# Mobility Management
# For Sustainable Growth


## ANNUAL REPORT 2006

For the year ended March 31, 2006

COSMO OIL CO., LTD.

# COSMO OIL GROUP MANAGEMENT VISION

**H**armony and Symbiosis

### Harmony and Symbiosis with the Global Environment

We regard problems of the global environment as some of the most important issues to be resolved by all human beings, and will take positive action to protect the earth's environment.

### Harmony and Symbiosis between Energy and Society

As a company that shoulders part of Japan's energy supply, we see our mission as being to provide a reliable supply of safe and comfortable energy in awareness of the needs of consumers and society, and we aim to evolve further into a comprehensive energy supplier.

### Harmony and Symbiosis between Companies and Society

Based on the perception that society is the bedrock for the existence of companies, we will respect the law and international rules and act with a fair and social conscience, while also taking positive action to contribute to society and aiming for comprehensive growth in harmony with society.

**In striving for harmony and symbiosis between our planet, man and society, we aim for sustainable growth towards a future of limitless possibilities.**

**C**reating Future Values

### Creating Value From the Diverse Ideas of the Individual

We will respect individual interests and concerns, as well as innovative ideas and value creation arising from a positive attitude of pioneering change.

### Creating Value by Expressing Collective Wisdom

The entire Cosmo Oil Group will create new values and technologies by collectively sharing information, knowledge and experience, and collectively harmonizing individual self-realization.

### Creating the Value of "Customer First"

By developing and providing safe, reassuring products and services based on innovative ideas, we will raise levels of satisfaction in response to the wishes of consumers and users, and thereby enrich their lives.

# PROFILE

The Cosmo Oil Group, in order to provide stable supply, has established an integrated business domain that encompasses upstream operations (oil exploration, development, and production), mid-stream operations (petroleum refining) and downstream operations (sales of petroleum and petrochemical products). The Group, as the result of improvements to its earnings and financial structure in response to past periods of severe operating environs, implemented a "New Consolidated Mid-Term Management Plan" from April 2005 that represented a shift to a new growth strategy. The Group seeks to maximize corporate value in providing satisfaction for all of its stakeholders.

# CONTENTS

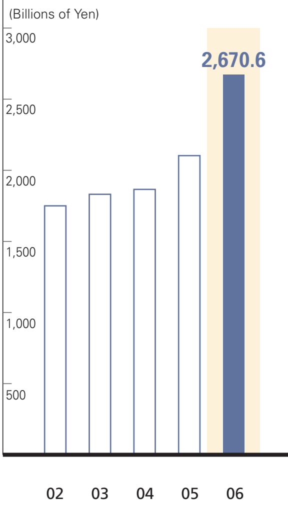
# FINANCIAL HIGHLIGHTS

*Cosmo Oil Company, Limited and Consolidated Subsidiaries. Years ended March 31*

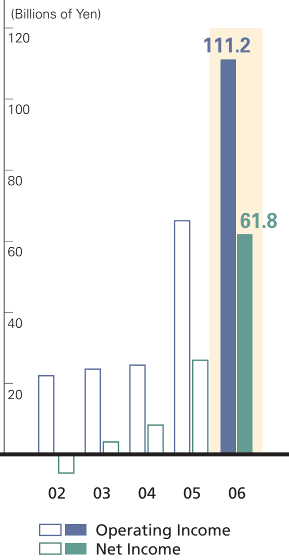
| | Millions of Yen | | | Thousands of U.S. Dollars |
|---|---|---|---|---|
| | 2004 | 2005 | **2006** | **2006** |
| **FOR THE YEAR:** | | | | |
| Net sales | 1,916,278 | 2,154,559 | **2,670,628** | **22,734,554** |
| Operating income | 25,246 | 65,698 | **111,248** | **947,033** |
| Net income | 8,179 | 26,415 | **61,795** | **526,049** |
| **AT YEAR END:** | | | | |
| Total assets | 1,260,092 | 1,323,149 | **1,463,579** | **12,459,173** |
| Shareholders' equity | 204,806 | 227,897 | **312,504** | **2,660,288** |
| Interest-bearing debt | 559,259 | 497,804 | **522,430** | **4,447,348** |
| | | Yen | | U.S. Dollars |
| **AMOUNTS PER SHARE:** | | | | |
| Net income per share | 12.95 | 41.73 | **94.54** | **0.80** |
| Shareholders' equity per share | 324.43 | 360.93 | **465.48** | **3.96** |
| Cash dividends | 6.00 | 8.00 | **10.00** | **0.09** |
| **RATIOS:** | | | | |
| ROA (%) | 0.7 | 2.0 | **4.4** | |
| ROE (%) | 4.1 | 12.2 | **22.9** | |
| Debt-to-equity ratio (Times) | 2.7 | 2.2 | **1.7** | |

*Note: U.S. dollar amounts in this report have been translated, for convenience only, at the exchange rate of ¥117.47 = $1.00, the prevailing rate at March 31, 2006.*

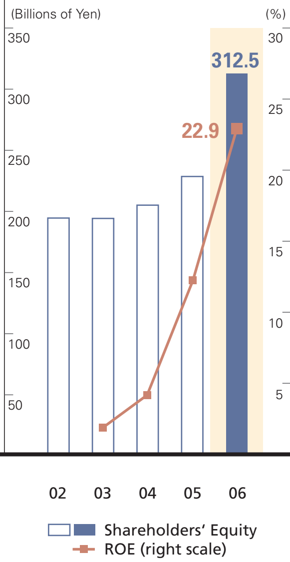
**NET SALES**



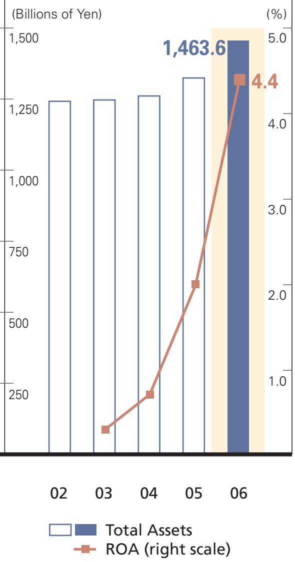

**OPERATING and NET INCOME**




**SHAREHOLDERS' EQUITY and ROE**

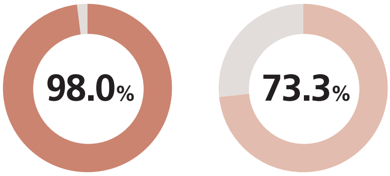



**TOTAL ASSETS and ROA**



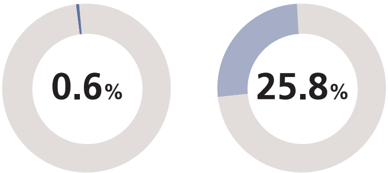
# AT A GLANCE

**Net Sales** **Operating Income**



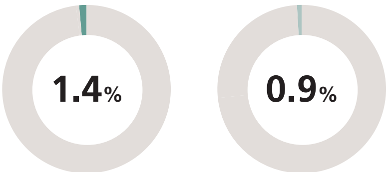

### Petroleum Business

Crude oil produced by the Cosmo Oil Group and imported from oil producing nations is refined at four domestic refineries for production and sales of petroleum products. Consolidated sales for this business in the fiscal year ended March 2006 were ¥2,616.9 billion (up ¥512.2 billion year-on-year) reflecting a rising in selling prices, while operating income was ¥83.5 billion (up ¥28.8 billion year-on-year) owing to the effects of value enhancement and cost rationalization and higher inventory valuations.




### Oil Exploration and Production

The Group produces crude oil in Abu Dhabi, UAE (United Arab Emirates) and Qatar. In the fiscal year ended March 2006, production volume was 24,850 barrels a day. As a result of continued stable crude oil production in the Middle East which is the Group's core production region, consolidated sales in this business for the fiscal year ended March 2006 were ¥17.0 billion (up ¥5.5 billion year-on-year) and operating income was ¥29.4 billion (up ¥17.4 billion year-on-year).

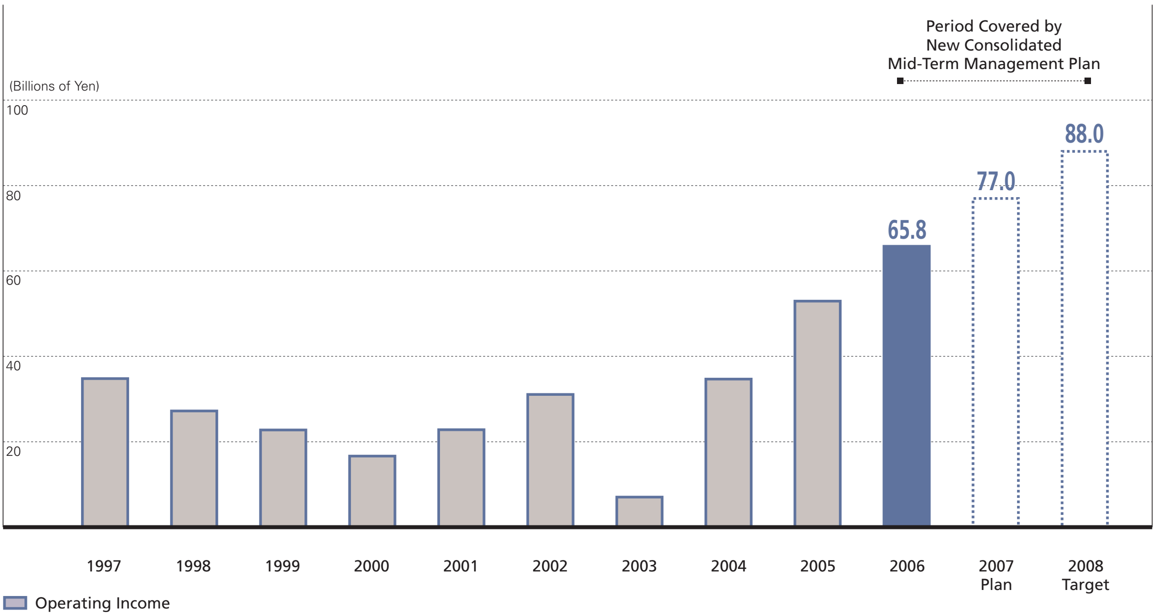



### Other Businesses

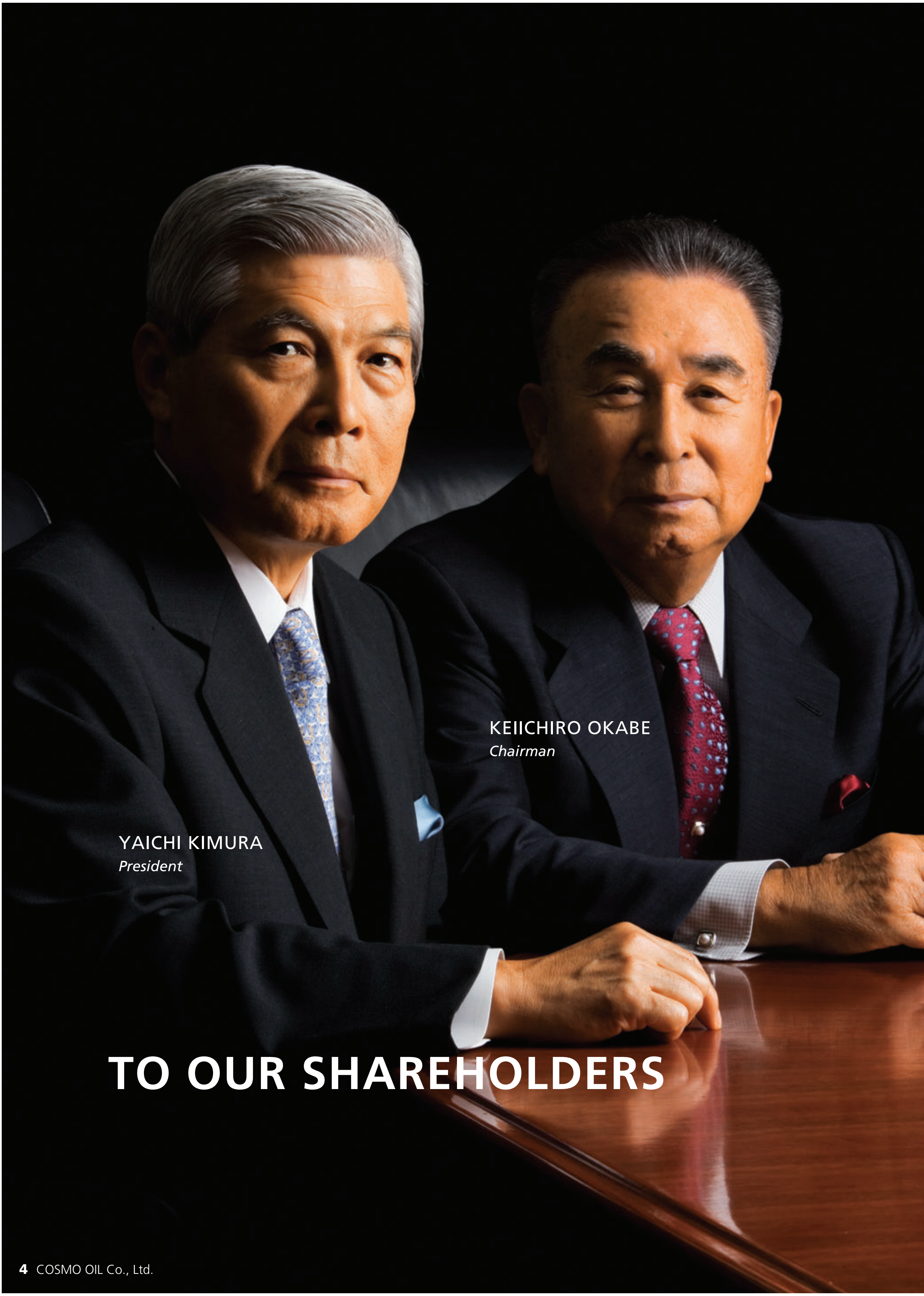
The Group is also involved in the purchasing, sale and rental of real estate properties, construction and leasing of petroleum-related facilities and insurance operations, and the Group is pursuing rationalization and efficiency improvements in each of these businesses. For the fiscal year ended March 2006, consolidated sales for other businesses were ¥36.7 billion (down ¥1.6 billion year-on-year) while operating income was ¥1.0 billion (up ¥1.1 billion year-on-year).

Note: Sales amounts adjusted for inter-segment sales. Operating income prior to eliminations or corporate adjustments.

## Trend in Operating Income Adjusted for the Impact of Inventory Valuations




* The gross average method was adopted as the inventory valuation method from fiscal 2001.
* Fiscal years ending March 31 of the following calendar year.



KEIICHIRO OKABE
*Chairman*

YAICHI KIMURA
*President*

# TO OUR SHAREHOLDERS

## The Cosmo Oil Group

**Petroleum Refining, Marketing**

**Oil Exploration and Production**

**Petrochemicals**

**Oil Related Businesses**

**New Businesses**

## The Cosmo Oil Group Mission and Vision

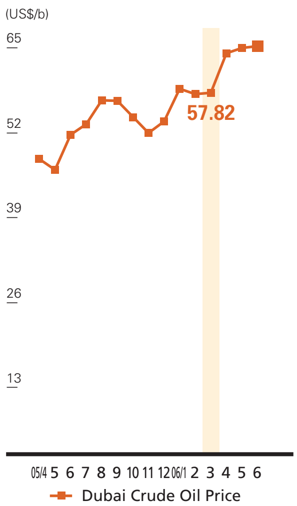
The Cosmo Oil Group's mission is to form a solid management base for operations encompasses oil production and exploration, petroleum refining/marketing and the petrochemical business, provides a stable source of energy, and fulfills its corporate social responsibilities in becoming a sustainable corporate group that continually responds to changes.

In facing its 20th year since its formation, the Group aims for continuous development over the next 20 years. Accomplishing this first requires the creation of a management base that responds to changes in the operating environment, and second requires social contribution in fulfilling corporate social responsibilities. In addition, we believe that the pursuit of the optimal balance of these two factors results in the maximization of corporate and shareholder value through the creation of trust and support from various stakeholders, including shareholders, consumers, employee, and society as a whole.

The Group's medium-term management strategy is to "maximize profit margins" in its core "Petroleum Refining and Marketing" Businesses, in its growth driver "Oil Exploration and Production" and "Petrochemicals" businesses, in affiliated company-centered "Oil Related" businesses and in "New Businesses" such as ALA (for details on ALA, please refer to the "Research and Development" section on page 24 of this report. ) that need to be nurtured as new business portfolios. Over the next 20 years, the Group aims to establish a presence as the "Asia" Cosmo Oil Group in evolving from the "Japan" Cosmo Oil Group.

Transparent, ethical management is a prerequisite for the execution of the Group's mission. As the stable supply of energy is the bedrock of the business, and based on the recognition that the assurance of safe operations is the basis for both corporate and social sustainable development, the Group places particular emphasis on thorough safety management. However, the occurrence of an accidental fire in the Group's Chiba refinery on April 16, 2006 is extremely regrettable, and we deeply apologize to our shareholders and to our various stakeholders for the concern caused. Going forward, the Group will be redoubling its efforts to continuously implement stronger safety measures in order to prevent the occurrence of such accidents and we will exert our utmost efforts to restore public trust in the Group.

## Dubai Crude Oil Price (Monthly average, FOB)

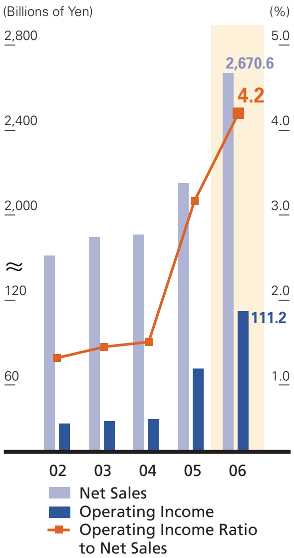



## Flexible Response to Changes in the Operating Environment Leveraging an Integrated Refining/Marketing Structure

The sharp gains seen in crude oil prices in the fiscal year ended March 2005 continued to trend at high levels in fiscal year ended March 2006. In addition to robust demand in Asia and North America, geopolitical risk in oil producing nations such as Iran and Nigeria added supply uncertainties. With prices also exacerbated by an influx of speculative money in the oil markets, Middle East produced Dubai crude oil prices in March 2006 hit a new historical high in the $60 per barrel range. Like petroleum products and crude oil, petrochemical product markets were also strong, mainly because of a tight supply-demand balance caused by a shortage of refining capacity in the U.S. and strong demand in Asia. While the continued new highs in crude oil prices were a profit windfall for the Group's oil exploration and production business on the one hand, these rises on the other hand led to higher costs for in-house fuel consumption which hurt profitability and accelerated the conversion to alternative fuels that was already beginning to emerge among mainly large users because of increased environmental awareness, which exacerbated the decline in heavy fuel oil demand.

