable footing.

MANAGEMENT VISION FOR SUSTAINABLE GROWTH



Haruyuki Niimi
Chairman and Representative Director

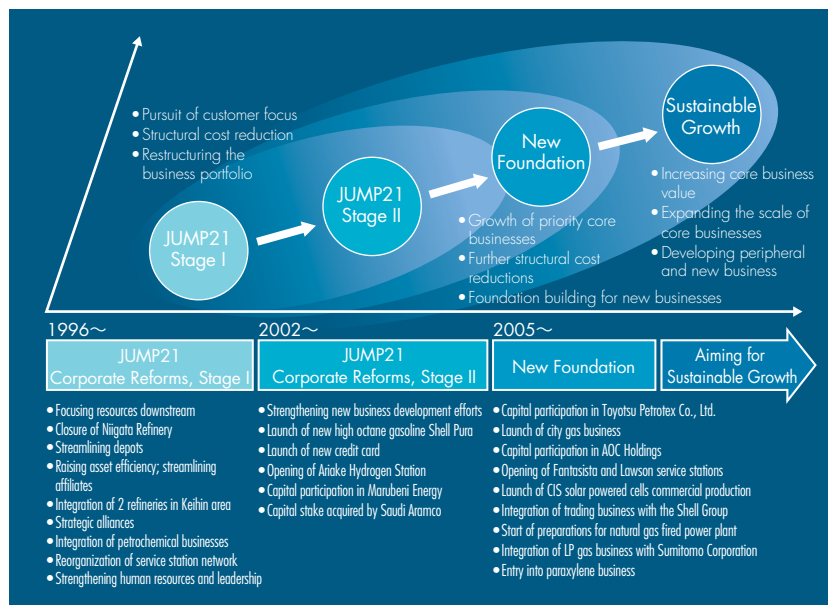
What is your vision for growth in Showa Shell Sekiyu?

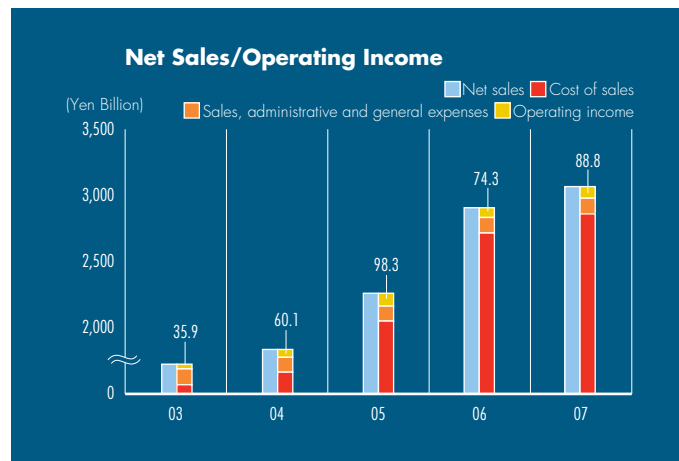
Q

A

Our mission is to provide our customers with oil and other energy products and high quality services in a safe, stable and sustainable manner. To fulfill this mission and become a leading company in every aspect of environmental, social, and economical dimensions, we began promoting drastic corporate reforms focused on structural cost reductions and a rearrangement of our business portfolio in 1996. Since 2005, the year we marked the 20th anniversary of our merger, we have been following a growth-oriented philosophy based on three pillars to achieve further corporate reforms and to create and provide new value to our customers. The three pillars are “to increase the value of our core business,” “to expand the scale of our core business,” and “to develop peripheral and new businesses.” At present these efforts continue.

This growth will be underpinned by establishing a sound customer base, maintaining a competitive edge in our financial position, promoting aggressive investment, and developing and training human resources. Above all else we consider leadership training and the developing of the ability of our human resources to be our important tasks in achieving high earnings. We are making great efforts in these areas. In the future the products and services that we provide to customers may change as advances in technology occur, but we believe that steadily implementing a strategy based on our basic philosophy listed above and maintaining competitiveness will enable us to sufficiently withstand major changes in the business environment.





What are the details of your growth strategy?

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In terms of “increasing core business value” and “expanding the scale of our core business,” we have plans to further increase our selling power in high value-added products and services. To begin with, in our oil business, which is centered on gasoline, we plan to do this through efforts in procurement based on our partnership with the Shell Group (Royal Dutch Shell plc) and Saudi Aramco (Saudi Arabian Oil Company). In refining, we plan to strengthen our ability to produce high value-added products based on stable capacity utilization, and in sales we plan to expand our service station network so that we can respond aptly and fully to the different needs of our customers in every region. Through these efforts we plan to boost our cost competitiveness and increase our market share of gasoline sales. To achieve these objectives, we will undertake capital investment aimed at the stable operation of our oil refineries and for retail expansion. We will expand exports when overseas profitability is better than profitability in domestic sales using the Shell Group global network.

In our LP gas business also, we are working with Sumitomo Corporation in a business integration that will strengthen our position by expanding the scale of the business and promoting cost improvement measures in logistics. In the special products business, we will offer high value-added products and services to meet the needs of our customers.

In 2008, in the “development of peripheral and new businesses,” we will focus particular attention on our solar powered cells business. CIS (copper, indium, selenium) solar powered cells developed by Showa Shell under commission from the New Energy and Industrial Technology Development Organization (NEDO), have been highly acclaimed for their superior manufacturing technology and their excellent design and environmental characteristics. In the year ahead, we plan to continue expediting the development of this business. In 2007 we commenced commercial production of the cells at our first plant, and we have already started constructing a second plant. We aim to further expand our production capacity of these cells to make this business into our second core business.

What is your view on sustainability to support your strategies for growth?

Q

A

As an energy company our mission is to provide customers with a safe and steady supply of energy over the long term. We also recognize that our mission is to work to create a sustainable society. Our strategy and vision take energy sustainability into consideration, and we are working for environmental sustainability in our efforts. To fulfill this mission, we promote thorough compliance through a strict framework for compliance with laws and regulations. We have also introduced the HSSE (health, safety, security, and environment) Management System used throughout the Shell Group to secure a sound framework for promoting corporate social responsibility.

In 2007, global warming increasingly became a serious worldwide issue. We responded to the issue by endeavoring to reduce CO₂ in our supply chain. We also have been promoting the development of products that have little burden on the environment, such as GTL (gas to liquids) fuel and solar powered cells. We also initiated activities with a focus on sustainability including the establishment of an energy vision that incorporates considerations such as sustainability and societal factors. As part of this we launched the Energy Sustainability Forum together with the Integrated Research System for Sustainability Science (IR3S), which is directed by The University of Tokyo. In 2008 we will continue to expand our area of activities aimed at sustainability.

CORE BUSINESS STRATEGY



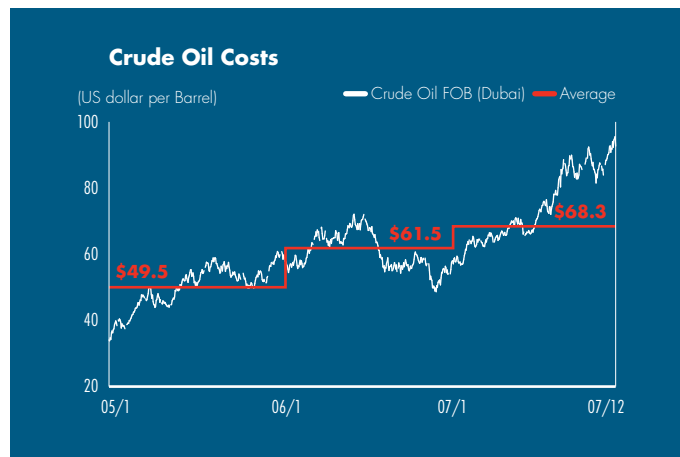
Yasuo Murayama
President and Representative Director

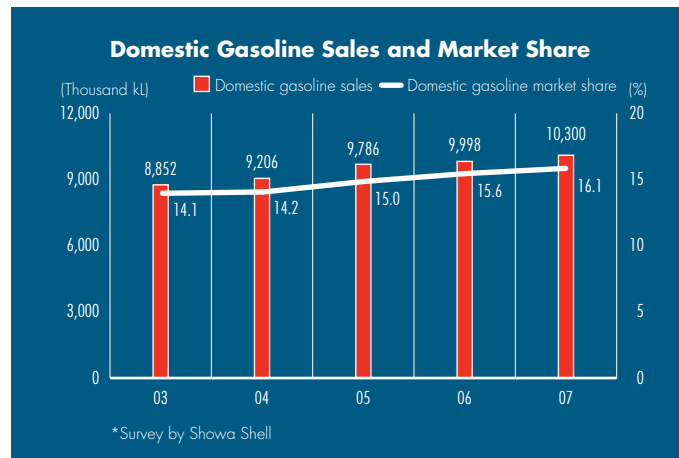
How do you view the market environment?

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Crude oil prices in 2007 continued to rise at a roughly consistent pace after Dubai crude started the year at around 57 dollars per barrel, rising sharply to around the 89 dollars per barrel mark at the end of the year. This was an unprecedented situation, and although we continued to try to reflect rises in costs on retail prices, the transfer of these costs to prices was outpaced by surges in crude oil prices each month. This resulted in significant losses during 2007. Consequently, although ordinary profit, which included gains due to inventory valuation effects, rose, ordinary profit on a current cost of supply basis (i.e. excluding inventory valuation effects) fell below the previous year's results. We continue to make efforts to revise retail pricing to appropriately reflect crude oil prices but it is difficult when crude oil price fluctuations are volatile. Stability in crude oil prices would certainly be best for us. For domestic demand for oil in 2008, we have formulated our business plan on the assumption that the trend of a slight decrease in demand will persist. On the other hand, world demand for oil products, particularly in emerging economies, is sound and we recognize that it is becoming easier to achieve economic efficiency in exports for the time being.





What kind of measures will you take in this severe market environment?

Q

A

We will promote measures in both the refining and sales areas. In refining, we have been more proactive than competitors in increasing our cost competitiveness, and now we have the top class cost competitiveness in the industry. To maintain and increase our competitiveness in refining, we believe that the key issue is to minimize the incidence of trouble at oil refineries. In 2007 we began a five year investment program for the stable operation of our facilities and the raising of their reliability. "Safety and Quality First 2008" is the theme of this program for 2008 (the theme in 2007 was "Quality First 2007") and through these efforts we are working to ensure safety and improve quality throughout our supply chain.

In our sales strategy, we are also taking an approach that is different from that of other companies. One area that we should always focus on in our sales strategy is our dealers who contribute to establishing our customer base. As the core of our sales strategy for growth, we see our affiliated dealers as our most important partners. In 2007 we held "Dealers' Meeting 2007" where we confirmed the idea of "Dealerism," or the close relationship that has existed between Showa Shell and dealers. This concept recognizes the importance of our dealers nationwide. As a measure for increasing sales through our dealers, we are continuing our efforts to expand the development of new types of service stations. In addition to the Shell brand service stations, we are promoting a service station model that is connected to a shopping center and a convenience store model. As of the end of 2007, there were more than ten of these new models. In the future we plan to expand these in line with the diversification of customer needs. Moreover, in line with intentions to boost our peripheral businesses, we must be flexible in the kinds of businesses we engage in with our dealers as our business environment changes. Even if demand per end user for oil products declines in the future, we must think of ways in which we can expand our product menu that enables us to retain and increase our customer base. Along the same lines, we have commenced to strengthen our home solutions business as well.

Although we sometimes hear pessimistic views that claim that the decrease in demand for oil will cause a decline in the business of oil companies, we do not subscribe to this view. Not all types of oil have shown a significant decrease in demand, and we believe that there are still ample business opportunities in Japan, particularly in the gasoline business. Also, at present no other form of energy for transportation has the advanced infrastructure network that oil has and can be steadily supplied in an economically efficient manner. Yet, as we prepare for responding to energy diversification over the mid to long term, we believe that we need to strengthen our current core business.

NEW BUSINESS STRATEGY



Shigeya Kato
Vice Chairman and Representative Director

What is Showa Shell's strategy and the strengths of its new businesses?

Q

A

There are a number of reasons why we are thoroughly strengthening our development of new businesses while working to expand our existing core businesses. Firstly, as a social responsibility demanded of an energy company, we need to drive forward energy development that is efficient and has a low environmental burden. As environmental issues increasingly become the topic of serious worldwide debate, we are determined to steadily implement environmental measures that are feasible for Showa Shell.

Secondly, in order to boost our corporate value and ensure further growth in the future, we have to nurture second and third core businesses while expanding earnings through the fulfillment of our responsibility to supply oil products.

If crude oil prices continue to be at the high levels as we have seen recently, the demand for new energies that can substitute for oil will expand and the development of those energies should accelerate. Our policy is to look for business opportunities in these areas and to seize those openings as growth opportunities.

Showa Shell is already involved in a range of energy businesses, including solar powered cells, distributed power generation, the independent power producer (IPP), fuel cells, gas to liquids (GTL) fuel and the sale of city gas and LNG. We believe these experiences add to our competitiveness as they can be used to tap diverse energy sources in the future, which will enable us to meet the needs of even more customers.

What is more, the dealers that support our main fuel sales and LP gas businesses give us strategic access to the market, since these dealers already have many latent customers. This is a great advantage that competitors do not possess, particularly in building of new businesses.



Miyazaki Plant. Commercial production of CIS solar powered cells began in 2007



CIS solar powered cells installation example

What is the current status of and future challenges for the CIS solar powered cells business?

Q

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The market for solar powered cells will continue growing as global environmental issues mount. In the past few years, in particular, the global solar powered cells market has been expanding rapidly at an annual rate of as much as 30 to 40%. We have had our eye on this field from early on, and have continued R&D in it for over 30 years. Based on those results, we decided in 2005 to commercialize the business. Since July 2007, we have been operating our first plant, with a production capacity of 20 megawatt per year. During 2007, we accumulated the know-how for ensuring stable production and have already entered full-scale production.

As the solar powered cells market grows, the competitive environment of this market is changing rapidly. The rise of new manufacturers in South Korea and China is especially striking, setting the stage for what looks to be growing competition in the market. As for our own competitiveness, we believe that we can secure an advantageous position with premium products featuring superior design on top of high performance.

The next stage in the development of this business is to put our marketing strategy on track while expanding the scale of production. So far we have given priority to marketing in Europe, which has a more developed market for solar powered cells. However, we are looking to gradually develop a market here in Japan. Furthermore, we are moving along with R&D to further improve conversion efficiency. This is the driver that will increase the cost competitiveness of our products dramatically.

What is the current status of Showa Shell's power generation business?

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A

Electrical power demand will continue to increase as environmental awareness becomes more prevalent in households and industry. Imagining the business environment of the future, we think that flexible electric power marketing will make new business opportunities. Accordingly, we are preparing to enter the power generation business in 2010 through Ohgishima Power Co., Ltd., a joint venture established with Tokyo Gas.

The power plant at Ohgishima Power Co.,Ltd. will employ gas turbine combined cycle power generation, which is a highly efficient power generation method using natural gas. In 2007, we obtained trading member qualifications for the Japan Electric Power Exchange (JEPX) in preparation for plant operation and finished registration as a power producer and supplier (PPS) in preparation for retailing electric power. These steps will allow us to accumulate electrical power marketing knowledge.

TO OUR SHAREHOLDERS

Business Performance in the Fiscal Year Ended December 2007

Consolidated sales for the fiscal year ended December 2007 increased 5.5% on the previous year to 3,826 yen billion. A difficult business environment prevailed as domestic oil demand continued to decline and product prices climbed due to sharp rises in crude oil prices. While our sales volume of kerosene and fuel oil fell, we took in measures to boost sales by meeting customers' needs and we increased our market share of gasoline sales as well as our sales volume by 3% year-on-year. In the area of profit, inventory valuation effects were significant, and consolidated operating income rose to 88.8 yen billion, an increase of 19.5% in comparison with the previous year. Moreover, consolidated ordinary income rose to 92.7 yen billion mainly due to an improvement of 2 yen billion in gains/losses on foreign exchange translations. Inventory valuation effects excluded, crude oil price increases that could not be passed on to retail prices had a significant effect on worsening our margin and the consolidated operating income on a current cost of supply basis (CCS basis) fell 14.3 yen billion from the previous term to 40.3 yen billion and consolidated ordinary income on a CCS basis fell 13.8 yen billion from the previous term to 44.2 yen billion. Furthermore, there was a year-on-year decrease of 104 yen billion in sales in the international trading business due to the transfer of this business, which sells oil products and other products, and is subject to consolidation in the Shell Group from August. However, the business is structured so that earnings will be stably recovered as business licensing fees, and the change will have little effect on overall Showa Shell earnings.

The Showa Shell Group posted net extraordinary losses of 14.1 yen billion for the term. Despite gains on asset sales accompanying the disposal of idle assets, losses accompanying the disposal of assets, including oil storage facilities, at affiliates and impairment losses accompanying a contraction in the power business of our consolidated subsidiary On-site Power brought extraordinary items to a net loss. As a result of the above, consolidated net income for the year under review came to 43.7 yen billion, down by 5.4% from the previous year.

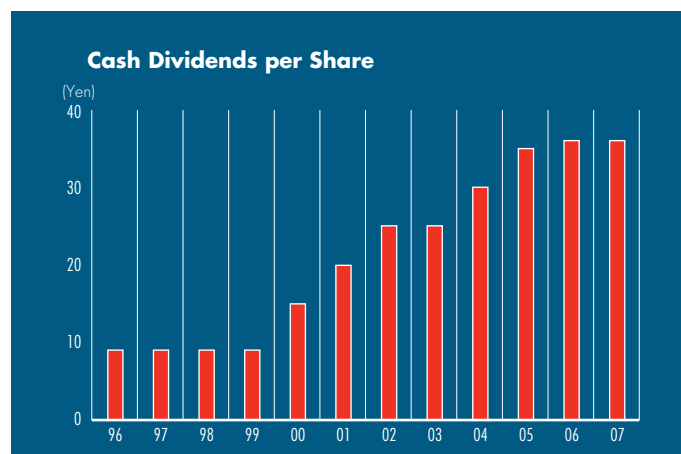
Enhancing Shareholder Value

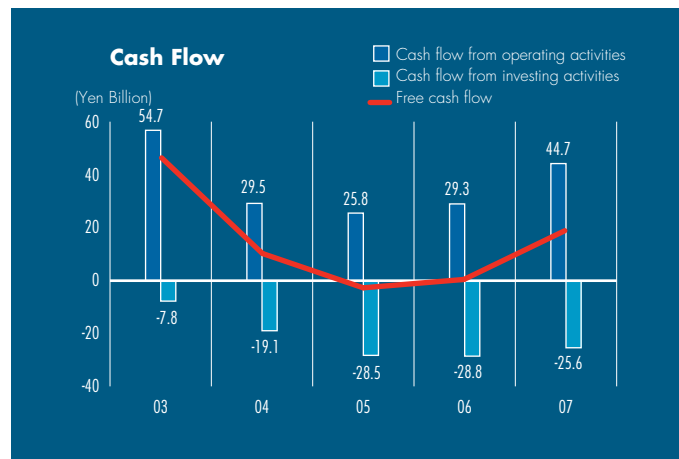
Demand for oil in the domestic market is expected to fall due to factors such as improvement in fuel efficiency, energy savings, and a switch to alternative energies. However, we at Showa Shell have our sights set on a course of growth which includes diversification in other energy areas apart from the oil business in addition to our existing oil product sales business in Japan and overseas. On this basis, we plan to optimize our corporate value through mid-term to long-term growth. To achieve this, we will direct our resources to expanding our retail sales channels and to new businesses such as CIS solar powered cells. We also plan to allocate resources to growth investments to expand our export facilities and enhance the reliability of our refineries.

Our fundamental policy for returning profits to shareholders is to pay stable and attractive dividends taking into consideration factors such as business conditions, our financial position, and trends in the financial markets. For the fiscal year under review we have decided to pay year end dividends of 18 yen per share, making total annual dividends 36 yen when including interim dividends.

Compliance and Corporate Social Responsibility

Considering the large responsibility to society companies have, we consider compliance and HSSE (health, safety, security, and environment) to be top priorities in our management. To improve transparency and efficiency in our management, we are building an internal control system with built-in check functions. Unfortunately, serious incidents





*Free cash flow=Cash flow from operating activities+Cash flow from investing activities

involving quality problems occurred at service stations in 2006. After carefully reviewing these incidents, we decided to redouble our efforts at providing our customers with the best quality possible. Under the slogan "Quality First 2007" we set 2007 as the period for systematically establishing quality systems through promotion of the Initiative for Establishing an Accident-free System and Quality Improvement Initiative. In quality improvement, we deployed a Quality First 2007 campaign focusing on the identification of latent risks at every stage of the supply chain from production to sales, and the resolution of problems. We are also continuing our efforts during 2008 under the slogan "Safety and Quality First 2008." As measures to improve safety, we will promote special efforts in the following four areas as priority tasks for 2008: (1) strengthen human error prevention measures, (2) conduct thorough training for staff in affiliated companies, partner companies, and staff, (3) promote the thorough use of appropriate safety apparatus, and (4) reinforce accident prevention measures for trucks, sales personnel cars, and work cars. In addition, as two quality improvement tasks during 2008 we will: (1) continue to resolve issues in each division and engage in quality maintenance activities based on the PDCA (plan, do, check, act) cycle and, (2) promote product safety courses.

Moreover, as a company that views corporate social responsibility very seriously, we do not stop at providing society with a stable source of energy. We hold a range of activities such as the Showa Shell Environment Photo Contest, and the Project for Reforestation of the Mt. Fuji. Together with the Integrated Research System for Sustainability Science (IR3S), an educational-industrial collaborative organization, we also launched the "Energy Sustainability Forum" to investigate and develop sustainable energy strategies. Furthermore, we continue our efforts to expand our line of eco-friendly products and services such as our CIS solar powered cells "Solacis" and "Shell Eco Toyu."

Tasks in 2008

To achieve our goals, we will continue to push forward with our efforts to strengthen our business. In procurement we will continue to promote optimal and flexible purchasing through cooperation with the Shell Group and Saudi Aramco. In production and supply, we will raise refinery utilization through stable and efficient operation and increase production volume of high value-added products. In domestic distribution, we will make efforts to strengthen competitiveness by enhancing the efficiency of our distribution network through the joint use of oil depots with other oil companies. At the same time, we will also continue to make efforts to boost sales by promoting self-service stations and accelerating the opening of new types of service stations in order to realize our growth strategy of customer expansion. In exports, we will focus on profitability and devote efforts to increase earnings opportunities that effectively utilize our international network by integrating operations with the Shell Group. In other businesses, we will direct our efforts to increasing business competitiveness aimed at growth in various areas. In the CIS solar powered cells business we will establish a sound business base at an early stage including the construction of a second plant for CIS solar powered cells. We will enter the paraxylene sector through a joint venture and in the LP gas business we will integrate our import operations with Sumitomo Corporation and establish a holding company under which the LP gas sales subsidiaries of both companies will be placed.

We at Showa Shell Sekiyu appreciate the understanding of our shareholders as we move ahead with these initiatives and we look forward to receiving your continued support in the future.

Haruyuki Niimi
Chairman and Representative Director

Shigeya Kato
Vice Chairman and Representative Director

Yasuo Murayama
President and Representative Director

At a Glance

Looking at sales by segment for 2007, sales in our oil business—which includes our main fuel sales business, LP gas business, petrochemicals business, and export/trading business—increased 5.7% over the previous year to 3.47 yen trillion thanks to factors such as increased sales of gasoline and strong export results of diesel oil. Our real estate business, which includes leasing office building space, posted sales of 4.2 yen billion (a 0.3% decrease from the previous year). Our CIS solar powered cells business, power generation business at our large-scale natural gas fired power plant, and other businesses listed under the “other businesses” category, most of which are in the preliminary stages of scaling up to full operations,

Main Business

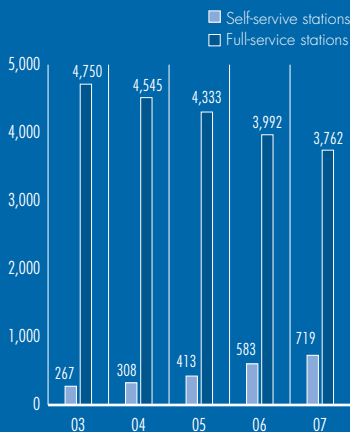
- Sales of gasoline, diesel oil, and automotive lubricants.
- Sales of kerosene for home-use.
- Sales of fuel for industrial use.

Topics

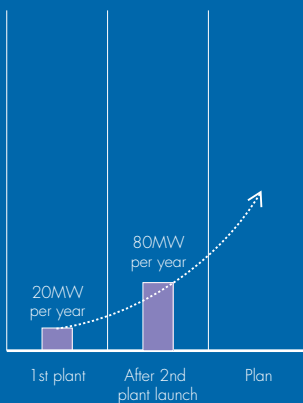
We are developing service stations that meet the needs of customers in different regions and promoting the enhancement of the competitiveness of existing service stations. Additionally, we are pursuing new business development with service stations connected to shopping centers and convenience store models. Thus, in 2007 we were again able to increase our market share of gasoline sales in Japan.

MAIN FUEL SALES

Number of Service Stations



CIS Solar Powered Cells Business Production Scale



CIS SOLAR POWERED CELLS

Main Business

- Production and sales of next generation CIS solar powered cells

Topics

Construction of the Miyazaki Plant (1st plant, annual production of 20 Megawatt worth of modules) of Showa Shell Solar K.K. was completed. Commercial production began in July 2007. We have begun construction of a second plant to meet the worldwide strong demand for solar powered cells. We are moving the project along with the aim of putting the plant into operation in the first half of 2009.

Main Business

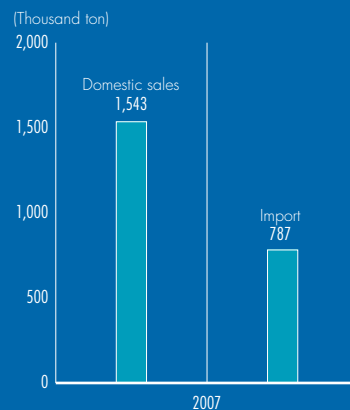
- Production and sales of Clean Propane used in homes and commercial stores.
- Production and sales of Clean Auto for automobiles.
- Production and sales of Clean Butane for industrial and consumer gas applications and as a raw material for chemical products.
- Production and sales of Clean Mix, a mixture of propane and butane.

Topics

In December 2007, we concluded a basic agreement with Sumitomo Corporation to integrate the two companies' LP gas businesses. Based on that agreement, Enessance Holdings Co., Ltd. is to be established in July 2008 as a holding company to administer LP gas marketing subsidiaries.

LP GAS

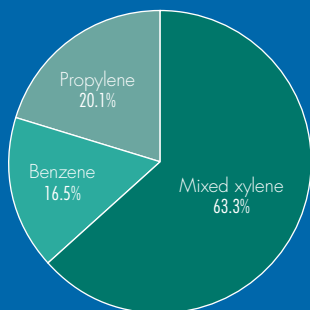
Domestic Sales and Import of LP gas (2007)



recorded sales of 31.3 yen billion (6.6% decrease from the previous year).

Operating income in our main fuel sales business increased significantly due to the inventory valuation effects as a result of the sharp rise in crude oil prices. Consequently, operating income in our oil business increased 14.5 yen billion over the previous year to 84.5 yen billion. Disregarding the impact of the inventory valuation effects, operating income fell 14.2 yen billion to 36.1 yen billion as cost increases could not be sufficiently passed on to product prices. Our real estate business posted operating income of 2.8 yen billion and our other businesses recorded operating income of 1.4 yen billion.

2007 Production Portfolio of Feedstocks for Petrochemicals



PETROCHEMICALS (FEEDSTOCKS)

Main Business

- Production and sales of mixed xylene.
- Production and sales of benzene.
- Production and sales of propylene.

Topics

In the field of xylene, we established a joint venture in the paraxylene business with Teijin Fibers Ltd and Mitsubishi Corporation. The company started sales in April 2008. To reinforce our production capacity of mixed xylene, we will construct an additional Continuous Catalytic Regenerator (CCR) at group company Seibu Oil Co., Ltd., aiming to start operation by the end of 2009.

Main Business

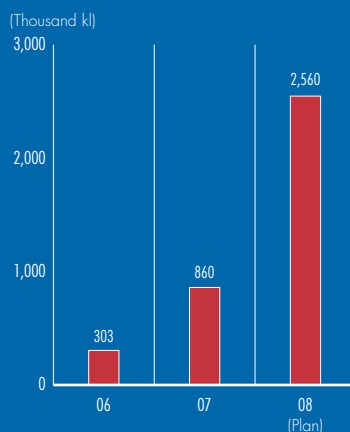
- Export of diesel oil and other oil related products.
- Cargo trade focusing on naphtha (this business has been leased to the Shell Group as of August 2007).

Topics

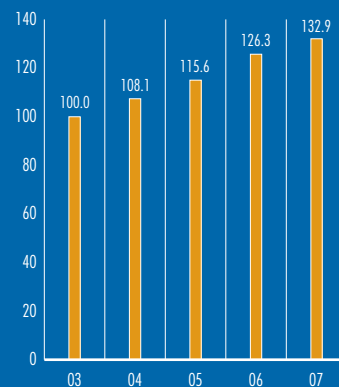
Operation of our trading business focusing on naphtha was integrated with the Shell Group in August 2007 to make more effective use of the Shell Group global network.

EXPORT/TRADING

Volume of Exports



Sales of High Grade Lubricants (2003=100)



SPECIAL PRODUCTS (LUBRICANTS, BITUMEN, AND INTERNATIONAL SALES)

Main Business

- Production and sales of lubricants and greases.
- Production and sales of bitumen for road paving, compounds for civil engineering foundation work, and other road and construction material products.
- Sales of fuel and lubricants for jets and tankers.

Topics

We are promoting the development of high value-added products including diesel engine oil that reduces environmental impact through energy conservation and long service life and environmentally-friendly bitumen that helps prevent the heat island phenomenon.

REVIEW OF OPERATIONS

MAIN FUEL SALES



Atsuhiko Hirano
Sales,
Director

Overview of Business Operations

Our main fuel sales business is broadly divided into retail sales of fuel for service stations and B to B sales of industrial fuel for users that require fuel for manufacturing, transport, electric power, agriculture, forestry, and fisheries. Our main products are gasoline, diesel oil, kerosene, heavy fuel, and automotive lubricants.

Our strategy is to broaden the customer base and increase sales per customer. Last year we concentrated our efforts on increasing the number of Shell customers one by one and raising the value of sales per customer and per company in both retail sales and industrial fuel sales by providing high quality products and services. Our efforts were rewarded with positive results. As domestic demand in Japan fell, our retail division succeeded in boosting sales of gasoline by approximately 3% in comparison with the previous year. These efforts included ambitious initiatives to convert existing service stations in the Tokyo metropolitan area to self-service stations, to widen the nationwide reach of our dealer network, and to open new service stations. As of the end of last year, our ratio of self-service stations rose to 16% of our total. In the future we plan to continue efforts to increase the number of self-service stations after carefully examining customer needs and the profitability of each station, irrespective of size. In industrial fuel sales, as our customers continue to look to fuel alternatives in response to environmental regulations and other factors, we directed our efforts to reorganizing structures within our branches and to training sales staff to provide them with skills that will enable them to offer a range of proposals to customers. Ever mindful of improving value chain efficiency in every department, we also devoted our efforts to enhance cost competitiveness and reach top-class levels in the industry.

Business Strengths

1. Partnership with Dealers

To continue as a brand that has the ongoing support of our customers over the years, it is essential for us to accurately grasp different customer needs, which vary from region to region, to enable us to provide customers with the ideal services for them. This is why we have stated our commitment to a policy to grow together with our network of affiliated dealers, which have developed their businesses deeply rooted in their local areas. We also understand that we cannot strengthen the competitiveness of service stations without enhancing the skills and motivation of staff at dealers, who come into direct contact with customers on a daily basis. Therefore, we are working to maximize our brand value throughout the value chain from products to services at service stations by revitalizing our system of human resource development for dealer staff as well as our organizational activities.