In terms of overseas petroleum and petrochemical product markets, the Group worked to leverage the favorable market environment by increasing the amount of crude oil refined at its own refineries in order to reduce import volumes on the one hand, while proactively working to expand exports on the other. As a result, the Group was able to maintain high operating ratios at its refineries of an average 95.2% for the fiscal year ended March 2006. We believe that the Group's business structure of "integrated refining and marketing" made such a flexible response possible. In addition, CM Aromatics Co., Ltd. began production of mixed xylene during the fiscal year, thereby establishing a foothold in a business domain where we foresee strong petrochemical product demand.

Net Sales, Operating Income, Operating Income Ratio to Net Sales

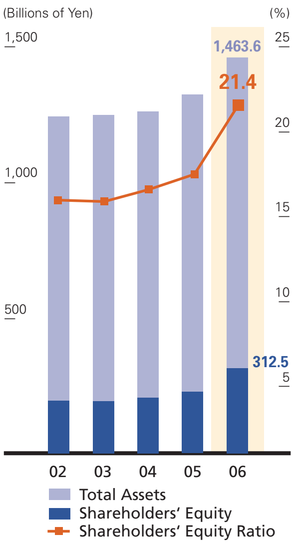



## New Historical Highs in Earnings for the Fiscal Year Ended March 2006

Consolidated net sales for the fiscal year ended March 2006 were ¥2,670.6 billion (up 24.0% year-on-year), operating income was ¥111.2 billion (up 69.3% year-on-year) and net income for the period was ¥61.8 billion (up 133.9% year-on-year), which represents the highest level of earnings recorded since the Group's founding in 1986. Operating income excluding the impact of inventory valuations was ¥65.8 billion. While the inability to fully transfer costs was a minus factor, the results of rationalization and value-added initiatives were greater than planned, which in addition to good performance from our oil exploration and production companies as well as the petrochemical company and other Group subsidiaries resulted in a ¥12.7 billion earnings increase over the previous fiscal year.

On the other hand, operating income excluding the impact of inventory valuations was ¥65.8 billion and ¥9.2 billion below the fiscal year target of ¥75.0 billion as was outlined in the "New Consolidated Mid-Term Management Plan". In addition to better-than-planned results from value-added enhancement and rationalization, there was a contribution from a flexible shift to exports utilizing our integrated refining and marketing structure. However, the reason the earnings target was not achieved was that the formation of prices in the domestic market was such that international crude oil prices could not be completely transferred despite the continued sharp rises in crude oil prices, which remains a major issue. In terms of major subsidiaries, crude oil production at our oil exploration and production companies and increased production of mixed xylene as planned both made a contribution to earnings.

Total Assets, Shareholders' Equity, Shareholders' Equity Ratio




## Solid Progress in the "New Consolidated Mid-Term Management Plan"

The Cosmo Oil Group's "New Consolidated Mid-Term Management Plan" covers a three-year period beginning from the fiscal year ended March 2006. The basic philosophy of the plan is "to establish a stable earnings base" and "shift toward a growth strategy". In order to achieve the targets of the Plan for the fiscal year ending March 2008 which are for operating income of ¥88.0 billion and net income of ¥41.2 billion, we are planning for strategic capital expenditures of ¥140 billion over the three years of the Plan and for an improvement in operating income of ¥35 billion compared to the fiscal year ended March 2005.

For the fiscal year ended March 2006, we achieved our target for net income and increased shareholders' equity by ¥84.6 billion to ¥312.5 billion including the capital increase in September 2005. As a result, the debt-to-equity ratio improved 0.5 points to 1.7X and ROE rose by 10.7 percentage points to 22.9%, thereby exceeding a targeted 13.3% and improving our financial stability.

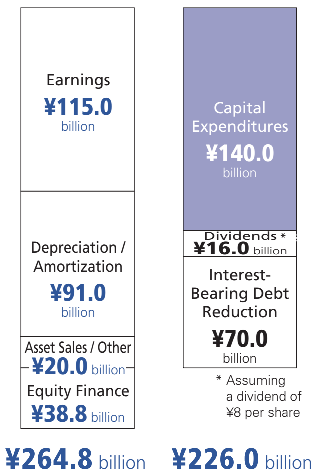
In addition, under "value-added enhancement" and "rationalization" which were a precept for achievement of the Plan, an improvement of ¥11.7 billion was achieved, which was 33% better than planned.

While continuing our energy saving initiatives in the supply area on the one hand and devising new equipment operation methods to increase value-added product production on the other hand, our earnings improvement program was a success.

In the marketing segment, our basic policy is to continue improving our marketing structure, petroleum product mix and channel structure, and the emphasis was on the three priorities of (1) active self-service SS development, (2) our card strategy and (3) building our network of "Auto B-cle" car care facilities, and our action program proceeded on schedule and made a contribution to the earnings improvement.

## Cash Flow Allocations

(Fiscal 2006–Fiscal 2008)



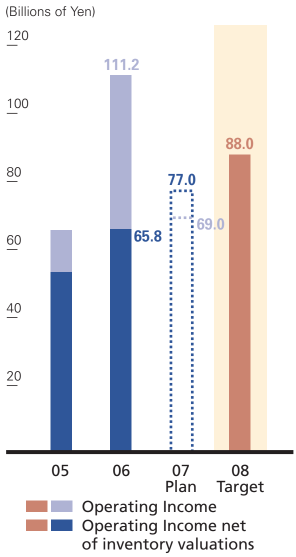

## Investment for Continuous Growth — Future Investment Plans and Equity Financing

Under the "New Consolidated Mid-Term Management Plan", capital expenditures of ¥140 billion are planned over a three-year period. Of this total, ¥99.0 billion has been earmarked for strategic investment. While this investment can be completely covered by planned cash flows during the three years of the Plan, we implemented equity financing as an alternative source of funds in order to implement planned investments without being influenced by the earnings environment. The funds procured were ¥38.8 billion through a public offering, a third-party allotment and an issue of non-collateralized convertible bonds with stock acquisition rights. The major components of the three-year cumulative ¥140 billion in planned capital investments are as follows.

| | | |
|---|---|---|
| ■ **Supply segment** | ¥40 billion | Product mix improvements in line with changes in the structure of demand and refinery upgrade with aim of enhancing the petrochemical business. |
| ■ **Oil exploration and production segment** | ¥30 billion | Maintain current production volumes at current operations in Abu Dhabi and Qatar and invest in capacity expansion. |
| ■ **Marketing segment** | ¥15 billion | Self-service SS construction and renewal |
| ■ **Petrochemical segment** | ¥34 billion | Construction of mixed xylene production facilities |
| ■ **Maintenance and repairs** | ¥41 billion | |
| ■ **Others** | ¥10 billion | |

Capital expenditures in the fiscal year ended March 2006 were ¥31.8 billion and ¥45.0 billion is planned for the fiscal year ending March 2007. Going forward, we will flexibly adjust capital expenditures in line with changes in the business environment as it works to maximize shareholder value.

## Earnings Plan / Target




* FY08 earnings assume no impact from inventory valuations.

## Management Issues

In order to achieve "sustainable development" and "maximization of shareholder value" the Cosmo Oil Group must flexibly respond to changes in the operating environment. In order to do this, we need to ceaselessly pursue structural management reforms in response to the market environment to achieve a more stable and solid management infrastructure. In addition, we believe it is important to conduct capital expenditures that anticipate future changes in the market environment in the pursuit of maximum future cash flows. In order to do this, we have identified two management issues that need to be addressed under the "New Consolidated Mid-Term Management Plan" that began from the fiscal year ended March 2006.

**(1) Improving the product mix and acquiring overseas sales routes in response to a maturation of the domestic petroleum industry and changes in the structure of demand.**

Domestically, continued high crude oil prices and growing environmental awareness is accelerating the decline in demand particularly among major consumers for industrial-use heavy distillates and demand is shifting to gasoline, diesel fuel and other fuels for

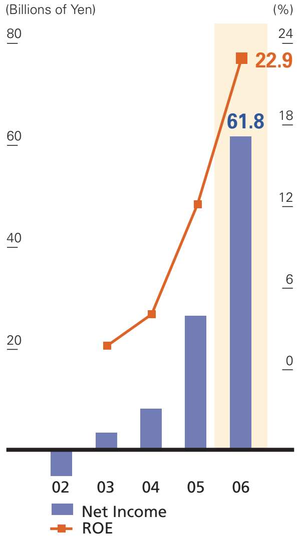
### Supply-Demand Balance Forecast for Petrochemical Products in Asia (2004–2010)

| | Demand Growth (%) | Supply-Demand Balance (Millions of Tons) |
|---|---|---|
| Ethylene Derivatives | **4.8** | **–5.7** |
| Polypropylene Derivatives | **5.6** | **–1.1** |
| Benzene | **4.9** | **–0.3** |
| Toluene | **3.1** | **–0.2** |
| Xylene | **2.0** | **–0.7** |
| Paraxylene | **6.6** | **–1.0** |

Note: Demand Growth: '04–'10, Average Growth per Annum
Supply-Demand Balance: 2010

Source: Japan Ministry of Economy, Trade and Industry, "Future Global Supply-Demand Balance Trends for Petrochemical Products"

### Net Income and ROE




transportation use. However, there is also the concern that demand for these fuel oils will also decline over the longer term, and the movement to strengthen environmental regulations is also a concern. On the other hand, continued high growth is foreseen in Asia. According to the Asian Development Bank, real GDP in 2006 for the Asia Pacific Region excluding Japan and other developed nations is forecast to grow 7.2% year-on-year for the fourth consecutive year of growth in the 7% range. The drivers for this demand are China and India, and future demand for petroleum and petrochemical products is expected to continue expanding. We believe new investment in refineries is urgently needed for the following three reasons. The first reason is the necessity to improve product mix in line with domestic and overseas changes in the structure of demand. The second reason is the need to expand the petrochemical business given the future growth we foresee. The third reason is the need to build a supply structure that can cope with more stringent environmental regulations. With regard to exports, as opposed to petroleum product exports heretofore which were mainly for domestic supply-demand adjustments, we need to acquire stable, long-term marketing routes and build the appropriate infrastructure.

**(2) Initiatives to accelerate strategic growth in the petrochemical business**

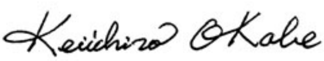
According to forecasts by Japan's Ministry of Economy, Trade and Industry, demand for petrochemical products in Asia between 2004–2010 is foreseen trending strong reflecting the forecast economic growth in the region. In particular, paraxylene demand is foreseen growing by an average 6.6% per annum. While there are plans to increase future production capacity, demand is foreseen exceeding supply up until 2010.

## The Cosmo Oil Concept of "Shareholder Value Maximization"

The Cosmo Oil Group's philosophy is to "aim for sustainable growth toward a future of limitless possibilities by striving for harmony and symbiosis between our planet, man and society", and we believe that the realization of this philosophy will lead to "shareholder value maximization". To realize this management philosophy, we have no other choice but to build a management infrastructure that can appropriately respond to changes in the operating environment, seek the acquisition of stable revenues, fulfill our corporate social responsibilities and contribute to society. By pursuing the optimal balance of the two drive wheels of "stable earnings" and "CSR management", we believe we can earn the trust of our various stakeholders, ensure that the business of the Group itself is sustainable and maximize future cash flows and in short "maximize shareholder value".

We promise to our shareholders and investors that we will continue to emphasize "shareholder value maximization".

June 2006



**Keiichiro Okabe**
Chairman

**Yaichi Kimura**
President

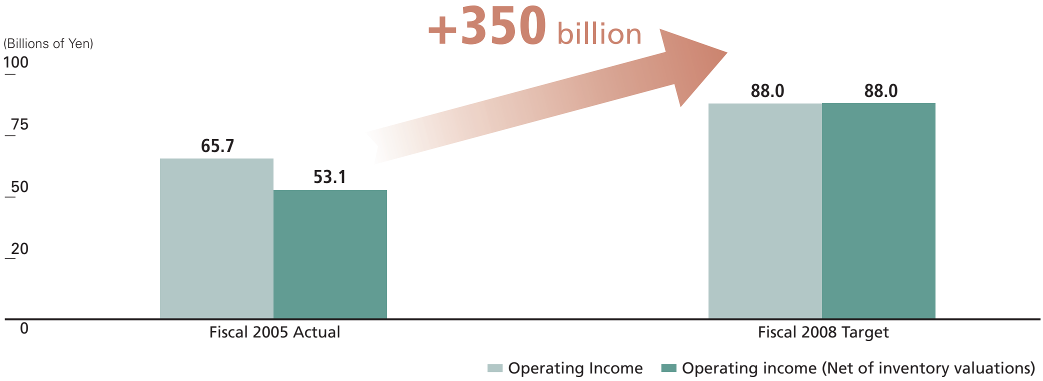
# NEW CONSOLIDATED MID-TERM MANAGEMENT PLAN

# NEW CONSOLIDATED MID-TERM MANAGEMENT PLAN
(Fiscal 2006–Fiscal 2008)

## EARNINGS TARGETS

| | 2008 |
|---|---|
| Operating Income<br>(Net of inventory valuations) | ¥88.0 billion<br>(88.0) |
| Ordinary Income<br>(Net of inventory valuations) | ¥82.0 billion<br>(82.0) |
| Net Income | ¥41.2 billion |
| ROE | 13.6 % |
| ROA | 3.1 % |
| Shareholders' Equity | ¥320.0 billion |
| Shareholders' Equity Ratio | 24.1 % |
| Debt-to-Equity Ratio | 1.3 x |

### ■ Fiscal 2008 Operating Income Target



## Fiscal 2008 Cumulative Improvement in Operating Income (Compared to fiscal 2005) ¥35.0 billion

### Cosmo Oil Non-Consolidated
**+¥21.2 billion**

- Value-added Enhancement +¥14.9 billion
  - Supply +¥6.0 billion
  - Marketing +¥8.5 billion
- Rationalization +¥6.0 billion
  - Supply +¥3.5 billion
  - Marketing +¥1.5 billion
- Other Factors +¥0.3 billion

### Affiliated Companies
**+¥13.8 billion**

- Oil Production and Exploration +¥5.8 billion
- Petrochemicals +¥2.7 billion
- Other Affiliates +¥5.3 billion

## Fiscal 2006–Fiscal 2008 Cash Flow Allocations

**Cash-in ¥264.8 billion**

- Earnings ¥115.0 billion
- Depreciation / Amortization ¥91.0 billion
- Asset Sales, Other ¥20.0 billion
- Equity Finance ¥38.8 billion

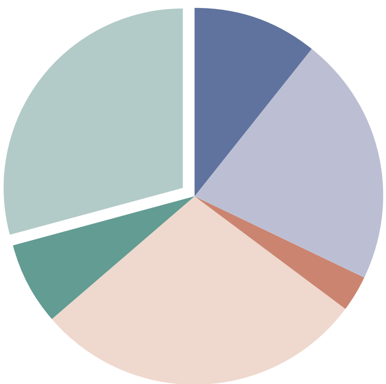
**Cash-out ¥226.0 billion**

- Capital Expenditures ¥140.0 billion
- Dividends ¥16.0 billion*
- Interest-bearing Debt Reduction ¥70.0 billion

*Assuming a dividend of ¥8 per share.

## Fiscal 2006–Fiscal 2008 Planned Capital Expenditures

**¥140.0 billion**

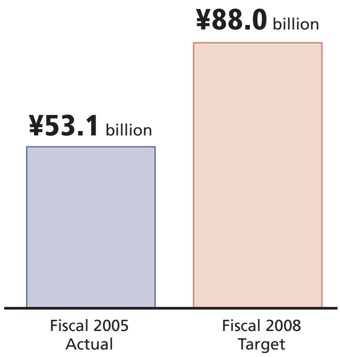


| | (Billions of Yen) |
|---|---|
| Marketing (Self-service SS) | ¥15.0 |
| Oil Exploration and Production | ¥30.0 |
| Supply (Petrochemicals) | ¥4.0 |
| Supply (Refinery upgrade) | ¥40.0 |
| Others | ¥10.0 |
| Maintenance and Repairs | ¥41.0 |

**New Consolidated Mid-Term Management Plan Operating Income Target**
(Net of inventory valuations)

**¥35.0** billion

| | |
|---|---|
| Cosmo Oil Non-Consolidated | **¥21.2** billion |
| Affiliated Companies | **¥13.8** billion |




## BASIC POLICIES OF THE NEW CONSOLIDATED MID-TERM MANAGEMENT PLAN

### — Establishing a Stable Earnings Base and Shifting to a Growth Strategy

The basic policies of the New Consolidated Mid-Term Management Plan have two pillars: establishing a stable earnings base and shifting to a growth strategy.

Establishing a stable earnings base refers to turning our attention from rationalization, a previous focus, to establishing an earnings base by enhancing value-added activities. At the same time, we will move toward a financial structure that will endure the risk of changes in the earnings environment.

Shifting to a growth strategy includes strategic capital investments to upgrade refineries, an approach which should bolster refinery profitability and expand the scale of our petroleum development, petrochemical and export businesses. The most noteworthy element of the New Consolidated Mid-Term Management Plan is its consistent focus on strategic investment and on improving financial structure. We aim to achieve ongoing growth by steadily implementing the measures outlined in this plan. In the final year of this plan (ending March 2008), we plan to achieve ¥88.0 billion in operating income, which represents a ¥35.0 billion increase in operating income over the fiscal year ended March 2005.

In terms of the operating environment that is the backdrop for our basic policies, we are aware of significant changes in the structure of demand, in that demand in Japan is shifting to lighter distillates while the overall volume of demand is declining on the one hand, while demand in the Asia Pacific region is expanding on the other. Crude oil prices remain high, while the price of light crude used to make lighter distillates is relatively higher due to the shift in demand to lighter distillates.