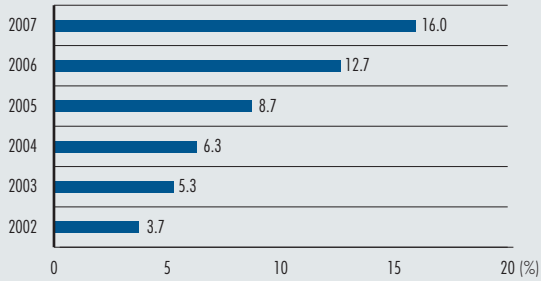
2. New Types of Service Stations

One of our areas of strategic investment in our main fuel sales business is the development of service station models in conjunction with shopping centers or convenience stores designed to provide the convenience of one-stop shopping. The promotion of integrated sales with shopping centers and shoppers being able to drop by a service station to fill up their tanks after finishing their shopping have been well regarded by customers and we are speeding up preparations to open more service stations of this type in all areas nationwide. Without being limited by the status quo, we will continue to look for innovative ways to improve the convenience of supplying fuels to our customers and will launch these services in the market.

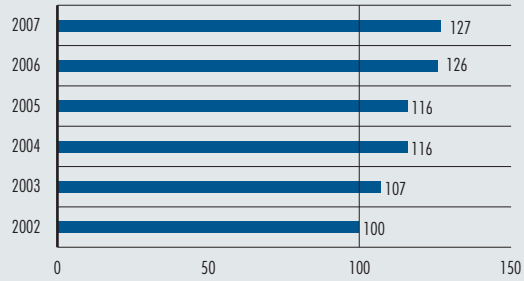
3. Cost Competitiveness

Since 1996 when the industry became effectively deregulated following the repeal of the Provisional

Self-Service Station Ratio



Average Gasoline Sales per Self-Service Station (2002=100)



Measures Law on the Importation of Specific Refined Petroleum Products, Showa Shell has continued ongoing efforts to increase management efficiency in all areas of the value chain from crude oil procurement to sales at service stations. Moreover, we continuously review from every angle and at every level our current cost structure in efforts to establish a foundation for the future.

Measures for 2008

Following on from the previous year, we will continue to promote our strategy to broaden our customer base and increase sales per customer in 2008 and we will cooperate with our affiliated dealers in directing maximum effort to achieving our goals. In retail sales we will promote the streamlining of service stations on the one

hand and the development of new types of service stations on the other in efforts to maximize per station efficiency. We will also utilize customer satisfaction surveys in existing service stations in efforts to develop service station concepts that will respond to diverse customer needs. In sales for industrial users, we will develop sales services that incorporate consulting services that consider the best energy mix for customers and provide them with proposals on rationalization. In these ways, Showa Shell will promote growth in existing and new business areas by introducing customers to a range of products that suit their individual needs including, for example, proposals for introducing our high-quality industrial lubricants and greases, or clean LNG fuel for customers considering switching to alternative fuels.



High value-added models

- Type based on location
- Comprehensive automotive support services "Total carlife support"



Self-service station models for sites with limited space

- Low-cost self-service
- Fuel sales and car wash



Shopping center model (Fantasista)

- Low-cost self-service
- Fuel sales and car wash



Convenience store models

- Convenience store with self-service station
- Specializing in fuel sales

REVIEW OF OPERATIONS

CIS SOLAR POWERED CELLS



Shigeaki Kameda
Senior Executive Officer,
Showa Shell Solar K.K.
President and Representative Director

Overview of Business Operations

In recent years world demand for solar powered cells is said to be growing at an annual rate of 30 to 40% and we see this as a valuable business opportunity with enormous potential. In accordance with our plans to grow business in next generation CIS (copper, indium, selenium) solar powered cells (hereafter "CIS") as our second core business, we made a decision in 2005 to commercialize the product and proceeded with the construction of our first plant. An investment of approximately 5 billion yen, in 2007 we completed the Miyazaki Plant (annual capacity of 20 megawatt worth of CIS), and commenced commercial production in July. During the plant's inaugural year, we placed priority on stable operation of the plant and the accumulation of production know-how.

Product Superiority

The CIS that Showa Shell produces are made up of three main elements: copper, indium, and selenium. One of the notable features of CIS is the thickness of each cell, which is only about two to three micrometers, or about 1/100 the thickness of crystal silicon cells. A further advantage is the availability of the materials used in CIS. Unaffected by market conditions for silicon, CIS materials can be stably supplied at a low cost. The amount of materials and energy required during production are also modest, and energy payback time (EPT), which indicates the amount of time it takes until the energy input during production is recovered through solar power generation, has been reduced to about half that required for conventional crystal silicon cells.

At the same time, CIS has properties superior in spectral sensitivity, so it is able to absorb light waves over a wider range than conventional solar powered cells and therefore can be expected to have greater electric power generation capacity. Moreover, unlike conventional solar powered cells which cease to function when a part of the cells is in the shade (one of the weaknesses of the traditional cells),

CIS is able to maintain stable generation, powered solely by the areas on which the sun is shining.

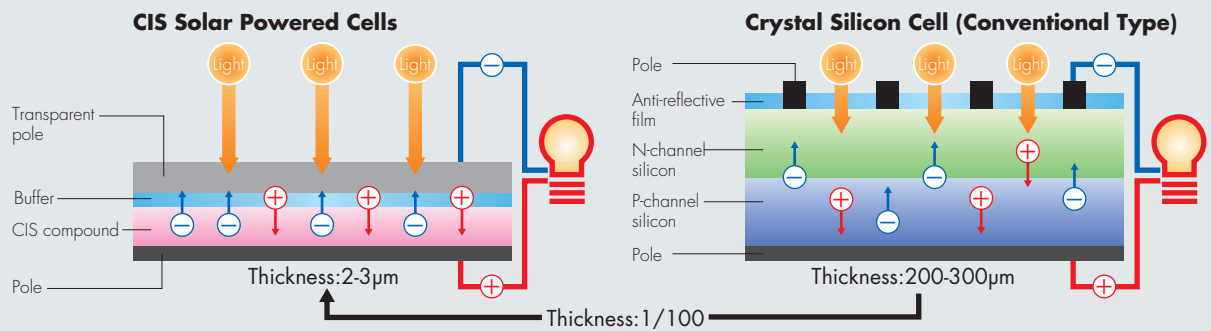
In addition to the superior features of CIS, Showa Shell's achievements in product technology in this area have also received acclaim. In February 2008, we received the METI* Minister's Award, the highest award presented at the 12th New Energy Awards sponsored by the New Energy Foundation. We also received further distinction when we were presented with the Ecology Design Prize in the Good Design Award 2007, sponsored by the Japan Industrial Design Promotion Organization. We believe that Showa Shell received these awards not only in recognition of the significant reduction in the burden on the environment our solar-powered products will achieve but also in recognition of the company's innovation in production technology and potential to improve performance, the prospects for cost cutting through mass production, and the future potential of the superior product design.

*METI: Ministry of Economy, Trade and Industry

Plans for 2008 and Outlook for the Future

We plan to make 2008 a year in which we solidify our operational base in both production and sales in anticipation of reaching a new benchmark in the expansion of our business. We have already commenced construction of a second facility in which we are investing approximately 15 billion yen and will have an annual capacity of 60 megawatt worth of CIS. We anticipate commencing operation of the new facility during the first half of 2009. Building on the knowledge we have gained from our first plant, we will pursue further improvements in product quality and cost competitiveness, and on the strength of these we aim to boost profitability.

As we proceed with the construction of the second facility, we will at the same time make concrete plans for a framework for future business expansion. The challenges



ahead for us are to determine how we can mass produce our products, which have high technical superiority, at a competitive cost, deliver them at a rapid pace to markets in Japan and overseas, and maintain and improve adequate earnings as a business. While there are a number of criteria that we must satisfy to achieve these objectives, our experience to date has given us a sound understanding of what is required. Therefore, we are currently reviewing a number of areas from various perspectives including reinforcement of our R&D framework and securing the necessary management resources.

By achieving business expansion at a rapid pace, we hope to realize high profitability and growth potential, which will provide strong support for our core business and to meet the expectations of our stakeholders.



With excellent design, CIS solar powered cells can be attractively fitted to various types of buildings

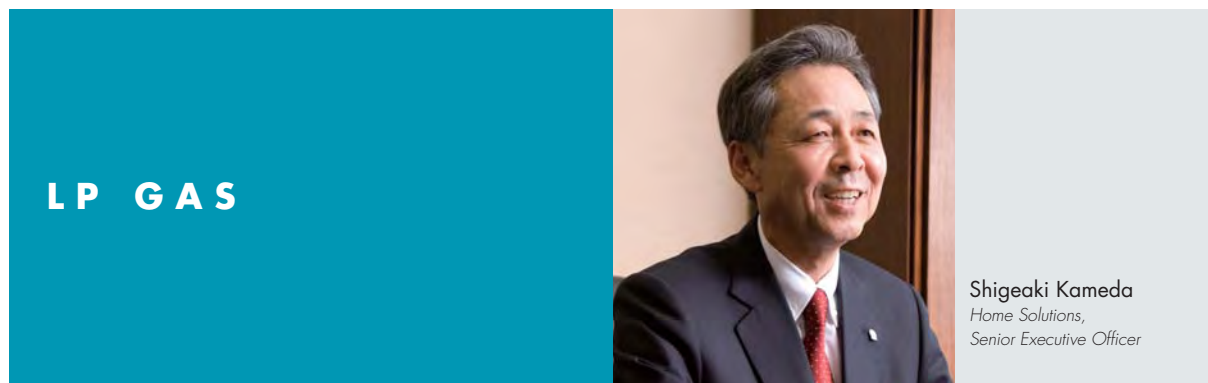
Quest for Commercialization

Amid growing concern about environmental problems and how we should address global warming, solar cells are promising as a clean energy alternative to oil. In 1978 Showa Shell commenced research in solar cells and in 1993 was commissioned by NEDO to start research on CIS. We continued our efforts in the practical application of our research, which included the experimental mounting of CIS on the mission demonstration test satellite Tsubasa MDS-1. In 2005 we made a decision to commercialize CIS and established Showa Shell Solar K.K. in September 2006 for this purpose.



Receiving the METI Minister's Award, the highest of the New Energy Awards

REVIEW OF OPERATIONS



Overview of Business Operations

In our LP gas business, we distribute LP gas refined at Showa Shell Group’s refineries and imported LP gas products for the domestic market through our dealers. Our main products and their users are Clean Propane for households and stores, Clean Auto for automotive purposes, chiefly taxis, and Clean Butane for industrial and consumer gas applications as well as basic materials for chemical products. As procurement and production costs of LP gas edge upwards and remain at high levels in line with crude oil price hikes, demand declines and competition between energy types are exacerbating the severe conditions of business environment.

LP gas Business Merger with Sumitomo Corporation

To strengthen our competitiveness in this difficult environment, Showa Shell decided to enter into a business alliance with Sumitomo Corporation and in December 2007 we signed a basic agreement to integrate the gas operations of both companies. We will consolidate import and domestic supply operations of the two companies into Showa Shell Sekiyu and we will establish a holding company, Enessance Holdings Co., Ltd, to control the

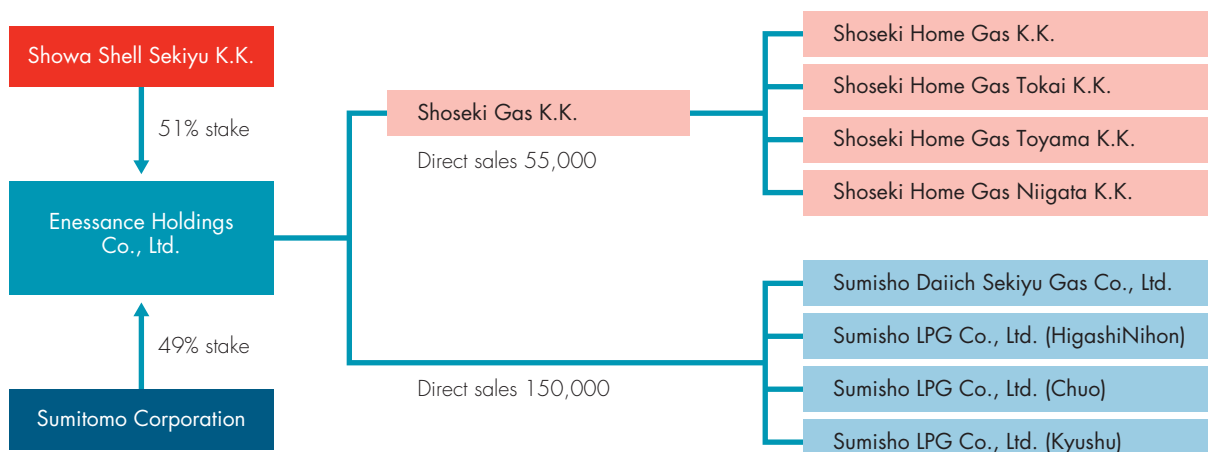
sales subsidiaries. Showa Shell will hold a 51% equity interest in the holding company and Sumitomo Corporation the remaining 49%.

Two main outcomes can be expected from the business merger. The first is an improvement in management efficiency through cost reduction. In the area of distribution, this will be achieved through the consolidation of supply operations, the streamlining of service stations, and joint delivery operations. In the area of management, the consolidation of administration operations of the distribution subsidiaries in a holding company will result in lower costs. The second outcome is the prospect of improving profitability by taking advantage of our large customer base of about 200,000 households to provide value-added services in addition to supplying LP gas.

Providing Household Services

One of the advantages of the LP gas business is our direct communication with customers as our affiliated suppliers deliver products right to the customer’s door. Utilizing this direct access, our new businesses such as CIS solar powered cells, fuel cells, home security, and housework services are also being developed.

New Sales Network of LP Gas Business



REVIEW OF OPERATIONS

PETROCHEMICAL (FEEDSTOCKS)



Hiroto Tamai
Supply,
Corporate Executive Officer

Overview of the Business Operations

At Showa Shell we produce various basic materials for petrochemicals as complementary products from crude oil, and our three main products are mixed xylene, propylene, and benzene.

Demand for these products is solid. In particular, the market for paraxylene, derived from mixed xylene, is growing rapidly as demand for polyester in Asia increases. In 2006, production of paraxylene in Japan was said to be about 3.36 million tons while domestic demand was 1.07 million tons. During the first half of 2007 market conditions for petrochemical feedstocks in general were influenced by strong demand in Asia and a decline in supply due to periodic plant maintenance in the United States; prices remained at a high level. In the second half, however, a cooling of these market

conditions and the inability of manufacturers to promptly pass on price hikes in crude oil and other materials to selling prices resulted in a market downturn. Nevertheless, from a mid-term to long-term perspective, solid demand in the future will ensure that crude oil price rises can be reflected in selling prices, and favorable market conditions can be expected to continue.

Establishment of a Joint Venture in the Paraxylene Business

In view of the growth in demand for paraxylene in recent years, we made a decision to team up with Teijin Fiber Co., Ltd. and Mitsubishi Corporation to promote this business and we established TS Aromatics Limited as a joint venture. The JV produces paraxylene from mixed xylene procured from Showa Shell and sells it mainly to Teijin Fiber. By assigning the production to the existing facilities of Teijin Fiber, the new company is in a more favorable position in terms of costs than investing in new facilities. Until now we produced mixed xylene, the raw material used to make paraxylene, at our group refineries and sold it to Teijin and other paraxylene manufacturers. In the future, we hope to secure a stable customer base for mixed xylene through the joint venture.

At the same time, we plan to boost our mixed xylene production capacity. Our group company Seibu Oil Co., Ltd. has a plan to expand its production facility, which will include a Continuous Catalytic Regenerator. The start of operation of this new facility is scheduled for the end of 2009.



Catalytic Reformer at a group refinery

REVIEW OF OPERATIONS

EXPORT/TRADING



Hiroto Tamai
Oil Products,
Corporate Executive Officer

Overview of Business Operations

In our export business, we sell mainly diesel oil refined at our Group refineries, and in our trading business we engage in the international transaction of selling naphtha that we procure overseas. In both of these businesses demand for oil products is increasing mainly due to growth in the booming economies of Asia, and these businesses are expected to grow in the future.

Although in principle domestic sales are the main focus of our business strategy, we also export our products when overseas markets are more profitable than the domestic market. The key to making profits lies in how appropriately we can grasp the trends in the global product market and how skillfully we can secure customers. We intend to effectively use the Shell Group global network to make this

business profitable.