As for domestic demand, the Ministry of Economy, Trade and Industry (METI) has announced its New National Energy Strategy, which calls for the country to reduce its dependency on petroleum as a primary energy source from slightly less than 50% at present to less than 40% by 2030. The Cosmo Oil Group also forecasts an overall decrease in demand for heavy fuel oil, and is responding with a sense of crisis. High crude oil prices and growing environmental awareness are causing demand to decline particularly for heavy fuel oil for industrial use.

While the supply-demand balance in the retail segment is tighter than previously because of industry efforts to adjust refining capacity in line with total demand, there is still the risk of margin deterioration from excessive price competition at the distribution level among service stations. For the Group, while management reforms spanning many years have improved our profit structure, it is also true that the potential for further rationalization is decreasing year by year. In addition, while financing risk has abated in line with the improvement in financial markets, we believe continued improvement in our financial structure is required to alleviate the risk of impending rises in interest rates.

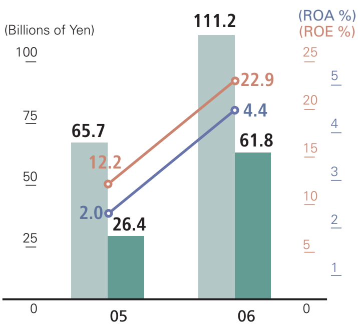
On the other hand overseas economic expansion in Asia—particularly China and India—is leading to higher demand for crude oil, petroleum products and petrochemicals. By shifting our focus to pan-Asia, we believe the environment shows good potential and is ripe for growth industries.

## New Consolidated Mid-Term Management Plan

| | Planned | Actual |
|---|---|---|
| Operating Income | 710 | 1,112 |
| (Net of inventory valuations) | 750 | 658 |
| Ordinary Income | 700 | 1,196 |
| (Net of inventory valuations) | 740 | 742 |
| Net Income | 320 | 618 |
| ROE (%) | 13.3 | 22.9 |
| ROA (%) | 2.4 | 4.4 |
| Interest-Bearing Debt | 4,662 | 5,224 |
| Shareholders' Equity | 2,548 | 3,125 |
| Shareholders' Equity Ratio (%) | 19.3 | 21.4 |
| D/E Ratio (X) | 1.8 | 1.7 |

(Unit: Billions of Yen)

## Actual Operating and Net Income, ROE, ROA




* Includes the impact of inventory valuations

# OPERATING PERFORMANCE IN THE FISCAL YEAR ENDED MARCH 2006

### ■ Overview of the Fiscal Year Ended 2006

The targets for the fiscal year ended March 2006 were for operating income of ¥71.0 billion, ordinary income of ¥70.0 billion and net income of ¥32.0 billion. Excluding the impact of inventory valuations, targets for the fiscal year were ¥75.0 billion and ¥74.0 billion for operating income and ordinary income respectively. Against these targets, operating income totaled ¥111.2 billion, and ordinary income was ¥119.6 billion for the fiscal year. Excluding inventory valuations, operating income was ¥65.8 billion (12.3% less than the target) and ordinary income was ¥74.2 billion (2.7% above). Thus, while operating income fell below the target amount, ordinary income was approximately on target, owing to equity in the earnings of affiliates, foreign currency exchange gains.

### ■ Petroleum Business (Oil Refining and Sales, Petrochemical Business)

In the fiscal year ended March 2006, the petroleum business delivered operating income of ¥83.5 billion, but excluding income from inventory valuations of ¥45.4 billion, operating income was ¥38.1 billion (20.63% below the plan's target). The primary reason for the decrease in operating income excluding inventory valuations was that sharply higher crude oil prices caused a rise in costs that could not be passed on sufficiently to market prices, which caused operating income to decline ¥16.5 billion year-on-year. On the other hand, value-added enhancement and rationalization contributed ¥11.7 billion (32.95% above the plan's target).

In addition, business results for CM Aromatics Co., Ltd., and Cosmo Matsuyama Oil Co., Ltd. were favorable, with these two companies recording combined operating income of ¥2.6 billion. In July 2005, CM Aromatics began the manufacture and sale of mixed xylene, which is used in the production of paraxylene, a raw material for the production of polyethylene terephthalate (PET) bottles and polyester fibers. This company generated operating income of ¥1.0 billion. Cosmo Matsuyama Oil produced operating income of ¥1.6 billion. Thanks to these results, the petrochemical business exceeded the performance targets defined in the New Consolidated Mid-Term Management Plan.

Exports of petroleum products, particularly diesel fuel, increased substantially, contributing ¥6.6 billion more to operating income than during the preceding year. In this area, we work to anticipate the balance between supply and demand in Japan and overseas and respond precisely to changing market conditions. Such flexible management policies enabled us to optimize sales and distribution amounts, thereby maximizing revenues.

### ■ Oil Exploration and Production

In the oil exploration and production business, we own rights to Abu Dhabi Oil Co., Ltd. and Mubarras Oil Co., Ltd. in the United Arab Emirates, and these companies contributed to consolidated performance. Although maintenance at producing wells caused sales volume to decline compared with the previous term, owing to high crude oil prices this business delivered operating income of ¥29.4 billion (33.64% higher than the plan's target).

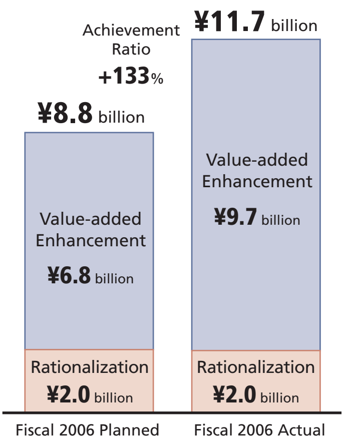
### ■ Other Businesses

We worked to rationalize and improve efficiency in such businesses as real estate sales and leasing, the construction and leasing of oil development equipment, and insurance. Other businesses provided operating income of ¥1.0 billion (approximately in line with the plan's target).

**Value-added Enhancement and Rationalization:**
Progress in the fiscal year ended March 2006

| | Planned | Actual |
|---|---|---|
| Value-added Enhancement | | |
| Supply | 2.8 | 4.8 |
| Marketing | 3.9 | 4.9 |
| Other | 0.1 | 0.0 |
| Subtotal | 6.8 | 9.7 |
| Rationalization | | |
| Supply | 1.7 | 1.5 |
| Administration | 0.3 | 0.5 |
| Subtotal | 2.0 | 2.0 |
| Total | 8.8 | 11.7 |

(Unit: Billions of Yen)




## Results of Fiscal 2006 Initiatives

### Value-Added Enhancement and Rationalization Deliver ¥2.9 Billion More than Targeted, for an Achievement Ratio of 133%

#### ■ Overview of Value-Added Enhancement and Rationalization

Achieving the revenue and earnings targets defined in the New Consolidated Mid-Term Management Plan requires that Cosmo Oil, during the three years from fiscal 2006 to fiscal 2008, deliver total profit improvements of ¥20.9 billion on a non-consolidated basis, comprising value-added enhancement of ¥14.9 billion and rationalization of ¥6.0 billion. For the fiscal year ended March 2006, the plan specified targets for value-added enhancement of ¥6.8 billion and rationalization of ¥2.0 billion, totaling ¥8.8 billion. Compared to the Plan, actual results were value-added enhancement of ¥9.7 billion (43% above the planned amount) and rationalization of ¥2.0 billion (exactly on plan), for a total of ¥11.7 billion (33% above planned), substantially higher than the plan's targets.

#### ■ Value-Added Enhancement during the Fiscal Year ended 2006: ¥9.7 Billion

In the fiscal year ended March 2006, the New Consolidated Mid-Term Management Plan sets the targets for value-added enhancement of ¥2.8 billion in the supply segment and ¥3.9 billion in the marketing segment. Actual value-added enhancement during the fiscal year ended March 2006 was ¥4.8 billion in the supply segment and ¥4.9 billion in the marketing segment. The total, therefore, was ¥9.7 billion, a target achievement of 143%.

In the supply segment, efforts to flexibly expand exports resulted in the merit of increased in-house refining. In addition, a profit improvement program was introduced at refineries to increase equipment operating efficiency, which allowed higher production of value-added products and resulted in a 171% target achievement. In the marketing segment, aggressive efforts to leverage the development of self-service gas stations and a shift toward a more highly profitable sales route structure, oil product mix and channel configuration resulted in a target achievement ratio of 126%.

#### ■ Rationalization during the Fiscal year ended 2006: ¥2.0 Billion

Under the New Consolidated Mid-Term Management Plan, the main rationalization target is a reduction of refining costs. Through the successful implementation of energy conservation measures such as the introduction of highly efficient equipment, the proportion of variable costs has been reduced in the supply segment. In the fiscal year ended March 2006, the improvement owing to rationalization was in line with the planned amount of ¥2.0 billion, comprising supply segment contributions of ¥1.5 billion and ¥0.5 billion from others.

## Pushing Forward with Structural Reform to Strengthen Sales

Of the structural reforms that the Cosmo Oil Group is carrying out, successes in the marketing segment are most apparent. As strengthening the refining and marketing segment had become a management issue for the Group, both the previous consolidated management plan and the New Consolidated Mid-Term Management Plan include the fundamental policies for sales of raising the profitability of the sales segment by improving the configuration of sales routes,

## Basic Policy on Sales

**Improve sales route structure**

Strengthen cooperation with SS operators and the Group's sales subsidiary, which operate highly profitable sales routes

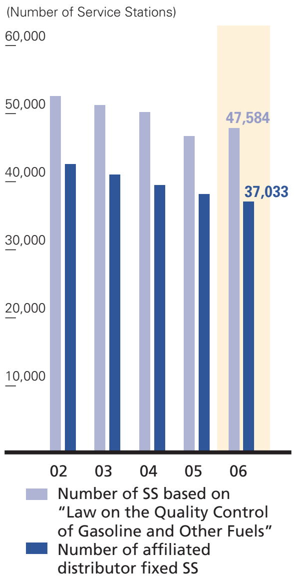
**Improve petroleum product mix**

Shift to sales of high-value-added distillates

**Improve channel structure**

Actively open self-service SS, with a focus on investment efficiency

### Trend of Nationwide SS




Sources: Agency for Natural Resources and Energy, Monthly Gasoline Stand

petroleum product mix and channels. We sell multiple products, ranging from relatively high-value-added petroleum products, such as gasoline and diesel fuel, to heavy fuel oil, which is experiencing a significant demand downturn. Furthermore, sales routes and channels are varied, with even the same petroleum products delivering different levels of profitability depending on the sales routes and channels used. To make sales more profitable, we recognized the need to employ high-value-added sales routes and channels and increase the sales volume ratio made up by certain oil products. The Group realized that its only option was to increase the sales volume ratio of gasoline and diesel fuel through service stations (SS) operated by local affiliated distributors and the Group's sales subsidiary.

### Sales Route Structure Improvements

In the Japanese oil industry, it is typical for petroleum refiners and primary distributors to wholesale petroleum products to SS operators (affiliated distributors) through sales agreements, and refineries rarely directly participate in the retail business. Given the market environment, sales route structure improvements involve revising the relationships with the distributors that sell the Group's products and shifting to a firmer profit structure. While working to strengthen relationships with competitive affiliated distributors, the Group is also working to strengthen the competitiveness of its sales subsidiary. As a result the Group's sales subsidiary's provision of its accumulated sales, rationalization and efficiency enhancement know-how to affiliated distributors produces synergy effects.

By volume, our sales subsidiary has a sales ratio for gasoline and diesel fuel of approximately 30%—one of the highest levels in the industry. The Cosmo Group is highly competitive because it is able to generate profits from its retail business as well as the wholesale business.

Transforming customary business practices and changing our consciousness has heightened our sales ability as well. By transforming customer business practices, we have made wholesale pricing more systematic, and we have altered our awareness so as to always take a sales approach toward our customers. These changes have created a new management style within the Group which has helped to strengthen our earnings base.

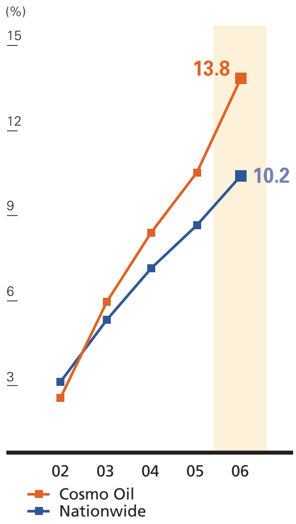
These structural reforms are benefiting SS operators as well as our sales subsidiary, and we believe the ensuing results for our sales segment are the biggest overall advantage for the Group.

### Petroleum Product Mix and Channel Configuration Improvements

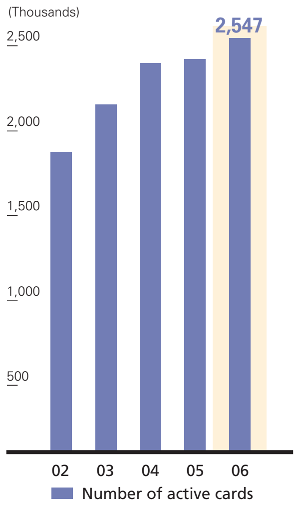
In the Group's sales structure, sales of gasoline, kerosene and diesel fuel are the most profitable for the SS channel, and the distillate mix improves as the channel configuration improves. As channels and distillate mix improve, it will be necessary to shift our SS channel portfolio toward self-service SS where there is high customer demand, and then to self-service SS with highly profitable car-care facilities. To achieve these aims, we are examining our SS portfolio by region, taking detailed demand movements into consideration as we seek to allocate our SS network in an optimal manner.

The total number of SS in Japan at the end of March 2000 was 55,153. This number had fallen 13.8%, to 47,584, as of the end of March 2006, while self-service SS had risen from 0.3% to 10.2% of the total. Owing to active investment in this area, in the same period the Group's percentage of self-service SS had risen from 0.1% to 13.8%, substantially surpassing the industry levels.

## Trend in Self-Service SS Ratio




## Number of Active "Cosmo The Card"




**■ Self-Service SS, Auto B-Cle Network and "Cosmo the Card" Credit Cards**

The Cosmo Oil Group is focused on improving its sales routes, distillate product mix, and channels, and will be solidifying these improvements by developing self-service SS, the Auto B-Cle network of car care convenience stores and "Cosmo the Card," which boasts one of the highest memberships in the industry. At the same time, the Group will be providing its local distributors with this know-how.

One reason customers support self-service SS is increasing gasoline prices, which grow higher each year. The Group is steadily increasing its ratio of self-service SS, and as noted earlier we outpace industry trends in this respect. A prompt "Cosmo the Card" issue function helps to draw in customers when SS are first opened and stabilizes our customer base.

While the cheaper gasoline prices at the pump are a factor in the growing demand for self-service SS, meeting customer needs with price alone would exacerbate price competition. Simultaneously providing customers with highly profitable car care services is therefore important. The Auto B-Cle network configures an SS into a car-care service offering automotive products, mandatory vehicle inspection and maintenance. In the fiscal year ended 2006, gross profit on Auto B-Cle SS averaged approximately ¥2.5 million/month, substantially outpacing the ¥1.8 million/month generated by the Group's affiliated standard SS.

The initial purpose behind "Cosmo the Card" was to deepen customer loyalty, first by ensuring steady revenue from fuel oil sales. However, as customers begin to periodically visit our SS, they develop a rapport with SS staff, which can translate into increased revenues from car care. To maximize these earnings, in January 2006 we entered into an agreement with the Aeon Group, the largest general merchandise store, to attract new card members.

## Sales Strategies Contributing to Higher Earnings

One factor behind the Group's competitiveness is its ability to operate flexibly in response to fluctuating crude oil prices, domestic and overseas supply-demand balances, and market conditions.

In addition, as refining and sales operations, where conflicts of interest are likely to arise, are not separate companies for the Cosmo Group, we have therefore been successful at finding a balance that is optimal for the Group as a whole. In the fiscal year ended 2006, we anticipated the differences between domestic and overseas prices on products, as well as the shifts in product margins, and therefore increased our refineries' production of kerosene for use in winter months. In addition to reducing our imports of kerosene, we were able to increase exports of diesel fuel, for which overseas market demand was firm. The Group has a demand-supply adjustment council, which facilitates a flexible response. This coalition between our supply, sales and planning departments meets regularly to reconfirm the Group's production status, sales conditions in Japan and overseas and inventory position. We then aim our operations toward a supply-demand balance that will maximize earnings.

We view exports as a long-term sales route. In fiscal 2002, our exports of diesel fuel (equivalent to 8% of our domestic sales volume) totaled 399,000 kiloliters. In the fiscal year ended March 2006, this amount had increased to 914,000 kiloliters (18.9% of domestic sales volume), or 229% of the fiscal 2002 level. In the past, as Japanese refineries were designed, constructed and

### Petrochemical Company Planned/Actual Operating Income

(Billions of Yen)

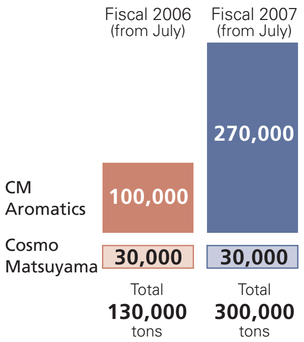
| Company Name | Fiscal 2006 Planned | Fiscal 2006 Actual | Fiscal 2008 Target |
|---|---|---|---|
| Cosmo Matsuyama | 1.1 | 1.6 | 1.3 |
| CM Aromatics | — | 1.0 | 2.7 |
| Total | 1.1 | 2.6 | 4.0 |

operated mainly for meeting domestic demand, we believe it will be necessary to develop refinery infrastructure for export going forward.

The Group has allocated capital expenditures for expanded export infrastructure in the fiscal year ending March 2007. In the past, geographic considerations have limited our exports of petroleum products to nearby countries, but growing environmental concerns are causing an increase in demand for high-quality Japanese products, such as low-sulfur gasoline and diesel fuel. For this reason, we expect sales to increase to developed nations in Europe and the Americas.