In our trading business, in the past we promoted independent development of our business while cooperating with the Shell Group. As demand grew and the scale of the flow of products in global markets expanded year by year, however, our view regarding the advantageous supply of products has shifted from the supply of products on a regional basis to supply on a more global basis. Therefore, to promote the advantageous development of our business in the future, we believe that utilizing the Shell Group global network, which covers the entire world, is the optimal approach for us and in August 2007 we integrated our trading business department with Shell Trading.

RESEARCH AND DEVELOPMENT

At our Central Research Laboratory, one of the Shell Group's research bases, we engage in research and development that takes advantage of the expertise of the Shell Group network covering the world. Through exchanges in human resources and sharing information among Group research centers in countries such as Great Britain, the United States, the Netherlands, and Germany, we make efforts to secure the most appropriate human resources and the latest technology. The Central Research Laboratory takes up a wide range of themes related to our business, focusing particularly on environmentally friendly energy in products such as high octane gasoline, *Shell Pura*, sulfur-free gasoline and diesel oil, *Shell Eco Toyu* (GTL kerosene), CIS solar powered cells, fuel cells and various types of lubricants.

In 2007 we started commercial production of CIS thin-film solar powered cells, which we have been researching

for more than a decade, at our first plant. By the end of 2007 the JHFC Ariake Hydrogen Station, which Showa Shell operates, surpassed the refueling of 2,500 fuel cells and hydrogen engine cars for the first time.

In addition, in corporation with Toyota Motor Corporation, Hino Motors Ltd., Shell International Petroleum Co., and Toyota Tsusho Corporation, we started public road trials of cars using FTD (GTL) fuel that contributes significantly to clean exhaust gas.

As one of our initiatives in the challenge to produce alternative energy sources with less environmental burden, we plan to promote sales of biogasoline (containing the additive ethyl tertiary butyl ether) through our operations to prove the feasibility of distribution as a member of the Petroleum Association of Japan. We also plan to continue to develop a range of products that give priority to environmental concerns.

REVIEW OF OPERATIONS

SPECIAL PRODUCTS
(LUBRICANTS, BITUMEN,
AND INTERNATIONAL
SALES)

Yukimichi Ikemura
Lubricants & Bitumen,
International Sales, Laboratory,
Senior Executive Officer

Overview of Business Operations

Showa Shell's special products consist of lubricants, greases, and asphalt, which are handled by the Lubricants & Bitumen Division, and fuel and lubricants for jets and tankers, which are handled by the International Sales Division.

A notable feature of this business area is the extensive lineup of more than 1,000 products that have spawned from the Group's research and development and the high level technology that sets these products apart from those of other companies. Representative of these products are, for example, *Shell Tellus Oil SX-Z*, a hydraulic oil that reduces the consumption of electricity at plants and can contribute to measures to alleviate global warming, and *Shell Rimula Signia*, a diesel engine lubricant that has

dramatically lengthened the intervals between oil changes in trucks. Using technology that other companies cannot imitate, we are also developing a product lineup dedicated to alleviating environmental problems which are certain to become more serious in the future. One example of products in this lineup is *New Mellowphalt*, a type of asphalt that is resistant to heat absorption and therefore effective in mitigating urban heat island effects.

In the International Sales Division, we have established a global supply network for fuel and lubricants for jets and tankers by taking maximum advantage of our affiliation with companies in the Shell Group global network. In this way, we have created a marketing system capable of fully accommodating the needs of airlines and shipping firms.



Central Research Laboratory (Inland Industrial Complex) in Kanagawa Prefecture



The supply of gasoline with a sulfur content of less than 10ppm contributes to CO₂ reduction.



The development of the high value-added lubricant series, *Shell Helix*, was the result of a range of advanced technologies honed through repeated use in F1 races.



Shell Eco Toyu, GTL kerosene synthesized from natural gas, has little of the odor or stickiness peculiar to petroleum fuels.



An asphalt product that comes in light colors to fit in with the surrounding scenery of highways, *New Mellowphalt* is used extensively in areas around historic buildings such as Dazaifu Tenmangu.



Participating in METI's Japan Hydrogen & Fuel Cell Demonstration Project since 2003, Showa Shell operates the JHFC Ariake Hydrogen Station.

INVESTMENT AND FINANCIAL STRATEGY

Showa Shell's policy is to ensure an efficient and stable supply of the funds necessary to strengthen its financial position and carry out its growth strategy while continuing the payment of stable dividends.

Investment Strategy

Showa Shell is determined to realize sustainable growth by investing financial resources in the expansion of its oil business and the further promotion of efficiency in the oil business and in peripheral and non-oil businesses.

- **Operational maintenance and safety measures in the oil business:** We will continuously carry out the maintenance and renovation of refineries and other major facilities.
- **Reinforcing earning power in the oil business:** We will make investments to develop service stations, expand our sales network, and improve the efficiency of our refining and distribution facilities.
- **Creation of synergy between existing businesses and entry into new business fields:** We will invest in new initiatives such as the CIS solar powered cells business and the development of new energies and also invest in other business areas that are expected to create synergies with our existing business, such as our electrical power business, city gas business, and total home solutions business.

Showa Shell carefully selects projects for investment taking into consideration the internal rate of return (IRR), payback period, and other economic indices.

Strengthening Our Financial Position

Showa Shell is working to strengthen its financial position by maintaining an optimal capital structure for securing a stable supply of funds while pursuing the minimization of financing costs. Since 1995, we have greatly reduced interest-bearing debt through the disposal of non-performing assets, the restriction of unnecessary and nonessential investments, and other means. Consequentially, the amount of our consolidated interest-bearing debt (net basis, subtracting cash equivalents) as of the end of 2007 stood at 166.6 yen billion with a gearing ratio of 33%.

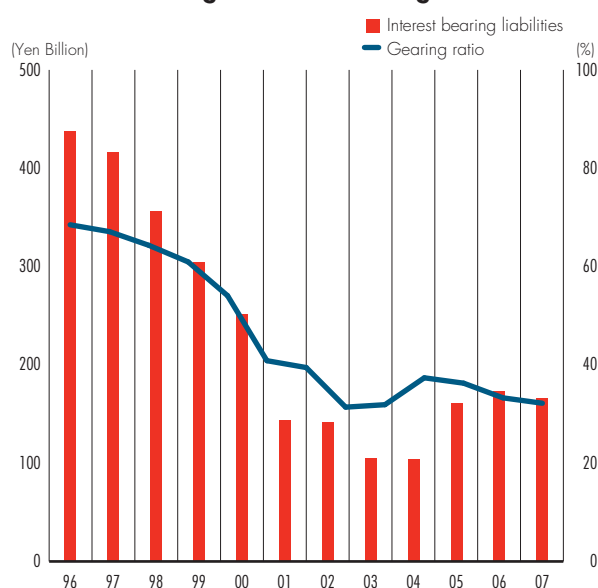
Financing Policy

Showa Shell finances funds through cash flow from operations, financial institutions, and the capital markets. We attempt to lower our funding cost by making aggressive use of the capital market based on our credit ratings.*

We are working to maintain the stability of funds by establishing a ratio of long-term to short-term debt that takes into consideration the time needed to recover invested capital, given that Showa Shell has a significant amount of fixed assets, which is a characteristic of a capital intensive industry. We are also striving to diversify procurement from financial institutions by making use of national banks, loan and trust companies, regional banks, Norinchukin Bank, Shinkin Banks and other financial institutions for small businesses, and life insurance companies.

* Note: As of March 2008, Rating and Investment Information, Inc., (R&I) has given Showa Shell's bonds an A rating and its commercial paper an a-1 rating.

Interest Bearing Liabilities/Gearing Ratio



Financial Risk Management Policy

Showa Shell has signed revolving credit contracts (i.e. line of credit agreements) totaling 150 yen billion with financial institutions in addition to its normal financing limits as a means of securing liquidity of funds. Of these lines, 140 yen billion is in the form of earthquake response financing (amount current as of the end of March 2008). In this way, we have made preparations to procure funds needed to reopen operations swiftly in the event that a major earthquake damages our main production facilities.

As for property and casualty insurance, we have insured against all risk above a certain threshold in order to ensure operational stability and mitigate any negative effects on business performance of a major natural disaster or accident.

Furthermore, in purchasing crude oil and other foreign currency transactions we have prepared for sudden fluctuations in exchange rates by taking currency hedges within the limits of actual demand.

Group-Wide Financial Management

We seek to reduce financing costs by concentrating the Group's procurement funds at the parent company. We increase the efficiency of funds within the Group by connecting the financial activities between group companies through a Cash Management System (CMS).

Shareholder Return

In 2007, Showa Shell paid dividends of 36 yen per share, the same amount as in the previous year. We are committed to continue payments of stable dividends while securing sufficient funds to strengthen our financial position and carry out our growth strategy.



Vice President Director Carruth (left) accepting presentation of a commemorative gift from Mr. Akira Segawa, Managing Executive Officer of Mizuho Corporate Bank, Ltd., in commemoration of the conclusion of a special earthquake response line of credit agreement.

CSR INITIATIVES

We will run our business based on a keen awareness of our corporate social responsibilities as a member of society. These responsibilities range from the stable supply of energy to more direct social contribution initiatives. As measures to cope global warming become a more urgent issue on the international agenda, we will focus our efforts on environmental issues in pursuit of global sustainability.

Basic Philosophy of CSR (Corporate Social Responsibility)

Showa Shell's mission is to fulfill its social responsibility to stakeholders and provide a reliable and stable supply of high quality products and services continuously over the long term. We are committed to supplying and developing efficient energy that does not place a burden on the environment while stably delivering oil-related products and services to customers in Japan on a long-term basis. In other words, we are determined not only to achieve short and mid-term economic gains but also to develop corporate activities that enable stakeholders to continue enjoying good standards of living far into the future from a long-term perspective. We will conduct our

business activities and social contribution activities in line with this philosophy.

We have disclosed information on these initiatives in "Moderate," Showa Shell's environmental report published since 1993, and then, since 2004, in our "CSR Report," which includes two elements, society and economy, in addition to information on environmental issues. In 2007, we published the first issue of the "Sustainability Report," which incorporates the perspective of global sustainability instead of focusing solely on environmental initiatives.

Tackling Environmental Issues in the Supply Chain

As part of our effort to construct a diverse energy supply system, we have been working on the development and commercialization of CIS solar powered cells, the first manufacturing plant of which we put into operation in 2007. We have started constructing a second plant, and plan to turn the photovoltaic module business into one of our core businesses. We are also putting effort into the development of high-quality products that have little environmental burden. We have pushed forward R&D on Shell Pura brand, an environmentally friendly high-octane gasoline that reduces harmful exhaust gases emitted from the engine, bio-gasoline that combines plant-derived bioethanol and oil-derived gas, and alternative fuels synthesized from natural gas (GTL fuels). We will reduce our burden on the environment through expansion of our capacity to supply these energies.

In each business area we are taking steps to reduce CO₂ emissions now and in the future. We are translating our mid-term energy conservation master plan into action by installing highly efficient machinery, heat recovery equipment, and energy-saving operational support systems at refineries, which account for approximately 85% of group-wide CO₂ emissions. In the area of transportation, we are making effort to implement further energy saving measures as a specified consignor under the revised Energy Conservation Act. Specifically, we are improving



From "CSR Report" to "Sustainability Report"

overland transportation efficiency by enlarging our tanker trucks, shortening transportation distances, and making highly efficient deliveries. For marine transportation, we have enlarged tanker sizes, adopted fuel oil additives, introduced electric propulsion ships in November 2007, and took other energy-saving measures. Moreover, the Group will continue making effort to reduce CO₂ emissions, including the possibility of making the best use of Kyoto Mechanism.

Social Initiatives

As a responsible member of society, Showa Shell is standing up to the challenge of ensuring global sustainability. What is more, we not only implement environmental measures in our businesses and undertake direct environmental protection activities, we also carry out social contribution activities in a range of fields, including fine arts and science.

Showa Shell established internal policies in 2006 in accordance with the Shell Group's policy on biodiversity protection. As part of those activities, we are participating in the Project for Reforestation of the Mt. Fuji Forest sponsored by the Organization for Industrial,

Spiritual and Cultural Advancement-International (OISCA-International). We hope that our Environment Photo Contest: Things to be Preserved and Ugly Scenes in the Neighborhood, which we started in 2005, will lead to protection of the global environment by encouraging people to think about the environment through photography of familiar scenes. We established the Shell Art Award in 1956, over a half-century ago, with the aim of discovering young Japanese artists.

We provide children, the bearers of the next-generation, with opportunities to learn about energy and science through Christmas Lecture—which is a British tradition of giving science experiment lecture—and our own Summer Vacation Energy Class.

With the aim of contributing to global sustainability, Showa Shell established the Energy Sustainability Forum (ESF) jointly with the Integrated Research System for Sustainability Science (IR3S), which is run by The University of Tokyo. Through the Forum, we are studying the theoretical approach of researchers in the field of energy sustainability and working to formulate an energy vision from the perspective of "Japan as part of Asia." The final objective is to propose to policymakers.



Christmas Lecture 2007: The Mystery of Numbers (Photo provided by the Yomiuri Newspaper)



Open symposium sponsored by IR3S: The Challenge of Energy Sustainability

CORPORATE GOVERNANCE

Showa Shell has set the objective of achieving sustainable growth and increasing corporate value through the fulfillment of its corporate social responsibilities to shareholders, customers, business partners, employees, society, and all other stakeholders. To achieve this goal, the Group is building a structure with an autonomous monitoring function, improving management transparency and efficiency through the establishment of a governance structure that is capable of responding to changes in the social and legal environment, and leveraging its advantages while driving ahead toward its corporate goals.

Corporate Governance Structure

Improving Management Efficiency

Showa Shell has continuously promoted corporate governance reforms since 1997. We have separated our management oversight from day-to-day business operational functions through reforms including a reduction of the number of board members in 1997 from 18 to the current 11, adoption of an executive officer system, and clarification of authority.

Strengthening the Monitoring Function of Management

We have increased the number of outside directors to three and outside auditors to two. In 2004, we established the Corporate Governance Committee, which includes outside experts, as a permanent advisory organization to the Board of Directors. The Committee evaluates and discusses important matters relating to corporate governance.

Improving Management Transparency

We recognize that the disclosure of corporate and financial information is an important topic in corporate governance. Accordingly, in 2007 we established a Basic Policy on Disclosure, which calls for the timely and accurate disclosure of information both in and outside the company. Disclosure Regulations were established in the same year, and a Disclosure Sub-Committee was established as a subordinate organization to the Internal Control Promotion Committee. Showa Shell and its group companies are implementing and employing systems to realize and ensure the timely and accurate disclosure of information. Furthermore, we abolished the executive retirement allowance system in 2007.

Internal Control

We established a Basic Policy on Internal Control in order to pursue further transparency and efficiency of management and the fulfillment of social responsibilities as a corporate group composed of Showa Shell Sekiyu and its subsidiaries. Through the dissemination of this policy

throughout the Group down to the working level we have built a system that provides an autonomous monitoring function that enables us to practice balanced and sound management.

Corporate Ethics and Compliance

Viewing corporate ethics and compliance as necessary conditions for attaining sustainable growth and increasing corporate value, Showa Shell established a Code of Conduct (see page 48) as a guide for the execution of all its corporate activities. The Code of Conduct clarifies not only the necessity of legal compliance, but also the need to fulfill social responsibilities with a high sense of corporate ethics.

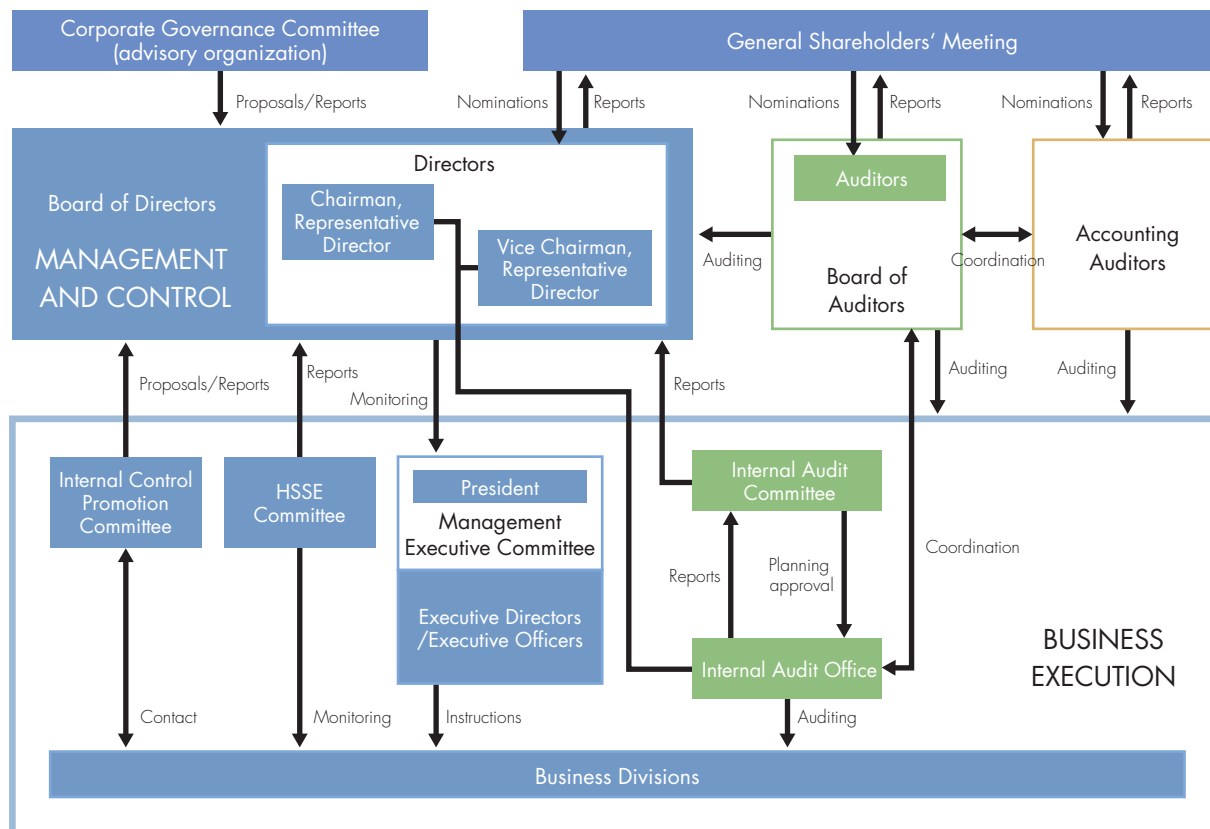
Showa Shell is making efforts to ensure that employees are thoroughly familiar and comply with the Code of Conduct by implementing related educational activities during various training sessions in addition to including it in messages sent out by top management and posting a "Commentary on the Code of Conduct" on the company intranet.

Further, we established an internal consultation service known as Voice of People (VOP), which solicits constructive proposals from employees and provides consultation on problems or concerns regarding compliance with the Code of Conduct, personnel actions and the workplace environment. These suggestions are then reflected in management practices. In November 2006, VOP points of contact were established at third-party organizations in addition to the existing internal contacts. We also promote the use of VOP by employees of the Group's subsidiaries.

Improving Operational Effectiveness and Efficiency

Showa Shell has organized various committees that serve as advisory bodies in order to reflect the specialized perspectives of each business segment when making decisions on important matters. We regularly verify the progress of our medium-term management plan and the status of our fiscal year budget and take measures accordingly to execute business efficiently.

Corporate Governance and Internal Control System



Reliability of Financial Statements

In addition to settling and disclosing quarterly results, we established a Financial Information Assurance Project Team to further ensure the correctness of financial statements. We are working to build a company-wide controls framework toward compliance with the Financial Instruments and Exchange Law (J-SOX), which becomes applicable from the fiscal year ending December 2009.

Reinforcing Controls at Group Companies

In order to develop a more effective group-wide internal control system, we have been carrying out an internal control system development project at affiliate companies since July 2006. The project, which is undertaken at 37 companies, covers the development of regulations relating to internal controls, ensuring employees are familiar with these regulations, and checking their operational status. In September 2007, we established the Group Auditors Office with the aim of strengthening the auditing functions of auditors at affiliates.

Risk Management System

Among the risks that have a potential effect on Showa Shell's corporate value and business, HSSE (health, safety, security, and environment) risks are under the purview of the HSSE Committee. This committee approves annual HSSE basic policies, monitors and supervises performance reviews of established action targets, and periodically conducts HSSE audits.

For matters not related to HSSE, Showa Shell is taking measures regarding high priority matters as needed through the annual preparation and review of business control matrix (i.e. through the identification of the risks associated with business targets and the ascertainment of the degree of effect and the status of control of these risks in view of the frequency of their occurrence.) In addition, the company has created checklists of items to monitor the status of the management of risks, including compliance risks, that are associated with daily operations. Department heads are required to conduct an annual self-evaluation of the status of the management of these items and report the results to the Internal Control Promotion Committee.

"SAFETY AND QUALITY FIRST 2008" GROUP-WIDE SAFETY AND QUALITY IMPROVEMENT INITIATIVE

To provide customers with reliable quality and safety, Showa Shell is engaged in a group-wide initiative to ingrain the concepts of stability of supply and quality improvement at the Showa Shell Sekiyu Group, including its affiliated dealers and subsidiaries. Following the campaign conducted in 2007, which we designated as the first year of a "New Era of Quality," from 2008 forward, we will carry out Safety & Quality First initiatives that incorporate efforts to ensure safety as well as quality.



Designating 2007 as the first year of a "New Era of Quality," Showa Shell has been carrying out a group-wide campaign including all related divisions in order to provide its customers with reliable quality and safety. Throughout the supply chain that leads from production to the sales and delivery of products to customers we have found problems regarding facilities, implemented thorough oil volume control and unloading observation, conducted cross-sectional training sessions, and made efforts to firmly establish a quality improvement system, including the strengthening of internal audits. Even in indirectly related areas, this campaign is leading to the steady strengthening of our quality improvement system through educational programs conducted during various training sessions, observation by the Finance Division of oil flow control at depots, the auditing of procurement source plants, and other efforts.

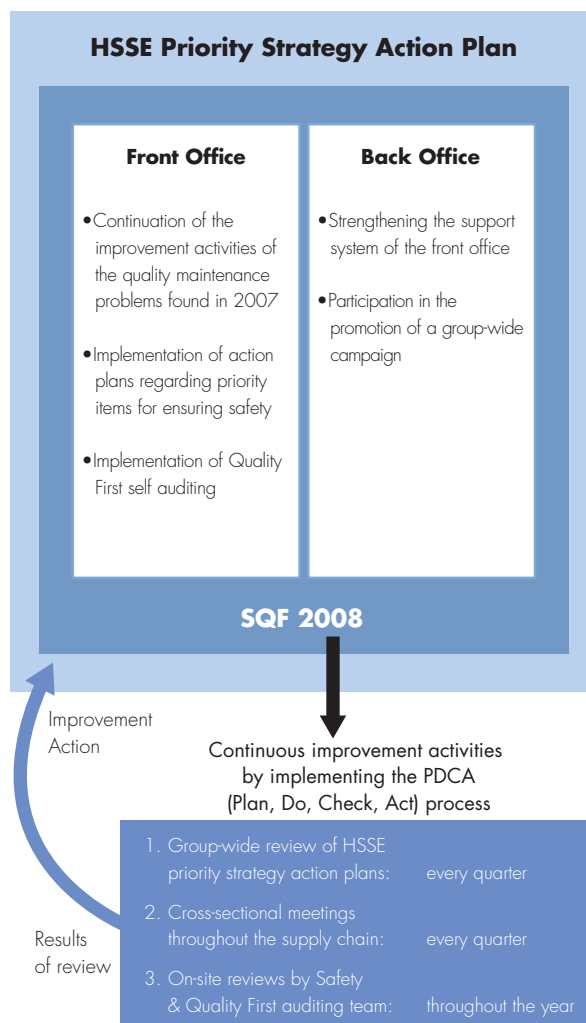
As for the ensuring of safety, last year all executives shared the responsibility of visiting each worksite to check health, safety, security, and environment (HSSE) risks and take necessary countermeasures in line with our key concept of "learning from mistakes." We designated June 5 and October 16 as Safety Days and undertook a range of safety initiatives, including rigorous steps to ensure compliance and prevent the recurrence of accidents, the sharing of nearmiss incidents, the identification and improvement of unsafe areas at each business site, the sharing of measures taken at other sites to prevent recurrence of accidents, and the verification that similar measures have been implemented at each worksite.

Continual implementation is the important point in these activities to ensure safety and improve quality. In 2008, we will unfold a group-wide Safety & Quality First 2008 initiative (SQF2008) to integrally continue promoting our drive to ensure safety and improve quality.

We will make efforts to check the fundamental risks to win the trust of the society. We are also working to translate the fruits of these efforts into corporate differentiation.

Overview of the Group-wide Safety and Quality Improvement Initiative

This year, we designated SQF2008 as an important item for our HSSE Priority Strategy Action Plan. All departments, including those at affiliated companies, established action plans to ensure safety and improve quality. We will steadily nip away the latent buds of risk through conscious implementation of the PDCA process.



BOARD OF DIRECTORS AND CORPORATE AUDITORS



CHAIRMAN AND REPRESENTATIVE DIRECTOR

Haruyuki Niimi

VICE CHAIRMAN AND REPRESENTATIVE DIRECTOR

Shigeya Kato

PRESIDENT AND REPRESENTATIVE DIRECTOR

Yasuo Murayama

VICE PRESIDENT AND DIRECTOR

Richard A. Carruth
CFO, Associate Relations, Procurement

MANAGING DIRECTOR

Hitoshi Sato
Health, Safety, Security and Environment (HSSE), Secretariat, Legal (including Personal Information Protection), Internal Control Promotion, Internal Audit

Jun Arai

Corporate Planning (Including Corporate Governance), Finance and Accounts, Treasury, Financial Information Assurance Project

DIRECTOR

Yoshihiko Miyauchi
Tan Chong-Meng
Khalid H.Al-Dabbagh

Tomoyuki Egami
Personnel, Industrial Relations, General Affairs, Public Affairs

Atsuhiko Hirano
Sales, Commercial Sales, Marketing Planning, Retail Sales, Distribution and Operations, Import Terminal, Branches

AUDITOR

Hisao Nozaki
Kanji Yamamoto

AUDITOR (OUTSIDE AUDITOR)

Midori Miyazaki
Kenji Yamagishi

SENIOR EXECUTIVE OFFICER

Yukimichi Ikemura
Lubricants and Bitumen, International Sales, Laboratory

Shigeaki Kameda
Home Solutions, New Business Development, President and Representative Director of Showa Shell Solar K.K.

CORPORATE EXECUTIVE OFFICER

Kazunori Yamamoto
Crude Oil and Marine

Hiroto Tamai
Supply, Power Business, Oil Products, Manufacturing

EXECUTIVE OFFICER

Kazuo Murakami
Metropolitan Branch

Naoto Komatsu
Retail Sales

Kiyotaka Yamada
Finance and Accounts

Tsuyoshi Kameoka
Kinki Branch

Katsuhiko Nakagawa
Chubu Branch

David J. Kinder
Corporate Planning, Specially Assigned Issues

Yukihiro Houshito
Associate Relations, Procurement

Misao Hamamoto
Manufacturing

Tomoaki Ito
Health, Safety, Security and Environment (HSSE), Research and Development

(From left, the first row):

Shigeya Kato
Haruyuki Niimi
Yasuo Murayama

(From left, the second row):

Tan Chong-Meng
Hitoshi Sato
Richard A. Carruth
Yoshihiko Miyauchi
Jun Arai
Khalid H.Al-Dabbagh

(From left, the third row):

Hisao Nozaki
Midori Miyazaki
Atsuhiko Hirano
Tomoyuki Egami
Kenji Yamagishi
Kanji Yamamoto

NETWORK, MAJOR SUBSIDIARIES AND AFFILIATES

NETWORK

Head Office

Daiba Frontier Bldg., 2-3-2, Daiba, Minato-ku, Tokyo 135-8074

Associate Relations Division	Manufacturing Division
Corporate Planning Division	Marketing Planning Division
Commercial Sales Division	New Business Development Division
Crude Oil & Marine Division	Oil Products Division
Distribution & Operations Division	Personnel Division
Finance and Accounts Division	Power Business Division
Financial Information Assurance Project Team	Procurement Team
General Affairs Division	Public Affairs Division
Health, Safety, Security and Environment (HSSE) Division	Research & Development Division
Home Solutions Division	Retail Sales Division
Industrial Relations Division	Sales Division
Internal Control Promotion Division	Secretariat Department
International Sales Division	Supply Division
Legal Department	Treasury Division
Lubricants & Bitumen Division	

Ishioka Training Center 3-21-11, Minamidai, Ishioka, Ibaraki 315-0035

Central Research Laboratory 4052-2, Nakatsu, Aikawa-machi, Aiko-gun, Kanagawa 243-0303

Branches

Hokkaido Branch	Nishi 1-1-2, Kita 7 jo, Kita-ku, Sapporo, Hokkaido 060-0807
Tohoku Branch	4-1-1, Ichiban-cho, Aoba-ku, Sendai, Miyagi 980-0811
Metropolitan Branch	1-6-1, Otemachi, Chiyoda-ku, Tokyo 100-0004
Kanto Branch	1-6-1, Otemachi, Chiyoda-ku, Tokyo 100-0004
Niigata Branch	21, Heiwa-cho, Higashi-ku, Niigata-shi, Niigata 950-8515
Shizuoka Branch	3-11, Otemachi, Aoi-ku, Shizuoka-shi, Shizuoka, 420-0853
Chubu Branch	3-25-9, Meieki, Nakamura-ku, Nagoya, Aichi 450-0002
Hokuriku Branch	1-5-2, Honmachi, Kanazawa, Ishikawa 920-0853
Kinki Branch	3-6-1, Doshumachi, Chuo-ku, Osaka-shi, Osaka 541-0045
Chugoku Branch	2-7-10, Otemachi, Naka-ku, Hiroshima-shi, Hiroshima 730-0051
Shikoku Branch	1-3-1, Kotobuki-cho, Takamatsu, Kagawa 760-0023
Kyushu Branch	3-11-1, Tenjin, Chuo-ku, Fukuoka-shi, Fukuoka 810-0001

Petro-Product Import Terminal

Niigata 21, Heiwa-cho, Higashi-ku, Niigata-shi, Niigata 950-8723

Lubricant Blending Plants

Yokohama 2-4, Anzen-cho, Tsurumi-ku, Yokohama, Kanagawa 230-0035

Kobe 6-1-17, Namimatsu-cho, Nagata-ku, Kobe, Hyogo 653-0055

Terminal Management Center

Management Terminal (Tokyo) 1-6-1, Otemachi, Chiyoda-ku, Tokyo 100-0004

Management Terminal (Osaka) 3-6-1, Doshumachi, Chuo-ku, Osaka-shi, Osaka 541-0045

Management Terminal (Yokkaichi) 1, Shiohama-cho, Yokkaichi, Mie 510-0851

Management Terminal (Seibu) 5, Oaza-Nishioki, Onoda, Yamaguchi 756-0885

Management Terminal (Sodegaura) 1, Kitasode, Sodegaura-shi, Chiba 299-0286

MAJOR SUBSIDIARIES AND AFFILIATES (December 31, 2007)

Company name	Major businesses
Consolidated subsidiaries (27 companies)	
Central Energy K.K.	• Sales of oil products
Chuo Shell Sekiyu Hanbai K.K.	• Sales of oil products
East Ohgishima Oil Terminal K.K. (Amalgamated with Toa Oil Co., Ltd. as March 1, 2008)	• Oil storage, contracts for receipts and payments, leasing of oil storage facilities
Genex Co., Ltd.	• Supply of electricity • Supply of electricity and vapour for Toa Oil Co., Ltd.
Heiwa Kisen Kaisha, Ltd.	• On-site services at refineries and oil fields, shipping agency
Kanto Koyu Energy Co., Ltd.	• Sales of oil products
K.K. Marushin	• Sales of oil products
Nakagawa Oil Co., Ltd.	• Sales of oil products
Nippon Grease Co., Ltd.	• Manufacturing and sales of grease and lubricating oil
Nissho Koyu K.K.	• Sales of oil products
K.K. On Site Power	• Supply of heat and electricity
Petro Star Kansai Co., Ltd.	• Sales of oil products
Petro Star Kanto Co., Ltd.	• Sales of oil products
K.K. Rising Sun	• Sales of oil and automotive products, insurance agency, leasing
K.K. Shinyo Sekiyu	• Sales of oil products
Shoseki Engineering & Construction Co., Ltd.	• Design and construction of industrial facilities, particularly those used in the oil industry
Shoseki Gas Co., Ltd.	• Sales of LP gas, high-pressure gas and other oil related engineering works, and sales of household appliances and office equipment
Shoseki Home Gas K.K.	• LP gas business • Oil related engineering works
Shoseki Kako K.K.	• Manufacturing, sales and execution of materials used for waterproofing buildings, and manufacturing and sales of oil products and bitumen pavement