## Status of Progress in Petrochemicals
## — Commencement of Mixed Xylene Production and Sales, and Future Plans to Increase Production Capacity

### Planned Mixed Xylene Production Expansion




In April 2005 the Cosmo Oil Group entered an agreement with Maruzen Petrochemical Co., Ltd., establishing CM Aromatics Co., Ltd. as a joint venture. In July of the same year, the company began production and sales of mixed xylene at a rate of 100,000 tons/year. Mixed xylene is used in the production of paraxylene, which is a raw material for PET bottles and polyester fibers. Demand for this substance is skyrocketing in the growing economies of Asia.

According to the METI Forecast of global supply and demand trends for petrochemical products, between 2004 and 2010 global demand for paraxylene will increase at an average rate of 5.6%, and in Asia this increase will be an average 6.6%. The forecast also predicts increased demand for ethylene derivatives (4.3% worldwide, 4.8% in Asia) and propylene derivatives (4.5% worldwide, 5.6% in Asia). These numbers suggest that demand will rise more rapidly for paraxylene than for other petrochemical products. Changes in the economic trends of China, India and other countries may affect these figures, while demand is expected to remain firm overall.

The New Consolidated Mid-Term Management Plan called for Cosmo Matsuyama Oil Co., Ltd. and CM Aromatics to deliver operating income of ¥1.1 billion in the fiscal year ended March 2006, but the actual figure was ¥2.6 billion. As can be seen, the petrochemical business is an important part of the Group's growth strategy. In July 2006, production capacity at CM Aromatics is slated to rise to 270,000 tons/year, and in addition to capacity at Cosmo Matsuyama Oil which is already producing, the Group's total production and sales capacity should increase to 300,000 tons/year. The aggressive development of this business is expected to support its growth strategy.

### E & P Company Planned / Actual Operating Income

(Billions of Yen)

| Company Name | Fiscal 2006 Planned | Fiscal 2006 Actual | Fiscal 2008 Target |
|---|---|---|---|
| Abu Dhabi Oil | 15.2 | 20.3 | 10.2 |
| Mubarras Oil | 6.9 | 10.3 | 5.1 |
| Qatar Petroleum Development | — | — | 3.1 |
| Total | 22.1 | 30.6 | 18.4 |

Note: Mubarras Oil was merged into Abu Dhabi Oil from January 2006

## Status of Progress in Oil Exploration and Production
## — Stable Production at Existing Fields, Production Commences at New Field in Qatar

In the oil exploration and production business, our basic policy is to (1) Invest in low-risk deals, (2) Leverage the current core region (Abu Dhabi, Qatar), (3) Seek an early return on cash flow and (4) Concentrate on operations to develop technical knowledge and accumulate experience.

In the fiscal year ended March 2006, the combined production volume of our two consolidated subsidiaries, Abu Dhabi Oil Co., Ltd. and Mubarras Oil Co., Ltd. (which was merged into Abu Dhabi Oil in January 2006) was 24,850 barrels/day.

Although production volume temporarily fell below that of the preceding year owing to the suspension of pumping at producing wells to construct electrical facilities, high crude oil prices resulted in operating income for the segment of ¥29.4 billion, ¥17.4 billion higher than the previous fiscal year.

In addition, consolidated subsidiary Qatar Petroleum Development Co., Ltd., completed preparations and began production in March 2006. We expect to deliver all the equity crude oil production from Qatar Petroleum to the Group's refineries. Initial production volume is expected to total 6,000 barrels/day, but by adding two more production sites we expect this level to rise to 10,000 barrels/day from 2007. Including the production volume of United Petroleum Development Co., Ltd., which is reflected in consolidated accounts on an equity basis, this increase should push up the Group's ratio of independently developed crude oil to the 5% level.

| Capital Investment for the Fiscal Year Ended March 2006 | |
|---|---|
| Marketing | ¥5.9 billion |
| Supply | ¥9.6 billion |
| Oil exploration and production | ¥12.4 billion |
| Others | ¥3.9 billion |
| **Total** | **¥31.8 billion** |

| Capital Investment Planned for the Fiscal Year Ending March 2007 | |
|---|---|
| Marketing | ¥11.4 billion |
| Supply | ¥14.7 billion |
| Oil exploration and production | ¥11.8 billion |
| Petrochemical | ¥1.9 billion |
| Administrative infrastructure | ¥5.2 billion |
| **Total** | **¥45.0 billion** |

## Capital Investment, Actual and Future Plans

The New Consolidated Mid-Term Management Plan calls for capital investment of ¥140.0 billion over a three-year period, of which ¥99.0 billion is strategic investment earmarked for value-added improvements. Investment in the marketing segment, focused on self-service SS, accounts for ¥15.0 billion; petroleum development accounts for ¥30.0 billion; and value-added improvements to refineries accounts for ¥40.0 billion in the supply segment.(Please refer to the graph on page 11).

Regarding investment in value-added improvements to refineries, while we plan to finalize a specific investment plan within the fiscal year ending March 2007, the main themes are to crack heavy fuel oil where demand is expected to decline to produce more gasoline and diesel fuel, while at the same time raising the competitiveness of our refineries by making them able to refine cheaper heavy grades of crude oil, and expanding the petrochemical business where growth is expected.

In the fiscal year ended March 2006, expenditures in the marketing segment amounted to ¥5.9 billion, most of which went for new construction of and conversions to self-service SS. Bringing Qatar Petroleum Development Co., Ltd., to the production stage while maintaining and expanding production at existing fields accounted for ¥12.4 billion, while ¥9.6 billion was invested in the supply segment, primarily for maintenance and repairs. Total capital investment was therefore ¥31.8 billion. In the fiscal year ending March 2007, the plan calls for total capital investment of ¥45.0 billion as we continue to invest in self-service SS and oil exploration and production while at the same time expanding our export infrastructure.

In September 2005, we raised ¥38.8 billion through equity financing. While we expect to cover the capital investment amount called for in the New Consolidated Mid-Term Management Plan out of cash flow over these three years, the Group decided on equity financing as one option in light of changes in the operating environment.

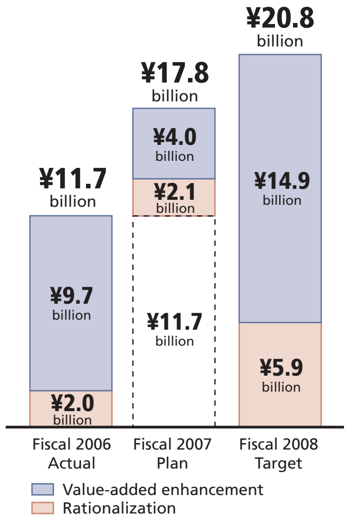
**Cosmo Oil Non-Consolidated**

**¥6.1 billion**

| | | | |
|---|---|---|---|
| Value-added Enhancement ¥4.0 billion | Supply ¥1.5 billion | Marketing ¥2.4 billion | Others ¥0.1 billion |
| Rationalization ¥2.1 billion | Supply ¥1.1 billion | Marketing ¥0.5 billion | Adminis-tration ¥0.5 billion |

| **Value-added Enhancement** | **¥4.0 billion** |
|---|---|
| Supply | Continued implementation of profitability improvement programs |
| Marketing | Sales routes, channels and improvement in distillates mix |
| **Rationalization** | **¥2.1 billion** |
| Supply | Energy saving measures, others |
| Marketing | Reduction of sales promotion expenses, others |

**"Value-added Enhancement" "Rationalization"**
Plan / Target




## INITIATIVES IN THE FISCAL YEAR ENDING 2007

In the fiscal year ending March 2007, the second year of the New Consolidated Mid-Term Management Plan, we will work toward the plan's three interim targets: i.e., operating income of ¥69.0 billion (¥77.0 billion excluding the impact of inventory valuations), ordinary income of ¥66.0 billion (¥74.0 billion excluding the impact of inventory valuations) and net income of ¥22.0 billion. We are assuming that the April 2006 fire at the Chiba refinery will have an negative impact of ¥10.0 billion, but after taking into account the effects of rationalization, efforts toward value-added enhancement and the contributions of our oil exploration and production, petrochemical and other consolidated subsidiaries, the negative impact on ordinary income is forecast to be ¥0.2 billion compared with the preceding term.

### 1 Value-added enhancements and rationalization to oil alone: ¥6.1 billion

Because of the April 16, 2006, fire at the Chiba refinery, rationalization may deliver less than originally planned, but we will continue with rationalization efforts after ensuring safety.

### 2 Oil exploration and production business

In March 2006, Qatar Petroleum Development Co., Ltd., began commercial production, while production at already operating Abu Dhabi Oil and United Petroleum Development continues favorable.

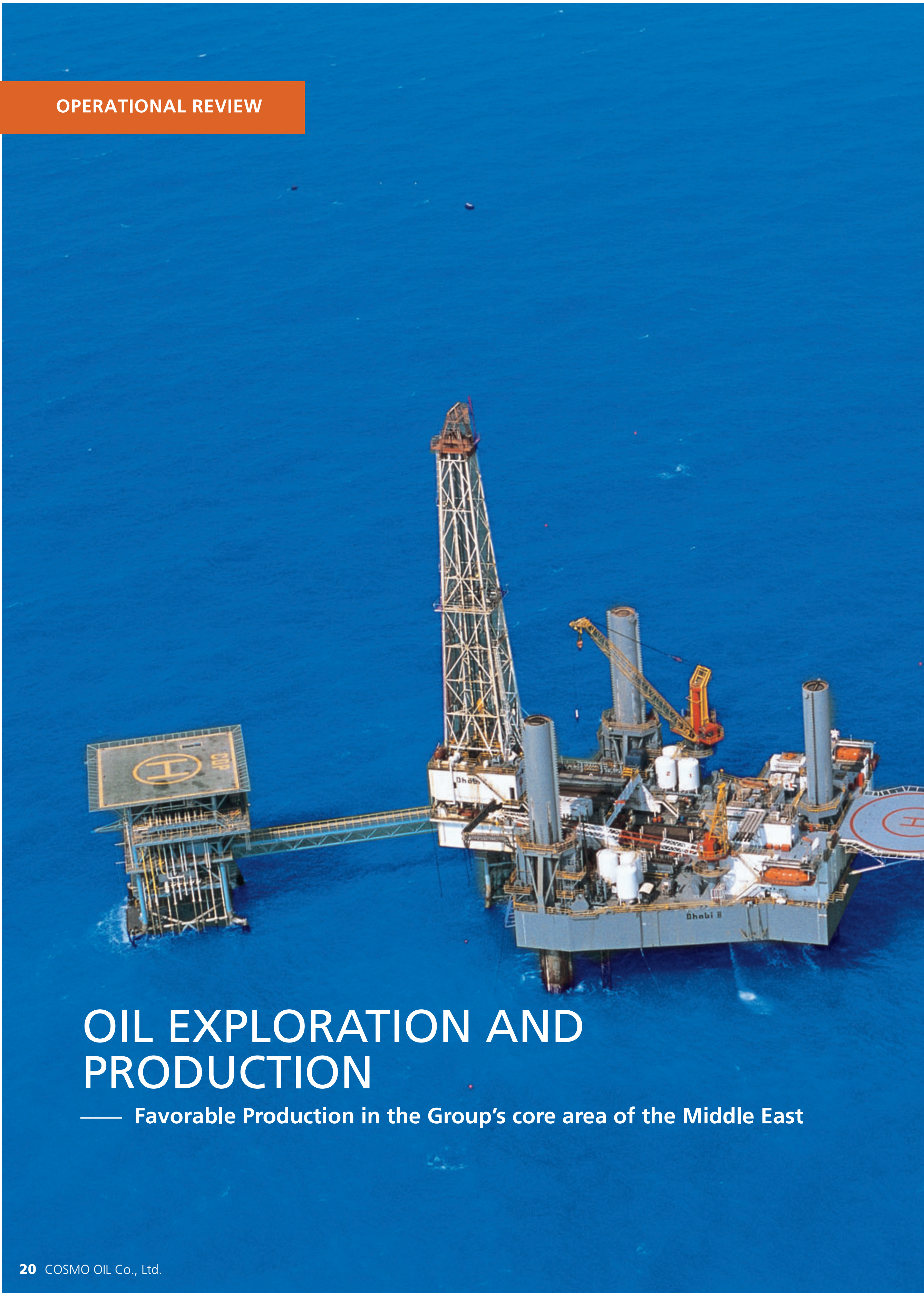
### 3 Accelerated growth strategy for entering petrochemical business

Plans are for CM Aromatics to increase production of mixed xylene to 270,000 tons/year in July 2006. Combined with the 30,000 tons/year already being delivered by Cosmo Matsuyama Oil, this brings the expected Group total to 300,000 tons/year.

Based on the Group's CSR-based management foundations, we plan to create an infrastructure to expand our CSR system further. We acknowledge that ensuring the safety of refineries, as well as distribution and sales activities, and the creation of a system to supply energy safely are necessary conditions for the Group's continued existence.

Although the operating environment was challenging during the fiscal year ended March 2006, we made progress in the specific policies outlined in the New Consolidated Mid-Term Management Plan. Although petroleum product demand in Japan are both forecast to decrease slightly, we believe that Asia as a whole has a shortage in refining capacity, as evidenced by substantial increases in exports. The Cosmo Oil Group aims to play a vital role in the Asian oil industry. For this reason, we are making strategic investments that we are convinced will contribute to revenues in the fiscal year ending March 2007 and beyond.

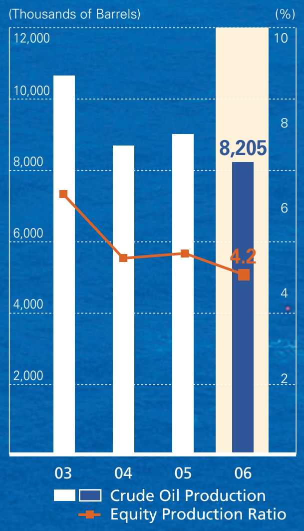
We will put forth every effort to meet our earnings and profits targets for the fiscal year ending March 2007, as well as the management targets established for the final year of the New Consolidated Mid-Term Management Plan in the fiscal year ending March 2008.



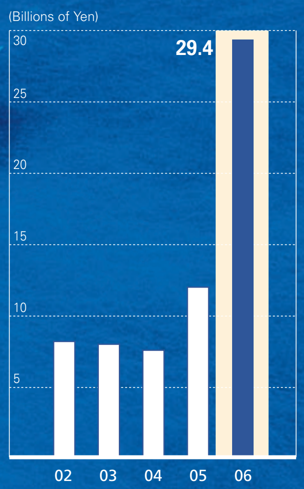
# OIL EXPLORATION AND PRODUCTION

## —— Favorable Production in the Group's core area of the Middle East

## Annual Crude Oil Production and Equity Production Ratio




## Oil Exploration and Production Segment Operating Income



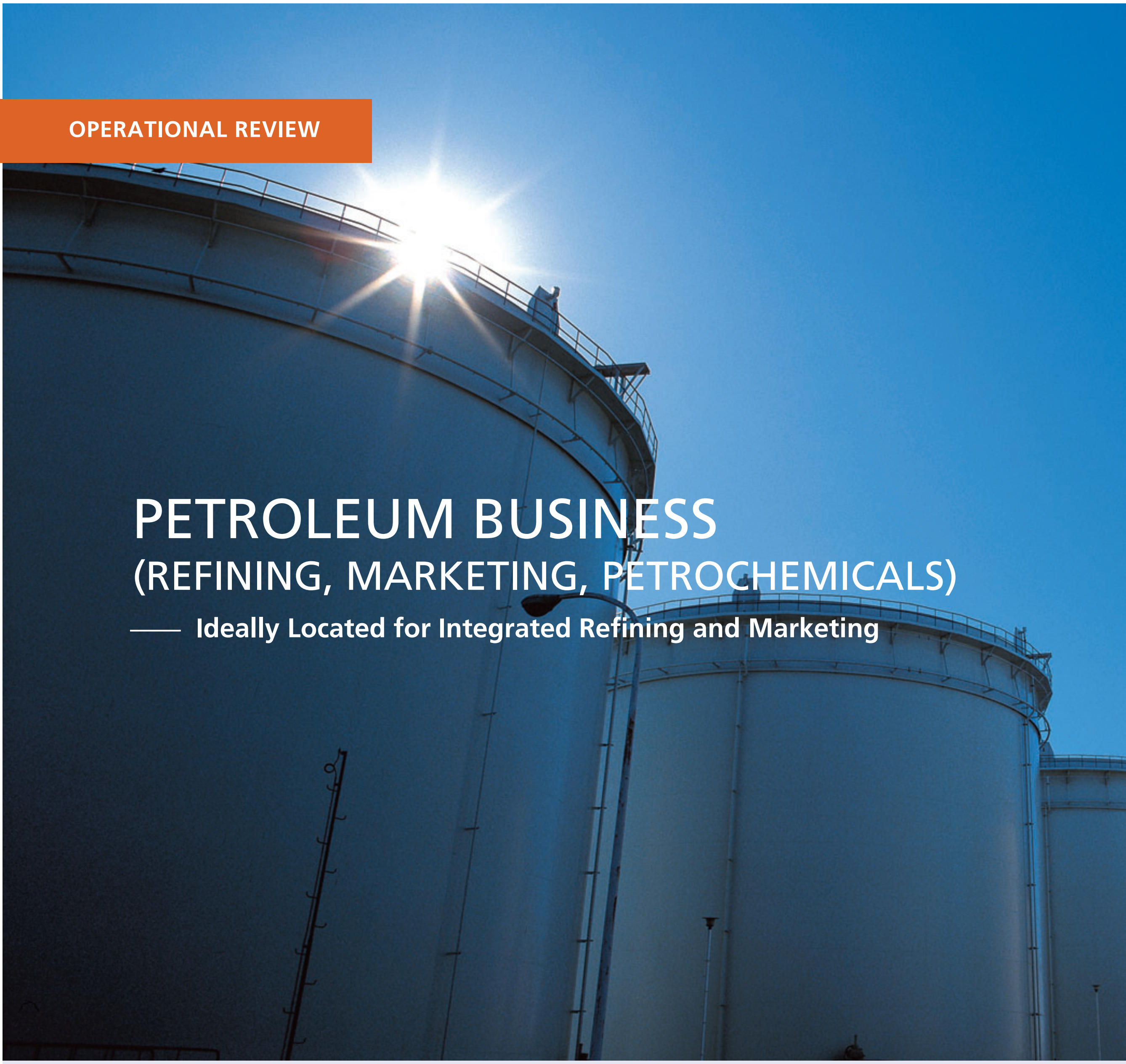

Notes: 1) Fiscal year ending March 31 of the following year
2) Sales amounts net of inter-segment sales

The Cosmo Oil Group operates through Abu Dhabi Oil Co., Ltd. and United Petroleum Development Co., Ltd. (reflected in consolidated accounts under the equity method) in Abu Dhabi, UAE (United Arab Emirates). In addition, Qatar Petroleum Development Co., Ltd. began commercial production from March 2006.