Company name	Major businesses
Shoseki Overseas Oil Development Co., Ltd.	• Mining, development, production and sales of oil and natural gas
Showa Shell Sempaku K.K.	• Domestic shipping • International shipping • Ship leasing
Showa Shell Solar K.K.	• Manufacturing and sales of solar batteries, development of solar powered cells and systems
Showa Yokkaichi Sekiyu Co., Ltd.	• Oil refining
K.K. Sun Road	• Sales of oil products
Toa Oil Co., Ltd.	• Oil refining
Tokyo Shell Pack K.K.	• Sales of kerosene
Wakamatsu Gas K.K.	• City gas and LP gas business, oil related engineering works • Sales of household appliances and oil products
Equity-method affiliates (11 companies)	
Central Sekiyu Gas Co., Ltd.	• Sales of LP gas products
Daia Shoseki K.K.	• Sales of oil products
Japan Oil Network Co., Ltd.	• Oil storage, contracts for receipts and payments, leasing of oil storage facilities
Joyo Shell Sekiyu Hanbai K.K.	• Sales of oil products
Marubeni Energy Corporation	• Sales of oil products
Mieseki Shoji K.K.	• Sales of oil products
Niigata Joint Oil Stockpiling Co., Ltd.	• Oil storage, contracts for receipts and payments, leasing of oil storage facilities
Seibu Oil Co., Ltd.	• Oil refining
Shell Sekiyu Osaka Hatsubaisho K.K.	• Sales of oil products
Shell Tokuhatsu K.K.	• Sales of oil products
Toyotsu Petrotex Co. Ltd.	• Sales of oil products

TWELVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

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

	2007	2006	2005	2004	2003
Sales proceeds	¥ 3,082,641	¥ 2,921,287	¥ 2,268,488	¥ 1,839,445	¥ 1,726,917
Cost of sales	2,874,422	2,728,137	2,056,023	1,665,978	1,570,155
Gross profit	208,219	193,149	212,465	173,466	156,761
Sales and administrative expenses	119,405	118,847	114,084	113,280	120,787
Operating profit	88,813	74,301	98,381	60,185	35,974
Ordinary profit	92,709	77,675	100,497	61,927	38,188
Net income after taxes	43,729	46,249	58,370	2,362	21,000
Total assets	1,339,114	1,195,015	1,145,191	905,823	882,299
Total shareholders' equity* 1	338,933	309,411	275,232	226,955	234,773
Net income after taxes per share (yen)	¥ 116.12	¥ 122.95	¥ 155.31	¥ 6.14	¥ 55.96
Shareholders' equity per share (yen)	899.90	822.20	732.08	605.25	627.07
Return on sales (operating profit basis) (%)	2.9	2.5	4.4	3.3	2.1
Return on sales (net income basis) (%)	1.4	1.6	2.6	0.1	1.2
Return on assets (%)	3.3	3.9	5.1	0.3	2.4
Return on equity (%)* 1	13.5	15.8	23.2	1.0	9.2
Equity ratio (%)* 1	25.3	25.9	24.0	25.1	26.6
Number of shares outstanding at end of term (thousand shares) * 2,3	376,633	376,323	375,863	374,868	374,303

*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.

Risks

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 oil products

Domestic demand for oil 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 oil products market is affected by factors such as fluctuations in demand, price competition with other companies in the industry, overseas prices for oil products, and price competition with other forms of energy. These fluctuating factors also exert an influence on the quantities and prices of oil 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 oil products sold by the Showa Shell Group is affected by changes in crude oil prices and the foreign exchange market, the Group'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 Group'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. Effects of inventory valuation

The Showa Shell Group uses the weighted-average method to value crude oil inventory. When crude oil prices decline, 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 rise, 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. Effects of competition with competitors

The Showa Shell Group faces severe competition in the domestic market, mainly in the oil business, due to continued overcapacity in refineries and filling stations, and due to falling oil product demand. The Group strives to maintain and increase competitiveness. In this competitive environment however, if operations cannot be conducted efficiently there is a possibility that the Group's financial position and operating results will be affected.

Yen Million

2002	2001	2000	1999	1998	1997	1996
¥ 1,620,359	¥ 1,664,954	¥ 1,639,475	¥ 1,365,478	¥ 1,324,752	¥ 1,588,067	¥ 1,600,067
1,460,458	1,513,626	1,477,361	1,218,732	1,171,788	1,408,789	1,404,722
159,901	151,328	162,113	146,746	152,963	179,278	195,344
123,500	123,274	124,442	133,691	144,445	164,434	174,646
36,400	28,053	37,670	13,054	8,518	14,844	20,698
40,101	29,052	38,913	12,191	7,223	12,901	15,225
18,665	2,610	12,499	1,828	1,999	6,387	6,054
916,690	909,902	1,002,146	974,916	992,282	1,049,931	1,071,464
221,604	212,168	216,349	197,562	199,711	201,479	198,536
¥ 49.69	¥ 6.95	¥ 33.19	¥ 4.85	¥ 5.31	¥ 16.95	¥ 16.06
592.18	565.36	574.77	524.25	529.95	534.64	526.84
2.2	1.7	2.3	1.0	0.6	0.9	1.3
1.2	0.2	0.8	0.1	0.2	0.4	0.4
2.0	0.3	1.2	0.2	0.2	0.6	0.6
8.6	1.2	6.0	0.9	1.0	3.2	3.1
24.2	23.3	21.6	20.3	20.1	19.2	18.5
374,125	375,280	376,409	376,850	376,850	376,850	376,850

5. Risks related to environmental regulations and tax levies

The oil industry, of which Showa Shell is a member, has enacted voluntary targets of blending biofuels in gasoline by 2010, as a component of meeting targets set forth in the Kyoto Protocol. The Showa Shell Group is making investments to meet these targets. Going forward, if restrictions are placed in Japan on CO₂ emissions and/or fossil fuel consumption, or if other environmental regulations are enacted, additional investments could be needed and higher costs could occur. In that case there is a possibility that the Group's financial position and operating results will be affected. Also, if provisional tax rates on oil products are abolished, differences will occur between the provisional tax rate, at which the Group's assets are recorded, and the permanent tax rate. If a tax rebate scheme for this difference cannot be implemented, or if the difference cannot be fully reflected in product prices, there is a possibility that the Group's financial position and operating results will be affected.

6. Effects of termination or restriction of business as the result of 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. The Group 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 operations if struck by a natural disaster such as a large typhoon or earthquake, or if the area of business operations of the Group is hit by a large-scale epidemic of a serious infectious disease such as avian influenza. These types of scenarios could affect the Group's financial position and operating results. There is also a possibility of being similarly affected by the termination or restriction of business as the result of an occurrence such as a serious industrial injury or equipment accident.

7. Risks related to the internal control system

The Showa Shell Group continues to strive for the strengthening of compliance. The Group appoints an executive in charge of compliance, has enacted regulations regarding compliance with antitrust laws, operates a risk management system, and conducts internal audits. However, in cases where the internal control system does not work effectively and compliance risk cannot be entirely avoided, there is a possibility that the trust of stakeholders will be lost and the Group's financial position and operating results be affected.

8. 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.

9. 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.

10. Risk concerning retirement benefits

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

MANAGERS' ANALYSIS OF FINANCIAL POSITION AND OPERATING RESULTS

Management Environment

The Japanese economy during the term under review on the whole maintained its momentum of recovery but concerns over a slowdown in the US economy since the second half have increased a sense of caution regarding the future.

Although Dubai crude oil prices started off the year in the range of 57 dollars per barrel, factors such as increased geopolitical risk in oil producing states and the massive inflow of investment funds into the crude oil market continued to drive prices up. By the end of the year prices per barrel were around the 89 dollars mark. In the foreign exchange market, the Japanese currency started off the year at about 119 yen to the dollar and around March began to gain ground against the dollar. After falling back for a short period thereafter, the yen continued to edge steadily upwards against the dollar from August onwards amid concerns of a worsening US economy triggered by the subprime loan problem. By the end of November the yen traded at the 107 yen mark, but after dollar buying regained strength it weakened, and at the end of the term was 114 yen per dollar.

Meanwhile domestic oil demand has been on a decline. Demand for gasoline and diesel oil has fallen off as consumers show restraint in consumption due to price rises and a growing orientation toward economizing on fuel consumption. Annual demand for kerosene also fell below that for the previous year due to a warm winter. The decrease in demand was even more conspicuous in industrial fuel products, attributable chiefly to progress in conversion to alternative fuels as companies take measures to address environmental problems and due to surges in crude oil prices.

Despite rises in domestic oil product prices as a result of surges in crude oil prices, again this year the full brunt of crude oil costs could not be adequately passed on to prices at filling stations and for oil products for industrial use.

Operating Results

Consolidated sales for 2007 came to 3,082.6 yen billion, an increase of 5.5% on the previous year. Although demand for oil

products in all areas including gasoline, diesel oil, kerosene, and fuel oil for industrial purposes decreased, the large increase in sales in the oil business was attributable mainly to an increase in prices due to surges in crude oil prices.

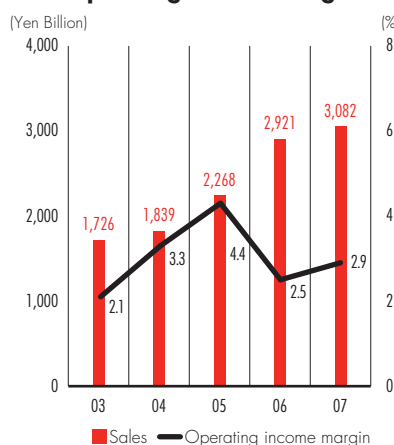
At the profit level, consolidated operating income increased 14.5 yen billion from the previous year to 88.8 yen billion. Consolidated ordinary income increased 15 yen billion from the previous year to 92.7 yen billion, due mainly to an improvement of 2 yen billion in gains/losses on foreign exchange translations. Consolidated ordinary income on a current cost of supply basis (i.e. excluding the effects of inventory appraisals) was 44.2 yen billion, representing a year-on-year decrease of 13.8 yen billion. Extraordinary gains/losses totaled a net loss of 14.1 yen billion on gains on sales accompanying the disposal of idle assets and impairment losses. As a result of the above, consolidated net income finished at 43.7 yen billion (down 2.5 yen billion on the previous year). Net earnings per share amounted to 116.12 yen.

Segment Information

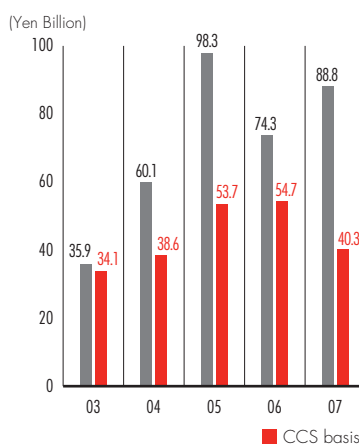
Oil Business

Although the oil business recorded sales volume decreases for kerosene and fuel oil in the Japanese market, these were offset by an increase in gasoline sales due largely to expansion of the Group's filling station network and an increase in exports centering on diesel fuel. An increase in oil product prices following steep rises in crude oil prices also contributed. As a result, sales finished at 3,047 yen billion, a 5.7% increase on the previous year. Operating income rose to 84.5 yen billion, an increase of 14.5 yen billion over the previous year. This was largely due to the effects of inventory asset appraisals accompanying increases in crude oil prices however. Operating income on a current cost of supply basis (i.e. excluding the effects of inventory appraisal) was 36.1 yen billion, a decline of 14.2 yen billion on the previous year's 50.3 yen billion. This was attributable largely to the inability to sufficiently pass on increases in crude oil costs to product prices.

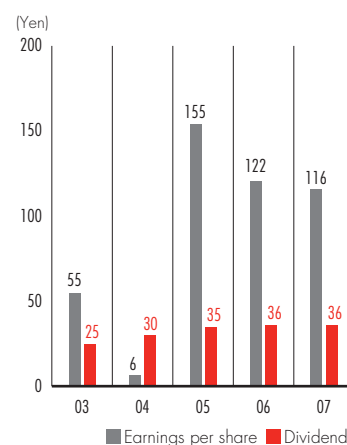
Sales/
Operating Income Margin



Operating Income



Earnings per Share/
Dividends



* CCS operating income (operating income on Current Cost of Supply basis): operating income based on the cost excluding inventory valuation effects.

Property Business

In the office building rental business, despite a revision in rental rates and building management arrangements, sales fell 0.3% on the previous year to 4.2 yen billion and operating income, which finished at 2.8 yen billion (a 0 yen hundred million change on the previous year), was roughly flat year-on-year.

Other Businesses

During the year under review we commenced commercial production in our CIS (copper, indium, selenium) solar powered cells business. We also decided to build a second plant for producing solar powered cells in response to robust demand for solar powered cells worldwide and expect it to be operational in 2009.

In the electric power business, environmental assessment procedures for Ohgishima Power were completed and construction of the electric power plant is now underway. We also became a qualified trading member of the Japan Electric Power Exchange (JEPX), a limited liability intermediate company, in preparation for the commencement of electric power trading in the future.

As a result of the above, sales in the Other Businesses segment finished at 31.3 yen billion, a decrease of 6.6% on the previous year, and operating income finished at 1.4 yen billion, down 200 yen million on the previous year.

Financial Position

Assets, Liabilities, and Shareholders' Equity

Consolidated total assets at the end of the term under review stood at 1,339.1 yen billion, an increase of 144 yen billion compared with the previous term-end. This increase is primarily attributable to a significant increase in both trade receivables and inventory assets due to the sharp rise in crude oil prices. Despite efforts to reduce loans payable, the reduction did not cover an increase in trade payables accompanying rises in crude oil prices and an increase in accrued income tax. Consolidated liabilities rose to 980.8 yen billion, an increase of 116.7 yen billion on the previous year. The combined total of interest-bearing debt, loans, commercial paper, and corporate bonds, decreased 7.3 yen billion in comparison with

the previous year to 183.1 yen billion (166.6 yen billion on a net of cash and cash equivalents basis).

Minority interest declined from the end of the previous term and retained earnings rose. As a result, consolidated net assets at the end of term stood at 358.2 yen billion, an increase of 27.3 yen billion compared with the previous term-end. Shareholders' equity per share at the end of the term increased from 822.20 yen at the previous term-end to 899.90 yen.

Cash Flows

Cash and cash equivalents at the end of term stood at 15.6 yen billion, a decrease of 800 yen million on the previous term.

Net cash provided by operating activities amounted to 44.7 yen billion (an increase of 15.4 yen billion on the previous year) due to the fact that the combined amount of increases in pre-tax income (78.5 yen billion) and depreciation expenses, which are non-cash, (26.7 yen billion) exceeded the amount of income taxes paid.

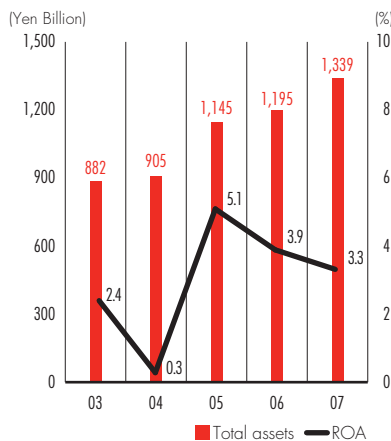
Net cash used in investing activities amounted to 25.6 yen billion, a year-on-year increase of 3.1 yen billion, as a result of capital investment in fixed assets accompanying refurbishment of filling stations and refining facilities.

Net cash flow used in financing activities amounted to 21 yen billion, a decrease of 7.3 yen billion from the previous year. Dividend payments of 13.5 yen billion and debt repayments of 7.3 yen billion were part of this cash usage.

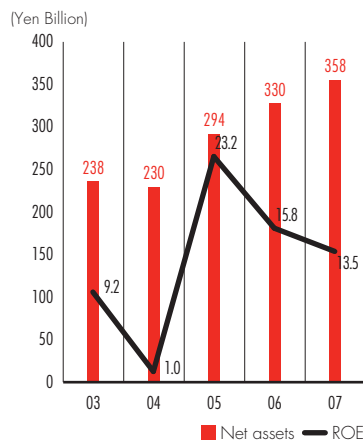
Outlook for 2008

In fiscal 2008, we expect crude oil prices to remain high. Due to this we project consolidated sales of 3,140 yen billion, consolidated ordinary income of 60 yen billion, and consolidated net income of 35 yen billion. On a current cost of supply basis, we project ordinary income to be 50 yen billion. These forecasts are based on assumptions of an average crude oil price of 91.3 dollars per barrel in the first fiscal quarter, 95 dollars per barrel in the second quarter, and 93 dollars per barrel in the second half of the fiscal year. The forecasts are also based on average exchange rate assumptions of 105.2 yen to the US dollar in the first quarter, 100 yen to the dollar in the second quarter, and 102 yen to the dollar in the second half.

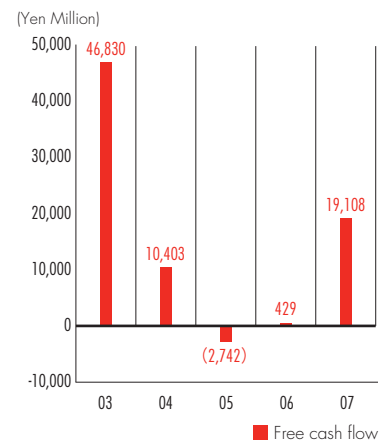
Total Assets/ROA



Net Assets/ROE



Free Cash Flow



* Free cash flow = Cash flow from operating activities + Cash flow from investing activities

CONSOLIDATED BALANCE SHEET

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
As of 31 December 2007

	Yen Million	
	2007	2006
ASSETS		
Current assets		
Cash and deposits (Note 12)	¥ 16,479	¥ 16,645
Notes and accounts receivable – trade (Note 14)	386,151	326,121
Inventories	361,738	276,298
Deferred tax assets (Note 7)	10,738	7,611
Others (Note 9)	27,920	24,748
Provisions for doubtful debts	(336)	(401)
Total current assets	802,691	651,025
Fixed assets (Notes 6, 11 and 12):		
Tangible fixed assets		
Buildings and structures	114,352	116,967
Tanks	11,773	10,768
Machinery and equipment	123,934	125,855
Land	162,295	162,162
Construction in progress	3,148	5,795
Others	5,467	5,313
Total tangible fixed assets	420,972	426,862
Intangible fixed assets		
Goodwill	1,207	1,629
Leasehold	3,972	3,692
Software	5,048	5,084
Others	927	1,051
Total intangible fixed assets	11,155	11,458
Investments		
Investment securities (Note 4)	53,000	54,509
Long-term loans	856	997
Deferred tax assets (Note 7)	24,677	25,362
Others (Note 9)	26,818	25,988
Provisions for doubtful debts	(1,057)	(1,189)
Total investments	104,295	105,669
Total fixed assets	536,423	543,990
Total assets	¥ 1,339,114	¥ 1,195,015

The accompanying notes are an integral part of these financial statements.

	Yen Million	
	2007	2006
LIABILITIES		
Current Liabilities		
Notes and accounts payable – trade (Note 14)	¥ 387,675	¥ 291,289
Short-term debts (Notes 5, 12 and 13)	82,602	51,254
Accounts payable – other (Notes 12 and 14)	201,629	201,769
Income taxes payable	22,976	9,032
Accrued expenses	14,042	11,666
Provisions for employees' bonuses	2,092	2,142
Provisions for directors' bonuses	63	62
Commercial papers (Note 5)	24,000	68,000
Others (Notes 9 and 14)	49,757	43,789
Total current liabilities	784,839	679,006
Long-term Liabilities		
Bonds (Note 5)	30,000	30,000
Long-term debts (Notes 5 and 12)	46,532	41,272
Deferred tax liabilities (Note 7)	8,441	7,418
Provisions for employees' retirement benefits (Note 8)	73,888	78,554
Provisions for special maintenance	12,809	11,353
Others (Note 9)	24,331	16,453
Total long-term liabilities	196,005	185,052
Total liabilities	980,845	864,058
NET ASSETS		
Shareholders' equity		
Share capital		
Authorised 440,000,000 shares		
Issued shares 376,850,400 shares in 2007 and 2006	34,197	34,197
Capital surplus	22,112	22,111
Retained earnings	278,251	248,108
Treasury shares		
216,636 shares as of 31 December 2007 and 527,370 as of 31 December 2006	(174)	(422)
Total Shareholders' equity	334,386	303,995
Valuation and translation gains/losses		
Unrealised gains/losses on investment securities, net of income taxes	4,546	5,416
Minority interests	19,336	21,544
Total net assets	358,269	330,956
Total liabilities and net assets	¥ 1,339,114	¥ 1,195,015

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
Year ended 31 December 2007

Yen Million

2007								
	Shareholders' equity					Valuation & translation gains/losses	Minority interests	Total net assets
	Share capital	Capital surplus	Retained earnings	Treasury shares	Total shareholders' equity	Unrealised gains/losses on investment securities, net of income taxes		
Opening balance	¥34,197	¥22,111	¥248,108	¥(422)	¥303,995	¥5,416	¥21,544	¥330,956
Changes in the period								
Dividend			(13,555)		(13,555)			(13,555)
Net Income			43,729		43,729			43,729
Acquisition of treasury shares				(11)	(11)			(11)
Reissuance of treasury shares		1		259	260			260
Changes in interest in a consolidated subsidiary			296		296	7	(478)	(174)
Decrease resulting from inclusion of a subsidiary in consolidation			(327)		(327)			(327)
Net changes in items other than shareholders' equity						(878)	(1,730)	(2,608)
Total changes in the period	—	1	30,142	247	30,391	(870)	(2,208)	27,312
Closing balance	¥34,197	¥22,112	¥278,251	¥(174)	¥334,386	¥4,546	¥19,336	¥358,269

The accompanying notes are an integral part of these financial statements.

Yen Million

2006								
	Shareholders' equity					Valuation & translation gains/losses	Minority interests	Total net assets
	Share capital	Capital surplus	Retained earnings	Treasury shares	Total shareholders' equity	Unrealised gains/losses on investment securities, net of income taxes		
Opening balance	¥ 34,197	¥ 22,106	¥ 214,346	¥ (781)	¥ 269,869	¥ 5,362	¥ 18,859	¥ 294,091
Changes in the period								
Dividend			(12,412)		(12,412)			(12,412)
Directors' bonuses			(74)		(74)			(74)
Net income			46,249		46,249			46,249
Acquisition of treasury shares				(9)	(9)			(9)
Reissuance of treasury shares		4		368	373			373
Net changes in items other than 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

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Showa Shell Sekiyu K.K. and Consolidated Subsidiaries
Year ended 31 December 2007

	Yen Million	
	2007	2006
Cash flows from operating activities		
Net income before taxes	¥ 78,569	¥ 77,190
Depreciation	26,708	27,329
Impairment loss	7,505	2,462
Loss on disposal of fixed assets	5,971	3,869
Gain on sale of fixed assets	(3,484)	(5,119)
Provisions for termination of directors' retirement benefits	1,073	—
Loss on disposal of subsidiaries business assets	3,344	—
Change in provisions for doubtful debts	(195)	330
Change in provisions for employees' retirement benefits	(4,682)	(1,131)
Change in provisions for special maintenance	1,456	(5,874)
Interest and dividend income	(700)	(665)
Interest expense	3,926	3,729
Change in accounts receivable	(59,850)	(14,923)
Change in inventories	(84,883)	(39,271)
Change in accounts payable	91,460	44,809
Others	5,595	(12,839)
Sub total	71,816	79,896
Interests and dividends received	696	701
Interests paid	(3,881)	(3,912)
Corporate taxes paid	(23,835)	(47,373)
Cash flow from operating activities	44,796	29,312
Cash flows from investing activities		
Payments for purchase of fixed assets	(23,617)	(32,540)
Proceeds from sales of fixed assets	4,668	6,485
Payments for purchase of investment securities	(1,170)	(1,559)
Proceeds from sales of investment securities	268	1,064
Net change in short-term loans	(2,504)	(919)
Payments for long-term loans	(72)	(97)
Proceeds from collection of Long-term loans	6	67
Others	(3,267)	(1,385)
Cash flow from investing activities	(25,687)	(28,883)
Cash flows from financing activities		
Net change in short-term debts	34,281	13,053
Net change in commercial papers	(44,000)	(18,000)
Proceeds from long-term debts	10,000	—
Repayments of long-term debts	(7,673)	(11,367)
Proceeds from bond issues	—	15,000
Payments for purchase of treasury shares	(11)	(9)
Dividends paid	(13,555)	(12,412)
Dividends paid to minority shareholders of subsidiaries	(330)	(349)
Others	260	373
Cash flow from financing activities	(21,029)	(13,712)
Change in cash and cash equivalents	(1,920)	(13,282)
Cash and cash equivalents at beginning of year	16,541	29,354
Increase in cash and cash equivalents from newly consolidated subsidiaries	1,066	469
Cash and cash equivalent at end of year	¥ 15,686	¥ 16,541

Reconciliation between cash and cash equivalents at year-end and cash and deposit on the balance sheet

	Yen Million	
	2007	2006
Cash and deposits on the balance sheets	¥16,479	¥16,645
Time deposit exceeding 3 months	(792)	(104)
Cash and cash equivalents	¥15,686	¥16,541

The accompanying notes are an integral part of these financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying consolidated financial statements of Showa Shell Sekiyu K. K. (the "Company") and its consolidated subsidiaries (together, the "Companies") have been prepared in accordance with the provisions set forth in the Financial Instruments and Exchange Act 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 Financial Instruments and Exchange Act, 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 2007: (27 companies)

Showa Yokkaichi Sekiyu Co., Ltd.	Shoseki Overseas Oil Development Co., Ltd.	Shoseki Home Gas K.K.
Toa Oil Co., Ltd.	Petro Star Kansai Co., Ltd.	K.K. Shinyo Sekiyu
East Ohgishima 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 Co., Ltd.	Nakagawa Oil Co., Ltd.	Shoseki Engineering & Construction Co., Ltd.
Nippon Grease Co., Ltd.	Tokyo Shell Pack K.K.	Wakamatsu Gas K.K.
Shoseki Kako Co., Ltd.	Petro Star Kanto Co., Ltd.	Genex Co., Ltd.
Heiwa Kisen Kaisha, Ltd.	K.K. Sun Road	On-Site Power Co., Ltd.
Central Energy K.K.	Nissho Koyu K.K.	Showa Shell Solar Co., Ltd. [*1]

(*1) Showa Shell Solar Co., Ltd. has become a consolidated subsidiary from this financial year because of increased materiality by its business expansion.

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

b) Account closing dates

30 September	Petro Star Kansai K.K., Petro Star Kanto Co., Ltd., Nakagawa Oil Co., Ltd., K.K. Sun Road, K.K. Shinyo Sekiyu, Shoseki Home Gas K.K., and K.K. Marushin, Central Energy K.K.
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 2007: (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.	Mieseiki Shoji K.K.	Shell Sekiyu Osaka Hatsubaisho K.K.
Shell Tokuhatsu K.K.	Diashoseki Co. Ltd.	

(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 stated 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 Ohgimachi Factory of the Keihin Refinery of the company 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 Service Act.

(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 market 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 Companies Act 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 statement of cash flows 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) Reclassification

Certain accounts in the consolidated financial statements for the year ended 31 December 2006 have been reclassified to conform to the 2007 presentation.

3. Change in Accounting Policy**Depreciation method for fixed assets**

Effective from the current financial year, the Companies changed their accounting policies for depreciation of fixed assets due to the revision of Corporate Tax Law and regulations whereby tangible fixed assets acquired on and after 1 April 2007 have been depreciated with no residual amount, while depreciation had been allowed until 95% of acquisition costs of tangible fixed assets prior to revision. The effect of the change in this accounting policy was not material to the consolidated financial statements.

4. Securities**(1) Investment securities**

	Yen Million	
	2007	2006
Securities	¥ 24,489	¥ 26,098
Security investments in non-consolidated subsidiaries and affiliates	28,510	28,410
	¥ 53,000	¥ 54,509

(2) Securities with market value

	Yen Million		
	2007		
	Historical cost	Market value	Unrealised gain (loss)
Securities with unrealised gains:			
Equity securities	¥ 2,081	¥ 10,468	¥ 8,386
Securities with unrealised losses:			
Equity securities	10,047	8,396	(1,650)

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

(3) Securities sold

	Yen Million	
	2007	2006
Proceeds from sales of securities during the year	¥ 141	¥ 1,064
Realised gains	75	725
Realised losses	0	0

(4) Securities with no market value

	Yen Million	
	2007	2006
Unquoted securities		
Equity securities	¥ 5,609	¥ 5,614
Debt securities	15	15
	¥ 5,624	¥ 5,629

5. Short-term and Long-term Debts

(1) Short-term debts

	Yen Million	
	2007	2006
Short-term debts	¥ 77,870	¥ 43,589
Commercial papers	24,000	68,000
	¥ 101,870	¥ 111,589

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

	%	
	2007	2006
Short-term debts	0.35	0.18
Commercial papers	0.73	0.44

(2) Long-term debts

	Yen Million	
	2007	2006
Loans from banks, other financial institutions, etc.		
Due from 2008 to 2015	¥ 51,265	¥ 48,937
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	15,000
	81,265	78,937
Less: due within one year	4,732	7,665
	¥ 76,532	¥ 71,272

Note: The weighted average interest rate on long-term debts (excluding the one due in 1 year) from banks outstanding as of 31 December 2007 and 2006 were 1.68% and 1.74%, respectively.

Annual maturities of bonds

	Yen Million
	2007
Within one year	¥ —
More than one year less than two years	—
More than two years less than three years	15,000
More than three years less than four years	—
More than four years less than five years	—
More than five years	15,000
	¥ 30,000

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

	Yen Million
	2007
Within one year	¥ 4,732
More than one year less than two years	8,820
More than two years less than three years	8,063
More than three years less than four years	500
More than four years less than five years	10,000
More than five years	19,149
	¥ 51,265

(3) 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 10 billion yen balance as at 31 December 2007 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 2007 and 2006.

	Yen Million			
	2007			
	Acquisition Costs	Accumulated Depreciation	Accumulated Impairment Loss	Balance
Buildings, structures and tanks	¥ 315	¥ 254	¥ —	¥ 60
Machinery and equipment	12,790	4,761	3,754	4,273
Tools, implements and fixtures	2,472	931	—	1,541
Intangible fixed assets	38	13	—	24
	¥ 15,616	¥ 5,961	¥ 3,754	¥ 5,900

	Yen Million			
	2006			
	Acquisition Costs	Accumulated Depreciation	Accumulated Impairment Loss	Balance
Buildings, structures and tanks	¥ 312	¥ 216	¥ —	¥ 95
Machinery and equipment	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

Lease payments and depreciation for the years ended 31 December 2007 and 2006 amounted to 1,498 million yen and 2,037 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 payments of finance leases as of 31 December 2007 and 2006

	Yen Million	
	2007	2006
Due within one year	¥ 2,897	¥ 3,384
Due over one year	9,382	14,156
	¥ 12,279	¥ 17,540

b) Operating Leases

	Yen Million	
	2007	2006
Due within one year	¥ 102	¥ 90
Due over one year	113	125
	¥ 215	¥ 215

(2) Lessor

Finance leases

Scheduled maturities of future lease payments of finance leases as of 31 December 2007 and 2006

	Yen Million	
	2007	2006
Due within one year	¥ 1,809	¥ 1,422
Due over one year	4,569	3,724
	¥ 6,379	¥ 5,146

Note: They are sublease transactions.