In the fiscal year ended March 2006, growth in sales and earnings of the Oil Exploration and Production segment was supported by stable production and sharply rising crude oil prices, as net sales were ¥17.0 billion (up ¥5.5 billion or 47.5% year-on-year) and operating income reached ¥29.4 billion (up ¥17.4 billion or 145.5% year-on-year).

In terms of production volume by operating company, production at Abu Dhabi Oil Co., Ltd. was 15,730 barrels/day (the Group's equity at the end of December 2005 was 62.6%), production at Mubarras Oil Co., Ltd. was 9,120 barrels/day (equity of 62.6%) and production at United Petroleum Development Co., Ltd. was 18,790 barrels/day (equity of 35.0%), and the amount taken up by the Group was in proportion to its equity holdings. In January 2006, Mubarras Oil Co., Ltd., a subsidiary of Abu Dhabi Oil Co., Ltd., was merged into Abu Dhabi Oil Co., Ltd. in order to establish a more efficient operating structure in Abu Dhabi.

In the fiscal year ended March 2006, the Group's equity oil production ratio (to total crude oil procured) was 4.2%, which represents a 0.5 percentage point decline from the previous fiscal year owing to electrical construction which resulted in a temporary reduction in well production volume. With the start-up of Qatar Petroleum Development Co., Ltd. production (with initial output of 6,000 barrels/day and maximum output forecast at 10,000 barrels/day), equity crude oil production is expected to reach just over 5% of total crude oil imports in the fiscal year ending March 2008. In addition, in the commencement of crude oil production in Area Block 1 southeast of Qatar, escaping gas that is a byproduct from daily oil production will not be burned off in the atmosphere but will be pumped underground (sour gas injection) for more environmentally friendly operation.



OPERATIONAL REVIEW

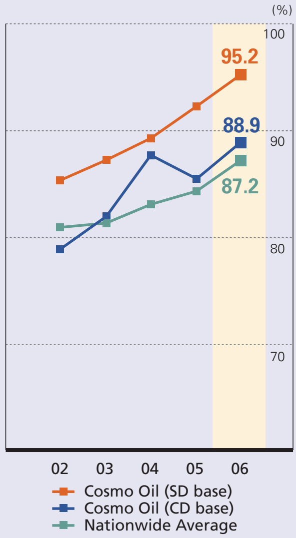
# PETROLEUM BUSINESS
## (REFINING, MARKETING, PETROCHEMICALS)
### —— Ideally Located for Integrated Refining and Marketing

The Cosmo Oil Group imports crude oil produced within the Group and from oil producing nations, refines it at four domestic refineries in Chiba, Yokkaichi, Sakai and Sakaide, and markets the output as petroleum products. The Group's refineries are located near large consumption regions in Tokyo, Osaka and Nagoya, which means the Group is ideally located for integrated refining and marketing operations.

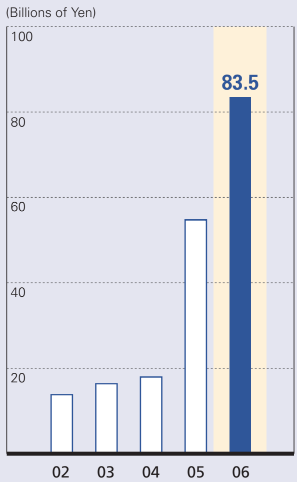
The petroleum business is the Group's core business. The parent company Cosmo Oil Co., Ltd. is a refiner and wholesaler of these products, and its main businesses are the direct sale of petroleum products to large users and the wholesale of petrochemical products through distributors to retail consumers. Retail sales for the Group are handled by a marketing subsidiary, who, like local distributors, purchases petroleum products from the primary distributor which is Cosmo Oil Co., Ltd., and operates a domestic network of service stations. In addition, the Group manufactures and sells lubricants in addition to the import and sale of LPG. Moreover, the Group also produces and sells mainly aromatic petrochemical products, which it considers to be a growth area.

In the fiscal year ended March 2006, both sales and earnings for the Petroleum business recorded growth, as net sales were ¥2,616.9 billion (up ¥512.2 billion or 24.3% year-on-year) and operating income grew to ¥83.5 billion (up ¥28.8 billion or 52.6% year-on-year). The effect of rising oil prices is to effectively lower the cost of sales because inventories are valued using the gross average method. As a result, the reported cost of sales declined by ¥32.8 billion

## Topper Operating Ratio




## Trend in Petroleum Business Operating Income




Note: Fiscal years to March 31 of the following year

from the previous fiscal year and was a factor in the reported increase in sales and earnings. In addition, while in-house fuel costs rose, another factor in the earnings increase was the results of the "New Consolidated Mid-Term Management Plan" in terms of ¥20.0 billion in cost rationalization and improved value-added of ¥9.7 billion were 133% above planned levels.

In oil refining, topper operating ratios improved. On a CD (Calendar Day) basis, the improvement was 3.3 percentage points from 85.6% in the fiscal year ended March 2005 to 88.9% in the fiscal year ended March 2006, both of which were better than the industry averages of 84.4% and 87.2% respectively. In addition, operating ratios excluding scheduled maintenance (Stream Day base) improved 2.9 percentage points to 95.2% in the fiscal year to March 2006.

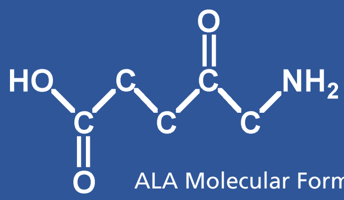
In Petroleum Marketing, the Group was able to achieve the three improvement objectives outlined in the "New Consolidated Mid-Term Management Plan" in **1) improving marketing structure, 2) raising the weight of gasoline and diesel fuel in the product mix, and 3) improving the structure of the retail channel**.

In Petrochemicals, CM Aromatics Co., Ltd., who manufactures and sells mixed xylene, was newly consolidated and contributed to sales for the segment.

Note: Please refer to the explanation of the "New Consolidated Mid-Term Management Plan" (page 12 – page 19) for further details.

# RESEARCH AND DEVELOPMENT

## Challenging the Ultimate Environmental Energy



ALA Molecular Formula

The Cosmo Oil Group is pursuing the development of environmentally friendly products and technologies as well as technologies for environmental countermeasures. As an oil company, the Group recognizes the need to reduce the environmental burden, and is conducting research and development on the reduction of $CO_2$, which is a cause of global warming. R&D expenditure for the fiscal year ended March 2006 was ¥3.4 billion.

### ■ Petroleum Business

In petroleum product areas, the Japanese oil industry led the world in supplying sulfur-free gasoline and diesel fuel (sulfur content of less than 10ppm) from January 2005 in response to a voluntary move within the oil industry. The Group successively incorporated a highly active diesel fuel desulfurization catalyst and is supplying diesel fuel desulfurization facilities at all of the Group's refineries, which has made the production of virtually sulfur-free diesel fuel possible without significant capital expenditures. The catalyst that was developed won the "Industry-University-Government Cooperation Meritorious Service Commendation Minister of the Ministry of Economy Trade and Industry Prize" in June 2006.

### ■ New Businesses

The Cosmo Oil Group is emphasizing "ALA (5-Amino levulinic acid)" as a new business and is nurturing this product area as a new business portfolio. A new ALA business center was established in June 2005 and full-scale development of the ALA business is under way. Going forward, the Group intends to appropriately allocate resources to this business based on profitability and future potential.

A base component of chlorophyll and blood, ALA is a type of amino acid which promotes plant photo synthesis ($CO_2$ absorption), and helps increase the absorption rate of nutrients (nitrogen). Focusing on this effect, a joint venture was established with Seiwa Co., Ltd. called "Cosmo Seiwa Agriculture Co., Ltd." in December 2004. This venture has already begun production and sales of "Pentakeep® V", a high performance fertilizer that contains ALA.

In addition, as bio-ethanol and other conventional plant fuels absorb and solidify $CO_2$ in the process of growing, and the amount of $CO_2$ remains unchanged even if burned, they present little burden to the environment as an energy source, and have been gaining increasing attention in recent years. As ALA works to promote plant growth, it is considered a source of "environmental energy". Moreover, because ALA also makes plants more cold resistant and more saline tolerant, it has promising potential in promoting crop cultivation in Eastern Europe and other cold climates, as well as crop cultivation in China, the Middle East, Africa and South America where the soil has a high saline content in addition to having promising potential applications for desert afforestation.

While the current focus is mainly on applications for plant growth promotion in agricultural applications, as potential applications are also being studied in "medical areas" such as cancer detection and treatment, and "cosmetic applications" such as hair growth and acne treatment, the Group plans to nurture this product as the core of a major new business.

# CSR Management

## Corporate Social Responsibility

As an entity that handles energy, the Group plays an important role in society by providing stable supply. We increase the convenience of people's lives on a daily basis and invigorate industry, and view this symbiosis with society and sustained growth as our mission and responsibility. Fulfilling our mission has two parts — ensuring that the Company itself derives ongoing economic benefits, while at the same time fulfilling our responsibility to and contributing to society. Pursuing a balance between these two enables us to respond to the expectations and demands of numerous stakeholders, earn trust and acceptance and link our operations to further business activities, all while increasing our contribution to society. The Group views CSR-based management as the key to raising corporate value through this positive spiral and contributing to the sustainable development of society.

# Corporate Governance

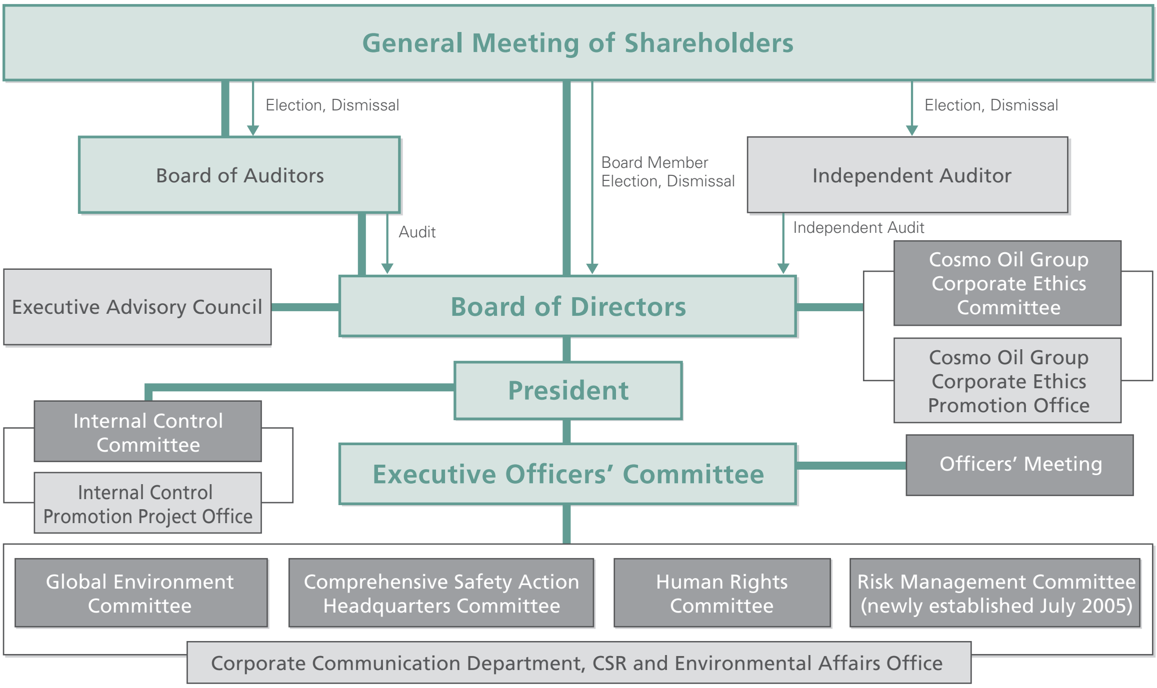
## Basic Stance on Corporate Governance

The Cosmo Oil Group believes that maximizing shareholder value requires “management with integrity” which includes quickly responding to changes in the operating environment and ensuring transparency.

An Executive Officers’ Committee and an executive officer system were established to clarify operating business authority and the Board of Directors and an auditor system strengthens our management supervisory function.

These initiatives are aimed at maximizing shareholder value by enhancing corporate governance.

## Corporate Governance System




## Corporate Governance Structure, Measures and Implementation Status

**■ Board of Directors (meets once a month in principle)**

The Board of Directors, which is chaired by the Chairman, holds meetings that are attended by all directors and auditors. As the top management decision-making authority, the Board of Directors makes important decisions on issues related to laws, regulations and items prescribed in the Articles of Incorporation, and establishes management policy. The Board of Directors also supervises the business activities of the directors.

**■ Executive Officers’ Committee (meets once a week in principle)**

Meetings of the Executive Officers’ Committee, chaired by the President, are attended by all directors with the title of managing director or higher, executive officers designated by the President, and the auditors. This entity makes decisions on the execution of business, based on management policy set by the Board of Directors.

### Officers' Meeting (meets once a month in principle)

In line with the June 2006 introduction of an executive officer system, the Officers' Meeting was established below the Executive Officers' Committee to ensure the expeditious execution of business and to enhance the company wide sharing of information.

### Executive Advisory Council (meets as needed)

This entity evaluates the performance of directors and deliberates on the selection of director and auditor candidates.

### Board of Auditors (meets once a month in principle)

Auditors make up the Board of Auditors and through attendance at Board of Directors and Executive Officers' Committee meetings supervise the execution of business by directors, hold liaison meetings and coordinate closely with independent auditors, the internal compliance organization and auditors of affiliated companies to ensure the appropriateness and thoroughness of audits.

## • Overview of Committees

**Cosmo Oil Group Corporate Ethics Committee** —— Chaired by the President

Promotes a spirit of respect for the law based on corporate ethics that encompasses all corporate activities

**Internal Control Committee (newly established)**

Handles overall operation of the internal control system Group wide and acts as an advisory council to the President

**Comprehensive Safety Action Headquarters Committee**

Strengthens safety measures to prevent operating accidents and workplace disasters

**Global Environment Committee**

Enhances environmental response

**Human Rights Committee**

Takes part in human rights activities

**Risk Management Committee**

Promotes thorough compliance

## • Internal Audit Status

Cosmo Oil has adopted the auditor system. The Company has five auditors, three of whom are outside corporate auditors as defined in paragraph 16, Article 2 of the Company Law. Furthermore, full-time staff members have been assigned to work with auditors, including outside corporate auditors, with the aim of enhancing the audit function.

Auditors are members of the Board of Auditors, and through attendance at Board of Directors and Executive Officers' Committee meetings they supervise the execution of business by directors. At the same time, they coordinate closely with independent auditors, the internal compliance organization and auditors of affiliated companies in an effort to provide appropriate and thorough audits.

The Internal Auditing Office, with eight full-time staff, forms the Company's internal compliance organization. The office performs internal audits according to predefined annual audit plans and confers with the Executive Officers' Committee in accordance with the plan. The office conducts audits of the legality and efficiency of the business activities of operating facilities and principal Group companies and offers specific advice and recommendations for improving these operations. In addition, the office submits audit reports to senior management, the Executive Officers' Committee and to Auditors, exchanges opinions with auditors and works to internally enhance audit functions.

There are no special-interest relationships between the Company and its outside corporate auditors. Of these auditors, Hajime Miyamoto is Chairman of Kansai International Airport Co., Ltd., as well as Chairman of Kinden Corporation. Yoshitsugu Kondo is a partner attorney at Sano Kondo Law Offices.

### • Status of Accounting Audits

The Company employs KPMG AZSA & Co. as its independent auditor in accordance with the previous Law for Special Exceptions to the Commercial Code Concerning Audit, etc., of Kabushiki Kaisha, and the Securities Exchange Law, and this company performs accounting audits. Performing the Company's accounting audits were Takaya Abe and Akira Yamamura, two certified public accountants assigned by its independent auditor. In addition, five certified public accountants, four assistant accountants and three others assisted in audit activities.

## Implementation Status of Initiatives during the Past Year to Enhance Corporate Governance

### • Implementation of an Executive Officer System

In June 2006, the Group put in place an executive officer system to clarify the division between management supervision and business execution and ensure the rapid response to changes in the operating environment. Executive officers are selected by resolution of the Board of Directors and execute business delegated to them by the Board of Directors. The President holds ultimate responsibility for the activities of the executive officers, whose term of office is limited to one year. Below the Executive Officers' Committee, the Officers' Meeting was established to promote the execution of business by enhancing the company wide sharing of information.

### • Changes from the Implementation of an Executive Officer System

In line with the implementation of an executive officer system, the limit on the number of directors was reduced from 30 to 15. In addition, to clarify the business performance management responsibilities of directors, and to create a management system that responds quickly to changes in the operating environment the term of office for directors was shortened from a maximum of two years to one year. In addition, the Associate Director system was abolished in June 2006.

### • Establishment of an Internal System of Controls

The Internal Control Committee (established in June 2006) oversees the internal control system of the entire Group. The Internal Control Promotion Project Office assists this department, helping to create, evaluate and promote the internal control system.

In terms of social responsibility, the Group has taken the initiative of creating the Consolidated Mid-Term CSR Management Plan, which covers the three years from fiscal 2005. This plan spells out major themes, such as "thorough awareness of CSR", "strengthening risk management and internal audit functions", "heightening environmental initiatives", "implementing thorough safety management" and "enhancing human rights and personnel measures", and sets objectives for each department.

In addition to establishing fundamental provisions, including crisis management provisions, crisis countermeasures and comprehensive disaster contingency provisions, the Risk Management Committee promotes smooth and efficient risk management by evaluating and reviewing management risks, and ensuring the proper implementation of countermeasures.

## Director and Auditor Compensation

During the fiscal year under review, executive compensation paid to directors and auditors and the compensation paid to the Company's audit corporation was as follows.

| | | |
|---|---|---|
| Executive compensation | Compensation, other payments to directors | 440 million yen |
| | Compensation paid to auditors | 126 million yen |
| | Total | 566 million yen |

Note: The above amounts include director bonuses and payments of executive retirement bonuses as approved by shareholder resolution.

| | | |
|---|---|---|
| Auditor compensation | Compensation for audit verification (Note) | 55 million yen |
| | Compensation other than the above | — million yen |
| | Total | 55 million yen |

Note: This compensation is as stipulated in Paragraph 1, Article 2, of the Certified Public Accountants Law.

## Revisions to the Executive Compensation System

In June 2006, the Group revised its executive compensation system to more clearly reflect responsibility for management performance and to increase fairness and transparency.

### 1 Abolishment of the Executive Retirement Allowance System

The system of providing executive retirement bonuses that do not reflect operating performance was abolished as of the end of the Ordinary General Meeting of Shareholders in June 2006, and executive compensation was consolidated.

### 2 Implementation of System of Executive Compensation Linked with Operating Performance and Establishment of Share Acquisition Guidelines

In line with the abolishment of the executive retirement allowance system, a system of compensation linked with operating performance was implemented, so that compensation for directors and executive officers would clearly reflect operating performance over a period of time. In addition, share acquisition guidelines were established to increase the motivation to work toward long-term increases in shareholder value.

### 3 Implementation of an Operating Performance Linked Bonus System

The New Consolidated Mid-Term Management Plan and consolidated net income are the standards for determining bonuses for directors and executive officers.

# CSR and the Environment

## Consolidated Mid-Term CSR Management Plan

To ensure an awareness of CSR-based management among all employees of the Cosmo Oil Group and to ensure that this awareness takes root in the corporate culture, the Group established a Consolidated Mid-Term CSR Management Plan which covers a three year period beginning from the fiscal year ended March 2006. These efforts have been recognized, as Cosmo Oil has been a constituent of the FTSE4Good Global Index since March 2003. In addition to establishing a framework for and increasing these efforts, the plan aims to promote an awareness of CSR activities to all employees throughout the Group. The Consolidated Mid-Term CSR Management Plan establishes a CSR vision for each Group company, in line with the content and scale of its business, which is to be incorporated into each management activity. Of the broad range of issues the plan addresses, five important areas are described below, along with the plans to address common Group wide issues.

| Topic | Content |
|---|---|
| Pervasive awareness of CSR | **This topic refers to efforts to encourage a pervasive awareness of CSR-based management among all Group employees and encourage voluntary activities that support this management.**<br>We produced and distributed a textbook that interprets the corporate action guidelines that were formulated in 2003. In addition, human rights and compliance training was performed at each operating location and Group company. |
| Strengthen the governance structure by enhancing the risk management and audit functions | **Since fiscal 2003, on an annual basis risks have been examined and categorized, countermeasures considered and implemented, and a monitoring and evaluation cycle implemented company wide.**<br>A Risk Management Committee was established, and under the vital theme of contingency response, plans that cut horizontally across the entire company were considered, through disaster countermeasures (particularly in the event of massive earthquakes) that address business continuity. |
| Implement thorough safety management as the base of our business activities. (Consolidated Mid-Term Safety Plan) | **We are formulating a safety management system that covers the entire Cosmo Oil Group, improving safety levels through self-imposed safety preservation efforts.**<br>The distribution division conducted joint training with shipping, and we as the Group endeavored to enhance and strengthen its crisis management system. |
| Advance environmental initiatives (Consolidated Mid-Term Environmental Plan) | **We are creating an environmental sustainability structure (environmental protection, contribution and educational activities) and working to reduce environmental risks.**<br>To prevent global warming, the Group is working to reduce consumption of energy resources at its refineries, and succeeded in reducing energy consumption by 13.5%, versus a target of 10.9% at our refineries we are working to reduce the consumption of energy resources. As part of our environmental communications, we promoted the "Cosmo Oil Eco Card Fund" project and social contribution activities and delivered reports on these activities. |
| Enhance human rights and personnel measures (Consolidated Mid-Term Human Rights/ Personnel Plan) | **We aim to create a corporate culture that fosters individual and corporate creativity and innovation.**<br>The Group supports the Global Compact's 10 principles in the areas of human rights, labor, the environment and anti-corruption, and we have made a commitment to society to participate in the Global Compact. As one of the first steps when joining the United Nations Global Compact, we amended existing corporate action guidelines that describe efforts to respect these 10 principles. We also revised the committee for functions concerning the preservation of the global environment. |

Fiscal 2006 Actual

## Environmental Cooperation and Contributions in Fiscal 2006

In addition to practicing sincere management through corporate governance and compliance initiatives, contributing to society as a corporate citizen and to becoming an attractive company for various stakeholders are key aspects of CSR. The Cosmo Oil Group's social contribution and environmental cooperation activities are based on the philosophy of originality, participation by Group employees and long-term continuity, regardless of the Group's financial performance.

### ■ Activities Themed on Children, the Environment and Society, and Pronouncement of Environmental Messages

#### Cosmo Waku Waku Camp


Through various programs during a two-night and three-day camp, the Group is providing children with the opportunity to appreciate the importance of the environment.

We aim to help develop healthy educations and environmental awareness among the children who make up the next generation. As one of these efforts, for each of the 13 years since the program began in 1993 we have sponsored the Cosmo Waku Waku Camp. This program helps children who have lost parents in traffic accidents to appreciate nature. We have also sponsored the Cosmo Fine Art Kids art therapy program for children who live in child-care institutions since 2004. In addition, the Group has been conducting clean campaigns that organize cleaning activities for Japan's mountains, rivers, lakes and public parks. These clean campaigns have cleaned up 211 locations since the program began in 2001 until July 2006, with a total of 83,555 volunteers participating and a cumulative total of 1,588,612 liters of waste recovered.

### ■ Cosmo Oil Eco Card Fund

#### Rain Forest Preservation Projects

Cosmo Oil is supporting forestation projects along the Qinling mountain range in China.

#### South Pacific Nations Support Project

Provision of trucks for water supply to the Tuvalu Islands

We are now in the fifth year of Living with Our Planet projects, which are funded by ¥500/year contributions from the approximately 81,000 Cosmo the Card "Eco" members who use Cosmo Oil service stations. Cosmo Oil adds its own contributions and operates the Cosmo Oil "Eco" Card Fund. Going beyond the corporate framework to become an environmental citizen, we join customers, and members of NGOs and NPOs, local societies and governments in global environmental contribution activities that work toward a sustainable society. With the theme of "stop global warming", which is the environmental issue most closely linked with oil, Cosmo Oil is working through a total of seven domestic and international projects on two fronts, i.e., to support the sustainable development of regions (emerging nations, etc.) expected to the be most affected by $CO_2$ emission growth and the impact of global warming, and to educate children, who will be the future stewards of this earth, about the environment.

New initiatives during the fiscal year under review included the donation of water trucks for water supply to the Tuvalu Islands, which is faced with salt water contamination of fresh water wells and other damage from rising sea levels caused by global warming, and reforestation activities in the Qinling mountain range in China.

# BOARD OF DIRECTORS AND AUDITORS

Managing Director
**KAORU KAWANA**
*(Responsible for Internal Auditing Office, Information System Planning Dept., General Affairs Dept., and Distribution Dept.)*

Managing Director
**MASAHIDE FURUZONO**
*(Responsible for R&D Dept., Demand & Supply Coordination Dept., Refining & Technology Dept. and Safety & Environment Control Dept.)*

Senior Managing Director
**KENJI HOSAKA**
*(Responsible for Corporate Planning Dept., International Business Incubation Dept., International Business Dept. and Crude Oil & Tanker Dept.)*

Managing Director
**NAOMASA KONDO**
*(Responsible for Corporate Communication Dept., Project Development Dept., Affiliate Relations Dept., and Purchasing Center)*

Managing Director
**SATOSHI MIYAMOTO**
*(Responsible for Card Business Planning Dept., Accounting Dept. and Finance Dept.)*

President
**YAICHI KIMURA***

Chairman
**KEIICHIRO OKABE***

Senior Managing Director
**KEIZO MORIKAWA***
*(Responsible for Personnel Dept., Sales Control Dept., Retail Marketing Dept., Wholesales Marketing Dept. and Industrial Fuel Marketing Dept.)*

Auditors
**MAKOTO SUZUKI**
**HIROKAZU ANDO****
**YUTAKA SHIMIZU**
**HAJIME MIYAMOTO****
**YOSHITSUGU KONDO****

* Representative Director
** Independent Auditor

Senior Executive Officers
**SEIZO SUGA**
*(General Manager, Yokkaichi Refinery)*
**MICHIO SHIMIZU**
*(General Manager, Tokyo Branch Office)*
**MASATOSHI SAWADA**
*(General Manager, Refining & Technology Dept.)*

Executive Officers
**HIDEO MATSUSHITA**
*(General Manager, International Business Incubation Dept.)*
**TAKASHI YASHIMA**
*(General Manager, Chiba Refinery)*
**KANESADA SUFU**
*(General Manager, Affiliate Relations Dept.)*
**KENSUKE SUZUKI**
*(General Manager, Corporate Planning Dept.)*
**HAJIME MARUKAWA**
*(General Manager, Sakai Refinery)*
**KIYOSHI AOYAGI**
*(General Manager, General Affairs Dept.)*
**YOSHIYUKI SATO**
*(General Manager, Industrial Fuel Marketing Dept.)*
**MASAHIRO HORIKI**
*(Manager, International Auditing Office)*
**TADASHI KANEMATSU**
*(Manager, Purchasing Center)*
**HIDETO MATSUMURA**
*(General Manager, Sakaide Refinery)*
**ATSUTO TAMURA**
*(General Manager, Corporate Communication Dept.)*
**HISASHI KOBAYASHI**
*(General Manager, Sales Control Dept.)*

# FINANCIAL SECTION

# CONSOLIDATED 11-YEAR SUMMARY

*Cosmo Oil Company, Limited and Consolidated Subsidiaries. Years ended March 31*

| | Millions of Yen | | | | |
|---|---|---|---|---|---|
| | 1996 | 1997 | 1998 | 1999 | 2000 |
| FOR THE YEAR : | | | | | |
| Net sales | ¥ 1,556,171 | ¥ 1,729,495 | ¥ 1,680,478 | ¥ 1,443,457 | ¥ 1,584,678 |
| Petroleum | N.A. | N.A. | N.A. | N.A. | N.A. |
| Oil resource development | N.A. | N.A. | N.A. | N.A. | N.A. |
| Other | N.A. | N.A. | N.A. | N.A. | N.A. |
| Cost of sales | 1,350,743 | 1,508,186 | 1,473,349 | 1,265,443 | 1,427,640 |
| Selling, general and administrative expenses | 173,359 | 185,900 | 179,228 | 155,154 | 140,373 |
| Operating income | 32,069 | 35,409 | 27,901 | 22,860 | 16,665 |
| Income (loss) before income taxes | 14,473 | 18,060 | 14,466 | 4,351 | 13,313 |
| Net income (loss) | 6,545 | 8,839 | 5,340 | 839 | 4,841 |
| Depreciation and amortization | 37,700 | 35,738 | 34,228 | 21,773 | 23,436 |
| Capital expenditures | 41,613 | 31,021 | 34,175 | 31,325 | 22,593 |
| Research and development costs | N.A. | N.A. | N.A. | N.A. | 4,567 |
| Cash flows from operating activities | 62,798 | (25,553) | 64,558 | 17,718 | (42,698) |
| Cash flows from investing activities | (55,764) | 13,972 | (59,532) | (17,806) | 13,538 |
| Cash flows from financing activities | (584) | 2,065 | (5,295) | (14,592) | 31,271 |
| AT YEAR END : | | | | | |
| Total assets | 1,286,000 | 1,287,172 | 1,277,022 | 1,229,285 | 1,294,843 |
| Shareholders' equity | 185,836 | 189,790 | 190,716 | 186,496 | 179,536 |
| Interest-bearing debt | 645,297 | 654,233 | 652,769 | 641,562 | 687,563 |
| | Yen | | | | |
| AMOUNTS PER SHARE : | | | | | |
| Net income (loss) per share | ¥ 10.36 | ¥ 13.99 | ¥ 8.45 | ¥ 1.33 | ¥ 7.76 |
| Shareholders' equity per share | 294.18 | 300.44 | 301.91 | 295.23 | 286.75 |
| Cash dividends | 8.00 | 8.00 | 8.00 | 6.00 | 6.00 |
| RATIOS : | | | | | |
| Return on Assets (ROA) (%) | 0.5 | 0.7 | 0.4 | 0.1 | 0.4 |
| Return on Equity (ROE) (%) | 3.5 | 4.7 | 2.8 | 0.4 | 2.6 |
| Interest-bearing debt ratio (%) | 50.2 | 50.8 | 51.1 | 52.2 | 53.1 |
| Debt-to-Equity ratio(Times) | 3.5 | 3.4 | 3.4 | 3.4 | 3.8 |

***Notes:** 1. U.S.dollar amounts in this report have been translated, for convenience only, at the exchange rate of ¥117.47=$1.00, the prevailing rate at March 31,2006.*
*2. Effective fiscal 2003, the Company adopted a new standard for earnings per share; prior year figures have not been restated.*
*3. The Company began reporting R&D expenses from fiscal 2000.*

| | | | Millions of Yen | | | Thousands of U.S. Dollars |
|---|---|---|---|---|---|---|
| 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2006 |
| ¥ 1,845,842 | ¥ 1,813,838 | ¥ 1,902,768 | ¥ 1,916,278 | ¥ 2,154,559 | ¥ 2,670,628 | $ 22,734,554 |
| N.A. | 1,746,659 | 1,830,940 | 1,862,554 | 2,104,737 | 2,616,887 | 22,277,067 |
| N.A. | 10,856 | 9,773 | 12,950 | 11,544 | 17,030 | 144,973 |
| N.A. | 56,323 | 62,055 | 40,774 | 38,278 | 36,711 | 312,514 |
| 1,664,757 | 1,659,438 | 1,754,853 | 1,758,858 | 1,956,160 | 2,422,272 | 20,620,346 |
| 144,503 | 132,343 | 123,748 | 132,174 | 132,701 | 137,108 | 1,167,175 |
| 36,582 | 22,057 | 24,167 | 25,246 | 65,698 | 111,248 | 947,033 |
| 22,460 | (1,881) | 12,966 | 17,592 | 47,533 | 120,393 | 1,024,883 |
| 8,674 | (5,190) | 3,426 | 8,179 | 26,415 | 61,795 | 526,049 |
| 24,672 | 23,492 | 22,843 | 23,632 | 24,927 | 28,313 | 241,023 |
| 17,108 | 25,430 | 24,132 | 36,573 | 30,113 | 31,762 | 270,384 |
| 3,566 | 3,805 | 3,867 | 3,558 | 3,635 | 3,483 | 29,650 |
| 58,824 | 76,646 | (26,975) | 101,827 | 40,494 | (20,685) | (176,088) |
| 27,348 | (13,944) | (12,811) | (32,709) | (36,577) | (1,348) | (11,475) |
| (87,229) | (88,546) | 10,127 | (7,679) | (70,163) | 39,608 | 337,175 |
| 1,319,960 | 1,242,171 | 1,246,730 | 1,260,092 | 1,323,149 | 1,463,579 | 12,459,173 |
| 177,773 | 194,303 | 193,595 | 204,806 | 227,897 | 312,504 | 2,660,288 |
| 610,686 | 548,653 | 562,649 | 559,259 | 497,804 | 522,430 | 4,447,348 |
| | | | Yen | | | U.S.dollars (Note) |
| ¥ 13.81 | ¥ (8.24) | ¥ 5.42 | ¥ 12.95 | ¥ 41.73 | ¥ 94.54 | $0.80 |
| 282.09 | 308.65 | 306.67 | 324.43 | 360.93 | 465.48 | 3.96 |
| 6.00 | 6.00 | 6.00 | 6.00 | 8.00 | 10.00 | 0.09 |
| 0.7 | — | 0.3 | 0.7 | 2.0 | 4.4 | |
| 4.9 | — | 1.8 | 4.1 | 12.2 | 22.9 | |
| 46.3 | 44.2 | 45.1 | 44.4 | 37.6 | 1.7 | |
| 3.4 | 2.8 | 2.9 | 2.7 | 2.2 | | |

## OPERATING ENVIRONMENT

During the fiscal year ended March 2006, Japan's economy recovered steadily on growth in exports, in addition to continued expansion in capital expenditures supported by rising corporate profits and a firm trend in personal consumption given an improvement in employment conditions. The U.S. economy saw growth in capital expenditures and personal consumption, while Asian economies continued to record high growth given strong infrastructure-related investment and exports in China.

In terms of crude oil prices, Dubai crude which was $48/barrel at the beginning of the period rose to $60/barrel by the end of the period on strong demand in China and other Asian nations, hurricane damage in the U.S. and a decline in available production capacity given political instability in oil producing nations such as Nigeria and Iran. For the full fiscal year, average crude oil prices were $17/barrel higher than the previous fiscal year at $53/barrel.

In the foreign exchange market, the Yen began the period trading at ¥107 per U.S. dollar, and while hurricane damage in the U.S. was a negative factor for the U.S. dollar, the Yen declined to ¥121 per U.S. dollar in December on a strong U.S. economy and an expanding gap between U.S. and Japanese interest rates. Thereafter, rising expectations for a removing of quantitative easing and an end to a zero interest rate policy by the Bank of Japan led to temporary buying of the Yen, which ended the fiscal year at ¥117 per U.S. dollar.