7. Income Taxes

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

	Yen Million	
	2007	2006
Deferred tax assets:		
Provisions for employees' retirement benefits	¥ 31,624	¥ 31,887
Impairment loss on fixed assets	16,448	14,287
Valuation loss on investment securities and others	824	900
Provisions for doubtful debts	205	219
Others	20,278	16,139
Sub-total	69,382	63,435
Valuation reserve	(19,607)	(14,742)
Total deferred tax assets	¥ 49,775	¥ 48,693
Deferred tax liabilities:		
Reserve for advanced depreciation on fixed assets transactions	¥ (9,788)	¥ (9,688)
Unrealised gain on investment securities	(2,619)	(3,377)
Others	(10,393)	(10,134)
Total deferred tax liabilities	(22,801)	(23,200)
Net deferred tax assets / (liabilities)	¥ 26,974	¥ 25,492

(2) Reconciliation between the effective statutory tax rate and the actual tax rate
2007

	%
Effective statutory tax rate	40.7
(Adjustments)	
Entertainment expense and others that are not deductible permanently	0.5
Dividend income and others that are not taxable permanently	(1.1)
Increase/(decrease) in valuation reserve	6.1
Inhabitant tax on per capita basis	0.2
Others	(0.4)
Actual tax rate	46.0

2006

Information on 2006 accounts is omitted because there was no significant difference between the effective tax rate and the actual tax rate.

8. Provisions for Employees' 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 employees' retirement benefits

	Yen Million	
	2007	2006
Retirement benefit obligations	¥ (104,352)	¥ (105,977)
Pension assets	21,675	17,326
Unfunded retirement benefit obligations	(82,677)	(88,650)
Unrecognised actuarial differences	8,448	9,695
Unrecognised past service cost (reduction in obligations) (Note 1)	(510)	(567)
Unrecognised transition differences due to accounting changes	850	967
	¥ (73,888)	¥ (78,554)

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. The Company's retirement benefit scheme includes three consolidated subsidiaries.

3. The simple method is used for calculating retirement benefit obligations, except the Company 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. The Company has introduced a new retirement benefit system in which employees choose from a scheme for advance cash payment of 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.

6. Employee pension trust has been set since this financial year.

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

	Yen Million	
	2007	2006
Service cost	¥ 2,274	¥ 2,315
Interest cost	2,535	2,535
Expected return on pension assets	(667)	(924)
Amortisation of unrecognised actuarial differences	1,181	1,171
Amortisation of unrecognised post service costs	(57)	(57)
Amortisation of unrecognised transition differences due to accounting changes	117	117
	¥ 5,384	¥ 5,158

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 2007	As of 31 December 2006
Allocation method for retirement benefit expenses	Periodical straight line	Periodical straight line
Discount rate	2.5%	2.5%
Expected rate of return	3.7%	6.5%
Period for amortisation of past service cost	14 years	14 years
Period for amortisation of actuarial differences	13-14 years	13-14 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 nonperformance by counterparties, the Companies deal these derivatives with major financial institutions and trading companies with a high credit rating.

(2) Current Value of Derivatives

Yen Million			
31 December 2007			
	Notional Amount	Market Value	Unrealised Gain (Loss)
Foreign currency contracts (US\$)			
To buy	¥ 122,457	¥ 123,823	¥ 1,365
To sell	15,091	15,484	(392)
			¥ 973
Commodity-related transactions			
To buy	¥ 4,820	¥ 16,721	¥ 11,900
To sell	3,083	3,062	21
			¥ 11,921

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

Interest rate swaps, which meet specific matching criteria are not measured at market 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 2007 and 2006

Yen Million		
	2007	2006
Transportation	¥ 45,271	¥ 44,649
Salaries	30,095	29,746
Rents	4,749	4,843
Depreciation	5,007	5,173
Research and development expenses	2,014	1,866
Others	32,267	32,569
	¥ 119,405	¥ 118,847

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%.

Impairment loss was recorded at the amount by which the carrying amount of each asset group exceeded its recoverable value. For the year ended 31 December 2007, the Companies recognised impairment loss of 7,505 million yen on 92 groups of impaired fixed assets, which were accounted for as extraordinary 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:

Yen Million				
2007				
	Land	Lease assets	Others	Total
Service stations (20 groups)	¥ 943	¥ —	¥ 378	¥ 1,321
Idle assets (72 groups)	34	3,689	2,458	6,183
				¥ 7,505

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

12. Collateral Assets

As of 31 December 2007, 164,165 million yen assets were mortgaged for certain liabilities of the Companies (82,747 million yen).

13. Contingent Liabilities

The Companies had the following contingent liabilities as of 31 December 2007 and 2006:

	Yen Million	
	2007	2006
Guarantees for:		
Non-consolidated subsidiaries, affiliates and other companies	¥ 3,685	¥ 6,227
Employees (housing loan)	1,197	1,355
Discounts of notes receivable	—	121
	¥ 4,883	¥ 7,703

14. Related Party Transactions

When transactions of the Company with its related parties are more than 10% of the consolidated sales proceeds, or 10% of the total amount of the consolidated cost of sales and sales administrative and general expenses, for the years ended 31 December 2007 and 2006 are disclosed by each item.

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

(1) Related parties — Corporation

For the year ended 31 December 2007

Name	Capital (Yen Million)	Voting right share owing (share owned)	Yen Million			
			Transactions		Closing balances	
Saudi Arabian Oil Co., Ltd.	—	(Indirect 15.0%)	Purchase of crude oil and oil products	¥886,713	Accounts payable (trade)	¥88,173
Seibu Oil Co., Ltd.	8,000	Direct 38.0%	Purchase of oil products	358,792	Accounts payable (trade)	47,851
			Joint procurement of crude oil	—	Accounts receivable (trade)	28,319
Marubeni Energy Corporation	2,350	Direct 33.4%	Sale of oil products	184,914	Accounts receivable (trade)	19,687
Shell Chemicals Japan Ltd.	250	NA	Sales and purchase of oil products /purchase of petrochemicals	135,883	Accounts receivable (trade)	25,925
Shell Eastern Trading (P.T.E.) Limited	714	NA	Sales and purchase of crude and oil products	307,564	Accounts payable (trade)	9,756

For the year ended 31 December 2006

Name	Capital (Yen Million)	Voting right share owing (share owned)	Yen Million			
			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 Ltd.	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

(2) Related 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 2007 and 2006 are as follows.

For the year ended 31 December 2007

Name	Post	Voting right share owing (share owned)	Yen Million			
			Transactions		Closing balances	
Haruyuki Niimi	Chairman of SSSKK, Head Director of Showa Shell Sekiyu, Foundation for Promotion of Environmental Research	—	Donation	¥ 13	—	—

For the year ended 31 December 2006

Name	Post	Voting right share owing (share owned)	Yen Million			
			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 2007

Yen Million						
	Oil business	Property business	Other businesses	Sub-total	Internal trade	Total
I. Sales and operating income						
Sales						
(1) Sales to customers	¥ 3,047,065	¥ 4,270	¥ 31,306	¥ 3,082,641	¥ —	¥ 3,082,641
(2) Inter-segment sales and transfers	5,811	125	7,217	13,154	(13,154)	—
Sales	3,052,876	4,396	38,523	3,095,796	(13,154)	3,082,641
Operating expenses	2,968,310	1,539	37,112	3,006,962	(13,134)	2,993,828
Operating income	84,566	2,856	1,411	88,833	(19)	88,813
II. Assets, depreciation, impairment and capital expenditures						
Assets	¥ 1,297,407	¥ 30,394	¥ 53,564	¥ 1,381,367	¥ (42,252)	¥ 1,339,114
Depreciation	23,262	807	2,637	26,708	—	26,708
Impairment loss	2,107	—	5,398	7,505	—	7,505
Capital expenditures	22,603	76	3,155	25,835	—	25,835

For the year ended 31 December 2006

Yen Million						
	Oil business	Property business	Other businesses	Sub-total	Internal trade	Total
I. Sales and operating income						
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)	—
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 loss	2,462	—	—	2,462	—	2,462
Capital expenditures	30,057	125	3,812	33,995	—	33,995

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, lubricants, LP gas, bitumen, 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, solar powered cells business 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, impairment loss and capital expenditures.

(2) Geographic Segment Information

For the years ended 31 December 2007 and 2006, 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 2007

Yen Million			
	Asia	Others	Total
Overseas sales	¥ 189,705	¥ 119,320	¥ 309,026
Consolidated sales			3,082,641
Overseas sales as a percentage of total consolidated sales	6.2%	3.9%	10.0%

For the year ended 31 December 2006

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

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

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

4. Overseas sales regarding international trading business decreased by 104,049 million yen compared with the previous financial year, mainly because the Company has leased it to the Shell group since 1 August 2007.



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Report of Independent Auditors

To the Board of Directors of 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 2007, 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 consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 2007, 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

March 28, 2008

CODE OF CONDUCT

We, the directors, officers and employees of the company, affirm our commitment to the Management Philosophy. In order to meet the challenges of an ever-changing business environment and to increase the trust and confidence of all stakeholders in our company and earn the respect of society, we hereby promulgate the Code of Conduct based upon the Management Philosophy.

1. Objectives

Showa Shell's objective is to engage responsibly and efficiently in profitable business activities in the field of oil refining and sales and related areas, as well as in areas that arise from those businesses. The company shall strive for a high standard of performance and aim to maintain its position in the competitive environment.

2. Responsibilities

Showa Shell recognizes the following responsibilities:

- 1) **Responsibility to shareholders**
To be trusted with shareholders' investments and offer satisfying returns.
- 2) **Responsibility to customers**
To win and retain customers by developing and offering products and services valued in terms of price, quality, safety, and the environment. Such services are based upon Showa Shell's expert knowledge of technology, the environment, and the industry.
- 3) **Responsibility to employees**
To respect the characteristics and individuality of all employees and provide a safe working environment and positive working conditions. To further encourage employee development and utilization of their skills and promote employee participation in accordance with this Code of Conduct.
- 4) **Responsibility to Cooperating Companies**
To pursue mutually beneficial relationships with cooperating companies (including joint venture partners) and to endeavor to promote the practice of Code of Conduct principles. To make respect for the principles in this Code of Conduct one factor in commencing or continuing relationships with cooperating companies.
- 5) **Responsibility to society**
To conduct business as a responsible corporate citizen, comply with the law, and respect basic human rights. To further give ample consideration to health, safety, security, and the environment in the quest for sustainable development.

3. Economic Principles

Showa Shell realizes that sound profits are essential to fulfilling its responsibilities and sustaining its business. Profits are a measure of both the company's efficiency and customers' satisfaction with the company's products and services. Profits are also essential to allocating company resources and continuous investment in order to ensure a stable energy supply in response to customer needs. Without profits and a firm

financial base, the company cannot fulfill its responsibilities outlined above. Investment decisions are made not only with regard to economic feasibility, but also with serious consideration for other factors, including social and environmental impact.

4. Corporate Ethics

The company has formulated and observes internal regulations, and it demands honesty, integrity, and fairness in all aspects of business operations. The same is expected in its relations with all business partners. The offer, payment, solicitation, and acceptance of bribes in any form constitute unacceptable business practice. Employees must avoid conflicts of interest between their private financial interests and the conduct of company duty. 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 are subject to audit.

5. Political Activities

Showa Shell shall act in a socially responsible manner under the law in the pursuit of its business objectives. Showa Shell shall not make payments to political parties, organizations or their representatives or take part in party politics. However, it shall retain the right to make known its position on any matter that affects its own interests, or the interests of its employees, customers, or shareholders.

6. Health, Safety, Security, and Environment

Showa Shell shall make systematic and continuous efforts in the areas of health, safety, security, and the environment in the pursuit of ongoing corporate development. The company shall approach these matters as it does other critical business matters, and shall set goals for improvement and measure, evaluate, and report results.

7. The Community

Showa Shell shall, as a responsible member of society, make positive contributions to the community. The company recognizes that the most important contribution to society it can make is in performing its business activities as efficiently as possible.

8. Competition

Showa Shell shall compete freely and fairly in compliance with competition laws.

9. Communications

Showa Shell shall recognize the importance of disclosing corporate information due to the importance of its business activities and the effect they may have on the national economy as well as individuals. The company shall disclose such information in a timely and appropriate manner.

10. Showa Shell Group Companies

Showa Shell shall strive to ensure that its subsidiary companies adopt and adhere to this Code of Conduct, just as the company has committed to do.

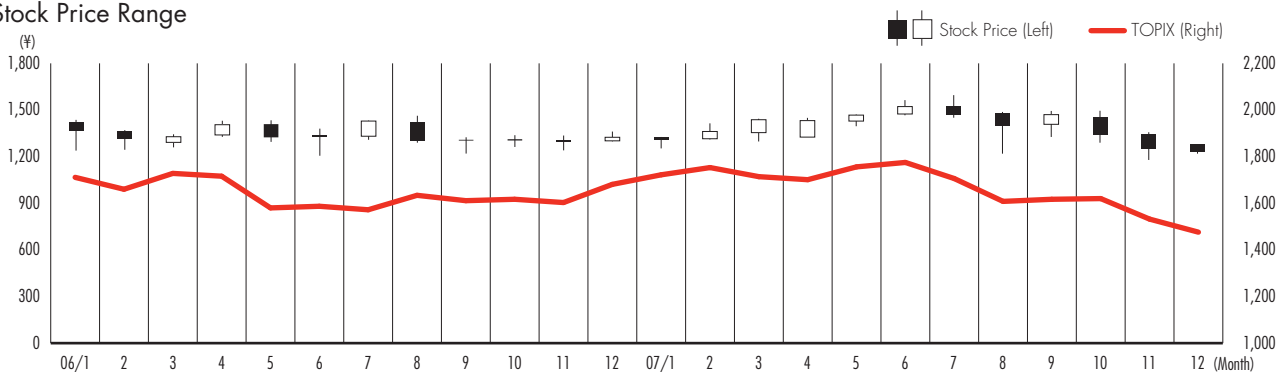
INVESTOR INFORMATION

Years ended December 31

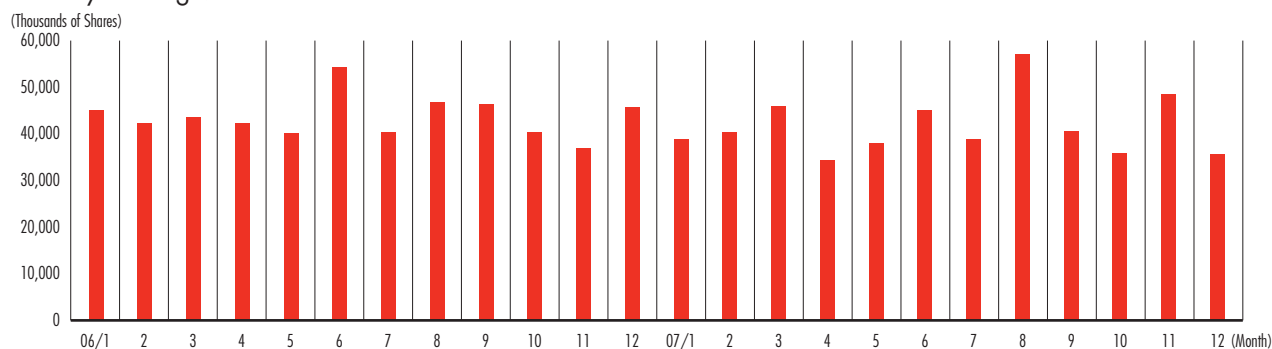
Date of Establishment:	January 1, 1985
Authorized Number of Shares:	440,000,000 shares
Number of Shares Issued:	376,850,400 shares
Paid-in Capital:	¥34,197,585,900
Number of Employees:	1,014
Total Number of Service Stations:	4,481
Number of Shareholders:	46,130
Securities Listings:	Tokyo Stock Exchange
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
Japan Trustee Services Bank, Ltd.	18,385.9	4.88
The Master Trust Bank of Japan, Ltd. (Trust Account)	14,960.0	3.97
Trust & Custody Services Bank, Ltd.	9,343.3	2.48
The Anglo-Saxon Petroleum Co., Ltd.	6,784.0	1.80
Investors Bank	5,574.9	1.48
Nomura Securities Co., Ltd.	5,100.6	1.35
Kochi Shinkin Bank	4,206.5	1.12
BNP Paribas Securities (Japan) Ltd.	3,709.8	0.98
Total	249,706.3	66.26

Stock Price Range



Monthly Trading Volume



Showa Shell Sekiyu K.K.

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