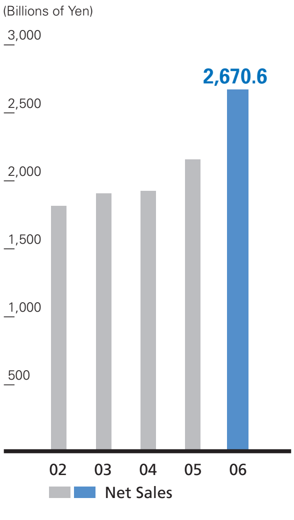
## OVERVIEW OF THE FISCAL YEAR

### Net Sales

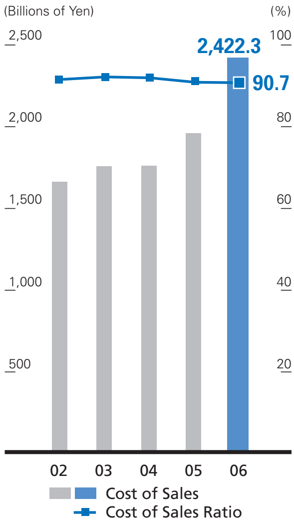
Consolidated net sales for the fiscal year ended March 2006 were ¥2,670.6 billion and ¥516.1 billion or 24.0% higher than the previous fiscal year. In the petroleum business, domestic demand for petroleum products as a whole declined by 457,000 kiloliters or 1.5% to 29,719 kiloliters. For heavy fuel oil C sales in particular, energy conservation efforts stimulated by increased environmental awareness and increased conversion to replacement fuels as well as rising crude oil prices led to a significant decline in demand. On the other hand, the Group actively worked to expand exports particularly of sulfur free diesel fuel given strong overseas demand. As a result aggregate volume growth and rising selling prices resulted in an increase in petroleum sales of ¥512.2 billion or 24.3% over the previous fiscal year to ¥2,616 billion.

In addition, the oil exploration and production segment saw a ¥5.5 billion or 47.5% increase over the previous fiscal year to ¥17.0 billion on steady production as well as rising crude oil prices.

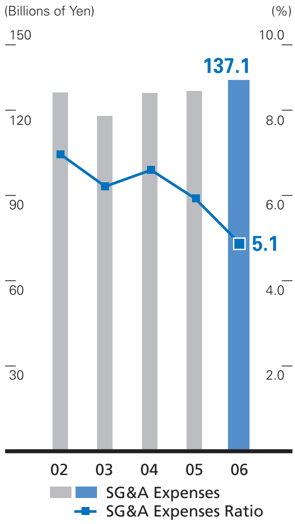
**Net Sales**




**Cost of Sales & Cost of Sales Ratio**




**SG&A Expenses & SG&A Expenses Ratio**



## Operating Income

Consolidated operating income recorded a sharp gain of ¥45.6 billion or 69.3% over the previous fiscal year to ¥111.2 billion. While the cost of sales rose 23.8% year-on-year to ¥2,422.3 billion and rising crude oil prices resulted in increased costs, inventory valuations based on the gross average method produced inventory lowered the reported cost of sales by ¥45.4 billion and resulted in inventory valuation gains of ¥32.8 billion, which was the major factor in the reported operating income increase for the year.

Other major factors contributing to earnings included rationalization and value-added enhancement measures under the "New Consolidated Mid-Term Management Plan" which contributed ¥11.7 billion, while the Oil Exploration and Production business contributed another ¥17.9 billion.

On the other hand, while active efforts were made to increase exports in order to improve the supply-demand balance, the significant impact of rising crude oil prices was not fully transferred to selling prices. In addition to the time lag during periods of rising costs and a noticeable increase in the burden of refining costs (in-house fuel consumption costs), these three negative factors reduced earnings by ¥16.5 billion.

However, while selling, general and administrative expenses increased by 3.3% to ¥137.0 billion over the previous fiscal year, the S.G. & A. ratio improved 1.1 percentage points to 5.1%.

As a result, the operating income to total sales ratio improved by 1.2 percentage points from the previous fiscal year to 4.2%.

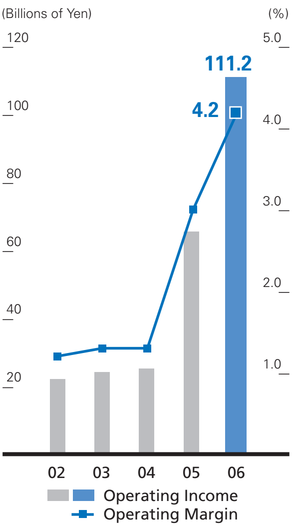
## Other Income (Expenses)

Other income (expenses) substantially improved by ¥27.3 billion to a surplus of ¥9.1 billion. The major factors in this surplus included an increase in interest and dividends income of ¥4.2 billion to ¥6.5 billion, and increase in earnings from the equity in earnings of affiliates of ¥4.1 billion to ¥9.6 billion, and an improvement in foreign exchange gains of ¥4.1 billion to ¥3.4 billion. In addition, interest paid declined by ¥0.7 billion for the fiscal year to ¥10.7 billion.

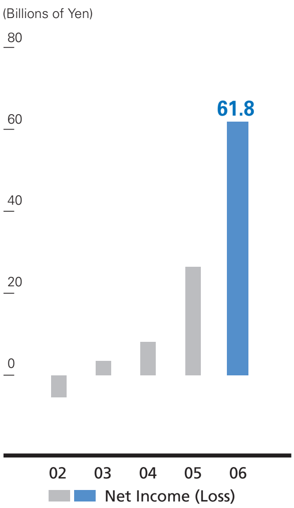
In terms of earnings from equity in the earnings of affiliates, affiliated Maruzen Petroleum Co., Ltd. recorded earnings growth supported by a strong petrochemical products market, while affiliate United Petroleum Development Co., Ltd. recorded stable production and growing sales on higher crude oil prices.

In addition, regarding the recognition of impairment losses on fixed assets which were front-loaded the previous fiscal year, impairment losses were recognized for land idled by SS closures and abandoned oil storage depots, which resulted

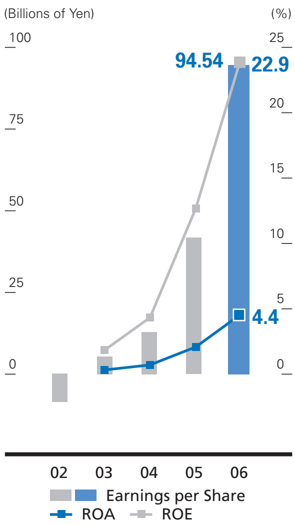
### Operating Income & Operating Margin




### Net Income (Loss)




### Earnings per Share



in ¥2.0 billion of impairment losses. In addition, ¥1.1 billion losses were recorded on the sale and liquidation of fixed assets related to SS closures.

### Net Income for the Period

Income before income taxes and minority interests increased by ¥72.9 billion or 153.3% from the previous fiscal year to ¥120.4 billion. In terms of income taxes, corporate, residence and other business taxes were ¥34.5 billion higher at ¥55.3 billion. In addition, the Group's effective tax rate adjusting for the effects of tax-efficient accounting was 45.9%.

Adjusting for income taxes of ¥55.3 billion and minority interests of ¥3.3 billion, consolidated net income for the period was up ¥35.4 billion or 133.9% from the previous fiscal year to ¥61.8 billion.

In addition, return on total assets (ROA) improved 2.4 percentage points to 4.4%, while return on shareholders' equity (ROE) improved 10.7 percentage points to 22.9% from the end of the previous fiscal year.

### Segment Information

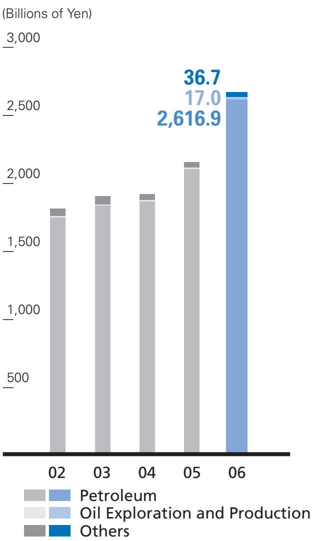
*Petroleum*

Consolidated net sales for the Petroleum segment were ¥512.2 billion or 24.3% higher than the previous fiscal year at ¥2,616.9 billion. The major factors behind this increase were an increase in aggregate fuel oil sales volume of 1,012,000 Kiloliters to 46,314,000 Kiloliters, and an increase in the average selling price of ¥10,800 per Kiloliter to ¥42,910 per Kiloliter.

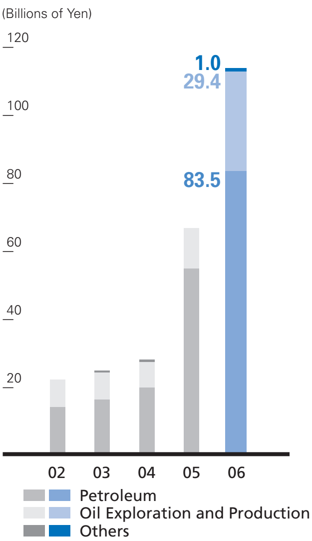
Domestic petroleum product demand in terms of total fuel oil declined. While Naphtha demand increased 2.6% for the fiscal year, heavy fuel oil C sales to industries such as electric power declined 11.0%, heavy fuel oil A sales declined 2.5%, diesel fuel sales declined 0.6% and gasoline sales declined 0.5%. While kerosene sales declined 0.3%, the Group flexibly re-allocated sales to customers including exports of diesel fuel (sulfur free) to Australia in an effort to maximize profit margins. In addition, as market conditions have not improved to the point that crude oil costs can be fully transferred to selling prices, this remains a future issue that needs to be addressed.

Given rationalization and efforts to improve value-added under the "New Consolidated Mid-Term Management Plan", export activities and the favorable impact of average cost inventory valuations on cost of sales for the segment, operating income for the Petroleum segment increased ¥28.8 billion or 52.6% over the previous fiscal year to ¥83.5 billion.

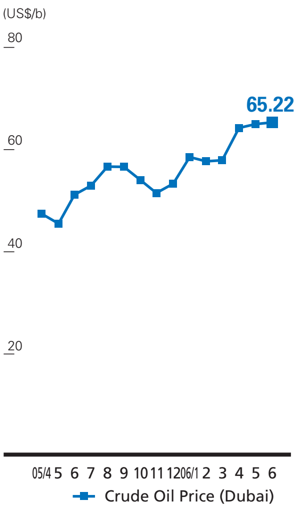
**Segment Sales**




**Segment Operating Income**




**Crude Oil Price (Dubai)**



*Oil Exploration and Production*
In Oil Exploration and Production, continued stable production of crude oil in the Middle East region resulted in segment sales growth of ¥5.5 billion or 47.5% from the previous fiscal year to ¥17.0 billion, while operating income increased ¥17.4 billion or 145.5% for the fiscal year to ¥29.4 billion. The reasons for increased sales and earnings at Abu Dhabi Oil Co., Ltd. included a weakening in the Yen from an average ¥108.84 per U.S. dollar to ¥109.1 per U.S. dollar and a rise in crude oil selling prices from and average $36.66/barrel the previous fiscal year to $52.7/barrel.

In addition, equity oil production as a proportion of total Group crude oil imports declined 0.5 percentage points for the fiscal year to 4.2%. This reflected a temporary interruption of production due to the stoppage of a production pump for electrical construction, and increased procurement due to an increase in crude oil consumed by the Group.

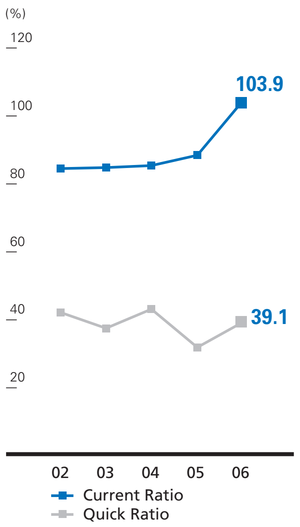
*Others*
In the Other business segment which consists of the purchase, sale and rental of real estate properties, construction and leasing of petroleum-related facilities and insurance operations, the Group continued working to rationalize and make operations more efficient. As a result, while sales in the segment declined ¥1.5 billion or 4.1% for the fiscal year to ¥36.7 billion, operating income increased ¥1.1 billion to ¥1.0 billion.

## Sources of Liquidity and Funds

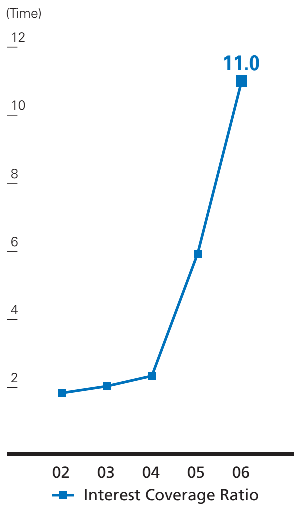
In the Group's main petroleum business, as the transportation of crude oil requires a significant number of days, there is a noticeable time lag between the import of crude oil and the receipt of funds from the sale of petrochemical products. In addition, the Group is required to maintain the equivalent of 70 days of domestic sales volume as reserves) Thus, as an import-dependent petroleum company, the Group is significantly affected by fluctuations in exchange rates and domestic selling prices. As a result, the Group engages in forward foreign exchange contracts to hedge this risk.

In addition, while the Group continued to proactively reduce interest-bearing debt during the fiscal year under review, short-term borrowings increased as a result of the need for increased operating capital for crude oil imports because of rising crude oil prices. Further, interest-bearing debt increased ¥24.6 billion for the fiscal year to ¥522.4 billion because of the issue of zero coupon bonds with warrants in September 2005. As the Group plans proactive capital expenditures under the "New Consolidated Mid-Term Management Plan", it will flexibly procure capital based on market trends, while at the same time working to achieve the optimal balance between strengthening its balance sheet and making strategic investments.

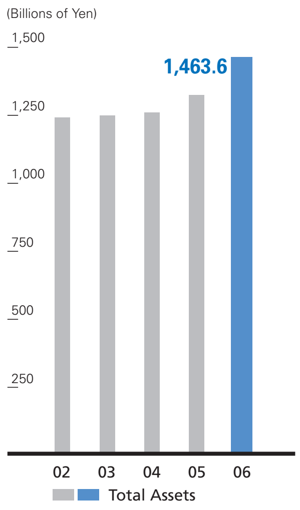
### Current Ratio & Quick Ratio




### Interest Coverage Ratio




### Total Assets



## FINANCIAL POSITION

### Assets

Consolidated total assets as of March 31, 2006 were ¥140.4 billion or 10.6% higher than at the end of the previous fiscal year at ¥1,463.6 billion. The main factors behind an increase in current assets were an 18.6% or ¥35.7 billion increase in notes and accounts receivable, and a 45.2% or ¥105.3 billion increase in inventories.

Net property, plant and equipment declined by ¥24.2 billion or 4.3% from the end of the previous fiscal year to ¥533.0 billion. The main reason for the decline was an ¥18.4 billion or 5.4% decrease in land holdings compared to the end of the previous fiscal year due to the sale of a 229,000$m^2$ idled refinery site in Yokohama in March 2006.

### Liabilities and Shareholders' Equity

Current liabilities at the end of the period were ¥40.8 billion or 5.9% higher than at the end of the previous fiscal year at ¥733.5 billion. As was mentioned regarding total assets, the main factor was a ¥26.2 billion increase in short-term borrowings due to rising crude oil prices. Together with a ¥18.0 billion issue of corporate bonds in September 2005, interest-bearing debt rose ¥24.6 billion or 4.9% over the end of the previous fiscal year to ¥522.4 billion. The interest-bearing debt ratio however improved 1.9 percentage points from 37.6% the previous fiscal year to 35.7%. In addition, net interest-bearing debt declined ¥3.0 billion from the end of the previous fiscal year to ¥465.8 billion, and the adjusted interest-bearing debt ratio improved 3.6 percentage points to 31.8%.

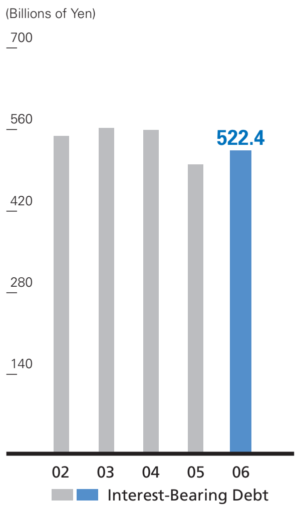
Shareholders' equity rose ¥84.6 billion or 37.1% from the end of the previous fiscal year at ¥312.5 billion. The major reasons for the increase were a ¥51.0 billion increase in retained earnings and a ¥10.5 billion increase in capital surplus as a result of the capital increase in September 2005. In addition, shareholders' equity ratio improved 4.1 percentage points over the end of the previous fiscal year to 21.4%.

### Cash Flows

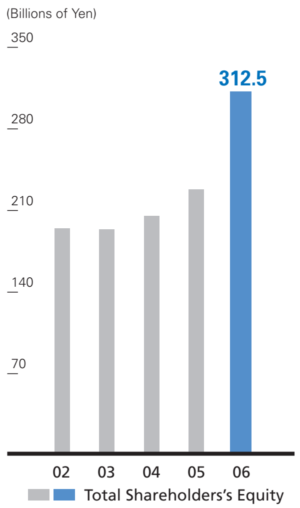
Net cash flow provided by operating activities declined by ¥61.2 billion to minus ¥20.7 billion. While income before income taxes and minority interests increased ¥72.9 billion, the major reasons for the net outflow of cash were a decline in inventories by ¥50.0 billion as the result of inventory valuations, notes and accounts payable, trade declined ¥98.5 billion, notes and accounts receivable, trade declined by ¥26.3 billion and income taxes increased ¥33.0 billion over the end of the previous fiscal year.

Net cash flow used in investing activities was ¥35.2 billion less than the previous fiscal year at ¥1.3 billion. While cash was used in the acquisition of marketable securities, sales of tangible assets, namely the sale of the idled Yokohama

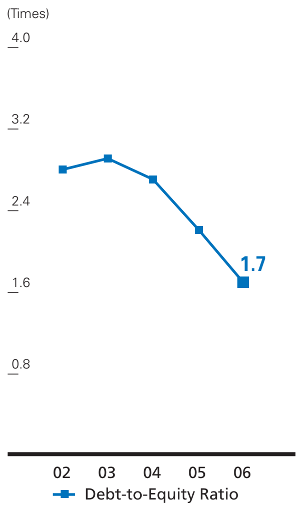
**Interest-Bearing Debt**




**Total Shareholders' Equity**




**Debt-to-Equity Ratio**



refinery site resulted in a cash inflow of ¥25.9 billion led to a significant improvement in net cash outflow, which has tended to be higher in recent years as a result of growth in investments. As a result of the above, net cash and cash equivalents at the end of the period increased ¥18.6 billion (48.8%) to ¥56.6 billion compared to the end of the previous fiscal year.

### Capital Expenditures

Capital expenditures for the Petroleum and Oil Exploration and Production businesses were ¥31.8 billion for the fiscal year. Capital expenditures in the Marketing segment were ¥5.9 billion and mainly for new and refurbished SS, while capital expenditures for the Refining segment were ¥9.6 billion, mainly for, maintenance/renewal expenditures for refineries. In addition, capital expenditures in the Oil Exploration and Production were ¥12.4 billion.

Capital expenditures of ¥140 billion are planned under the "New Consolidated Mid-Term Management Plan" between the fiscal 2005 and 2007. Of this total, ¥99.0 billion of capital expenditures are planned for strategic investments in refinery value-added improvements, investment in SS, and oil exploration and production.

### Basic Policy Regarding Earnings Appropriation

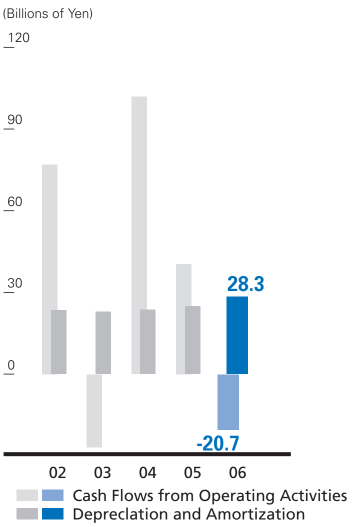
The Group places particular emphasis on shareholder returns, and its basic policy is to maintain stable dividends while maintaining an appropriate funding balance between strengthening financial structure, future business development and business performance. For the fiscal year under review, a dividend increase of ¥2 per share over the prior fiscal year was declared, resulting in a full year dividend of ¥10 per share (consisting of an interim dividend of ¥3 per share, an end of period dividend of ¥5 per share and a 20-Year anniversary commemorative dividend of ¥2 per share).

## BUSINESS AND OTHER RISKS

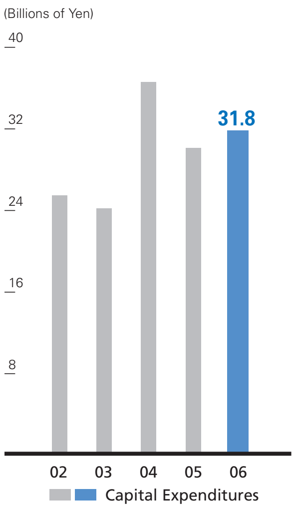
The Group's business performance and financial condition is subject to a number of factors that in the future could have a significant impact. The following is a summary of the major risk factors that the Group incurs in the course of its business development that could have a material impact on business performance and financial condition. The Group proactively discloses all risks it considers important to investors investing in Cosmo Oil stock, including external factors over which the Group has no control and which have little probability of occurring. Moreover, the following risks are not all-inclusive of the risks associated with investment in Cosmo Oil's stock.

In addition, forward-looking statements contained in the following discussion are based on Group assumptions and forecasts as of June 29, 2006.

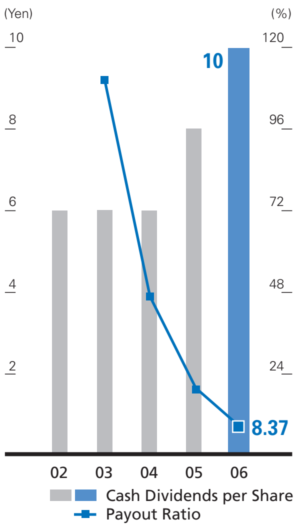
**Cash Flows from Operating Activities & Depreciation and Amortization**




**Capital Expenditures**




**Cash Dividends per Share & Payout Ratio**



(1) Supply and Demand Trends

Gasoline, kerosene and diesel fuel sales are a major proportion of the Group's total sales and are strongly affected by general trends in personal consumption. In addition, demand for naphtha is strongly affected by demand trends in the petroleum industry, while diesel fuel demand is affected by the transportation industry, and heavy fuel oil demand by the electric power and shipping industries. As a result, changes in economic as well as weather conditions can cause fluctuations in demand, which in turn can have a material impact on the scale of the Group's sales.

(2) Crude Oil Price Fluctuations

Crude oil prices are significantly affected by demand and production trends. In terms of demand trends, the impact of large consuming nations and regions such as the U.S. and the rapidly growing Asian region (particularly China) is particularly significant, while production increases and decreases in Middle Eastern oil producing nations have a large impact on production trends. In addition to the outbreak of war around oil producing nations, political instability, terrorism and other uncertainties that can significantly affect crude oil prices and supply, production stoppages at the Group's production bases can also have a material impact on the Group's business performance and financial condition.

As the price of crude oil accounts for the bulk of the Groups cost of sales, sharp declines in crude oil prices as a result of global supply-demand trends can result in a higher-than-market cost burden for the Group. Thus price fluctuations in crude oil prices can significantly affect the Group's costs.

(3) Foreign Exchange Rate Fluctuations

The Group imports crude oil and petroleum products from overseas, and usually pays for these imports in U.S. dollars, which means that fluctuations in foreign exchange rates can cause foreign currency exchange rate losses or gains. In order to minimize the impact of foreign exchange rates, the Group engages in currency hedge transactions. However, as a weaker Yen results in higher procurement costs, exchange rate fluctuations can have a material impact on the Group's business performance and financial condition.

(4) Market Impact

As previously explained, the cost of the Group's major petroleum products is determined by international market prices of crude oil and foreign exchange rates. On the other hand, the Group's marketing activities are conducted within Japan and selling prices are determined by domestic market conditions. Consequently, gaps and/or time lags between international and domestic market prices can have a material impact on the Group's business performance and financial condition.

(5) Interest Rate Fluctuations

Interest rate fluctuations can lead to future rises in borrowing costs as interest rates rise. Thus interest rate fluctuations can have an impact on the Group's borrowing costs and can materially affect the Group's business performance and financial condition.

(6) Asset Value Fluctuations

Depending on economic circumstances, valuation losses on the value of assets such as land and marketable securities that are held by the Group because of fluctuations in asset prices could have a material impact on the business performance and financial condition of the Group.

(7) Competition Risk

The Group is engaged in stiff competition with domestic and overseas companies mainly in the petroleum business. While the Group is working to maintain and improve its competitiveness, the inability to maintain efficient business operations relative to competing companies may have a material impact on the Group's business performance and financial condition.

(8) Natural Disasters and Accidents

As refineries handle large volumes of flammable material, the Group takes particular care in implementing various safety measures to prevent accidents and avoid workplace injuries. This notwithstanding, the occurrence of an earthquake, other natural disasters or unforeseen accidents can result in unavoidable stoppages of operations. In addition, unforeseen accidents in non-refinery operations such as storage depots, service stations, marine tankers and tanker trucks could noticeably affect the Group's operations and have a material impact on the Group's business performance.

(9) Oil Industry Regulations

Various regulations regarding pollution and environmental issues that affect the oil industry have been implemented, and the Group bears the cost of complying with these regulations. As more stringent environmental countermeasures are expected, the Group recognizes the possibility that it could be subject to new laws, regulations and taxes. Going forward, there is a risk that new laws or amendments to existing laws will result in an additional cost burden for the Group.

(10) Information Management

In term of information security, virus countermeasures and personal information protection measures have been implemented to strengthen the Group's internal IT system security. In addition, the Group has contracted external third parties and implemented audits in addition to establishing internal monitoring procedures and internal regulations for the handling of confidential information, including customer information. However, the unforeseen loss, leakage and alteration of confidential information including personal information could result in a loss of customer trust and tarnish the Group's brand image, which in turn could have a material impact on the Group's sales base and business performance.

## OUTLOOK

Regarding the future outlook, in addition to uncertainties in terms of crude oil prices and exchange rates, given market trends as well as responses to environmental issues, we believe that the operating environment will need to be closely monitored. By consistently implementing the "New Consolidated Mid-Term Management Plan", the Cosmo Oil Group plans to strengthen its earnings base and implement its strategies for growth. The targets for the fiscal year ending March 2008 include consolidated operating income of ¥88 billion and net income of ¥41 billion.

In addition, regarding the April 2006 fire at the Group's Chiba refinery, while many uncertainties such as the outlook for the complete restoration of operations and alternative product supply methods remain, we are currently forecasting an impact of approximately ¥10 billion in terms of the loss of earnings from alternative supplies and lost export opportunities.

The fiscal year ending March 2007 is the second year of the Group's New Consolidated Mid-Term Management Plan. Based on our assumptions for an average Dubai crude oil price of $56.5/barrel (FOB), an average exchange rate of ¥115.00/US$ and full fiscal year domestic fuel oil sales volume of 97.1% the previous fiscal year's levels, we are forecasting consolidated net sales of ¥2,680 billion, operating income of ¥69 billion and net income for the period of ¥22 billion.

# CONSOLIDATED BALANCE SHEETS

*Cosmo Oil Company, Limited and Consolidated Subsidiaries. Years ended March 31*

| | Millions of Yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| **ASSETS** | | | |
| Current assets: | | | |
| Cash and deposits (Notes 4 and 15) | ¥ 28,987 | ¥ 56,646 | $ 482,217 |
| Marketable securities (Notes 4, 9 and 15) | 5,896 | 2,247 | 19,128 |
| Notes and accounts receivable, trade | 192,295 | 228,008 | 1,940,989 |
| Less allowance for doubtful accounts | (914) | (553) | (4,707) |
| | 191,381 | 227,455 | 1,936,282 |
| Inventories (Note 3) | 233,077 | 338,340 | 2,880,225 |
| Other current assets (Note 12) | 151,872 | 137,716 | 1,172,350 |
| Total current assets | 611,213 | 762,404 | 6,490,202 |
| Property, plant and equipment (Notes 2, 6 and 15): | | | |
| Land | 338,188 | 319,765 | 2,722,099 |
| Buildings and structures | 437,681 | 440,742 | 3,751,954 |
| Machinery and equipment | 388,968 | 396,607 | 3,376,241 |
| Construction in progress | 6,716 | 6,742 | 57,393 |
| | 1,171,553 | 1,163,856 | 9,907,687 |
| Less accumulated depreciation | (614,319) | (630,850) | (5,370,307) |
| Net property, plant and equipment | 557,234 | 533,006 | 4,537,380 |
| Other assets: | | | |
| Investments in securities (Notes 9 and 15) | 88,327 | 98,318 | 836,963 |
| Long-term loans receivable | 4,578 | 3,134 | 26,679 |
| Other (Note 12) | 64,870 | 68,239 | 580,905 |
| Less allowance for doubtful accounts | (3,073) | (1,522) | (12,956) |
| Total other assets | 154,702 | 168,169 | 1,431,591 |
| Total | ¥ 1,323,149 | ¥ 1,463,579 | $ 12,459,173 |

| | | Millions of Yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| Current liabilities: | | | |
| Short-term loans and current maturities of long-term debt (Notes 5 and 15) | ¥ 171,613 | ¥ 197,797 | $ 1,683,809 |
| Notes and accounts payable, trade (Notes 15) | 279,154 | 273,182 | 2,325,547 |
| Income, excise and other taxes payable | 116,860 | 121,822 | 1,037,048 |
| Accrued expenses and other current liabilities (Note 12) | 124,993 | 140,651 | 1,197,335 |
| Total current liabilities | 692,620 | 733,452 | 6,243,739 |
| Long-term debt, less current maturities (Note 5 and 15) | 326,191 | 324,633 | 2,763,540 |
| Deferred tax for revaluation reserve for land (Notes 6 and 12) | 13,705 | 20,332 | 173,082 |
| Retirement and severance benefits (Notes 2 and 11) | 8,234 | 5,565 | 47,374 |
| Other long-term liabilities (Notes 12 and 15) | 36,557 | 46,290 | 394,058 |
| Minority interests | 17,945 | 20,803 | 177,092 |
| Contingencies (Note 8) | | | |
| Shareholders' equity: | | | |
| Common stock, authorized - 1,700,000,000 shares; issued - 671,705,087 shares at March 31, 2006 | 51,887 | 62,367 | 530,919 |
| Capital surplus | | | |
| Additional paid-in capital | 34,093 | 44,561 | 379,339 |
| Retained earnings | 115,161 | 166,149 | 1,414,395 |
| Revaluation reserve for land (Note 6) | 20,076 | 24,277 | 206,666 |
| Net unrealized gains on securities | 7,862 | 15,999 | 136,196 |
| Foreign currency translation adjustments | (1,103) | (753) | (6,410) |
| Less treasury stock, at cost | (79) | (96) | (817) |
| Total shareholders' equity | 227,897 | 312,504 | 2,660,288 |
| Total | ¥ 1,323,149 | ¥ 1,463,579 | $ 12,459,173 |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF INCOME

*Cosmo Oil Company, Limited and Consolidated Subsidiaries. Years ended March 31*

| | Millions of Yen | | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|---|
| | 2004 | 2005 | **2006** | **2006** |
| **Net sales** (Note 14) | ¥ 1,916,278 | ¥ 2,154,559 | ¥ 2,670,628 | $ 22,734,554 |
| **Cost of sales** (Note 2) | 1,758,858 | 1,956,160 | 2,422,272 | 20,620,346 |
| Gross profit | 157,420 | 198,399 | 248,356 | 2,114,208 |
| **Selling, general and administrative expenses** (Note 2) | 132,174 | 132,701 | 137,108 | 1,167,175 |
| Operating income (Note 14) | 25,246 | 65,698 | 111,248 | 947,033 |
| **Other income (expenses):** | | | | |
| Interest and dividend income | 1,559 | 2,333 | 6,490 | 55,248 |
| Interest expenses (Note 5) | (11,867) | (11,484) | (10,747) | (91,487) |
| Foreign currency exchange gain (loss), net | (18) | (649) | 3,439 | 29,276 |
| Net loss on sale and disposal of property, plant and equipment | (1,864) | (1,832) | (1,141) | (9,713) |
| Impairment loss on fixed assets (Notes 2,13 and 14) | — | (11,330) | (1,976) | (16,821) |
| Equity in earnings of affiliates | 2,717 | 5,508 | 9,578 | 81,536 |
| Write-down of marketable securities and investments in securities | (283) | (70) | (79) | (673) |
| Provision for prior year portion of allowance for retirement benefits for directors and corporate auditors (Note 2) | — | (460) | — | — |
| Gain on sale of investments in securities | 1,321 | 1,974 | 344 | 2,928 |
| Loss on sale of investments in securities | (69) | (26) | (24) | (204) |
| Bad debt expense for affiliates | — | (3,300) | — | — |
| Compensation received for the transfer of the facilities | — | — | 1,200 | 10,215 |
| Collection of receivables written-off | — | — | 2,602 | 22,150 |
| Other, net | 850 | 1,171 | (541) | (4,605) |
| | (7,654) | (18,165) | 9,145 | 77,850 |
| Income before income taxes and minority interests | 17,592 | 47,533 | 120,393 | 1,024,883 |
| **Income taxes:** | | | | |
| Current | 11,375 | 28,113 | 50,741 | 431,949 |
| Deferred (Note 12) | (2,641) | (7,320) | 4,556 | 38,784 |
| | 8,734 | 20,793 | 55,297 | 470,733 |
| Income before minority interests | 8,858 | 26,740 | 65,096 | 554,150 |
| **Minority interests** | (679) | (325) | (3,301) | (28,101) |
| **Net income** | ¥ 8,179 | ¥ 26,415 | ¥ 61,795 | $ 526,049 |

| | | | Yen | U.S.dollars (Note 1) |
|---|---|---|---|---|
| **Earnings per share:** | | | | |
| Basic | ¥ 12.95 | ¥ 41.73 | ¥ 94.54 | $ 0.80 |
| Diluted | 12.74 | — | 92.17 | 0.78 |
| Cash dividends (Note 16) | 6.00 | 8.00 | 10.00 | 0.09 |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

*Cosmo Oil Company, Limited and Consolidated Subsidiaries. Years ended March 31*

Millions of Yen

| | Number of shares of common stock (Thousands) | Common stock | Capital surplus | Retained earnings | Revaluation reserve for land | Net unrealized gains(losses) on securities | Foreign currency translation adjustments | Treasury stock, at cost |
|---|---|---|---|---|---|---|---|---|
| **Balance at March 31, 2003** | 631,705 | ¥ 51,887 | ¥ 34,092 | ¥ 93,568 | ¥ 15,528 | ¥ (658) | ¥ (746) | ¥ (76) |
| Net income for the year | — | — | — | 8,179 | — | — | — | — |
| Adjustments from translation of foreign currency financial statements | — | — | — | — | — | — | (293) | — |
| Cash dividends | — | — | — | (3,792) | — | — | — | — |
| Bonuses to directors and corporate auditors | — | — | — | (13) | — | — | — | — |
| Increase resulting from increase in consolidated subsidiaries | — | — | — | 73 | — | — | — | — |
| Reversal of revaluation reserve for land (Note 6) | — | — | — | (37) | 37 | — | — | — |
| Changes in effective tax rate | — | — | — | — | (235) | — | — | — |
| Adjustment to revaluation reserve for land | — | — | — | — | 116 | — | — | — |
| Increase resulting from mergers | — | — | — | 63 | — | — | — | — |
| Decrease resulting from mergers | — | — | — | (152) | — | — | — | — |
| Increase due to revaluation of available-for-sale securities | — | — | — | — | — | 7,260 | — | — |
| Loss on retirement of treasury stock | — | — | — | (6) | — | — | — | — |
| Sales of treasury stock, net | — | — | — | — | — | — | — | 11 |
| **Balance at March 31, 2004** | 631,705 | 51,887 | 34,092 | 97,883 | 15,446 | 6,602 | (1,039) | (65) |
| Net income for the year | — | — | — | 26,415 | — | — | — | — |
| Adjustments from translation of foreign currency financial statements | — | — | — | — | — | — | (64) | — |
| Cash dividends | — | — | — | (3,789) | — | — | — | — |
| Bonuses to directors and corporate auditors | — | — | — | (5) | — | — | — | — |
| Decrease resulting from increase in consolidated subsidiaries | — | — | — | (177) | — | — | — | — |
| Reversal of revaluation reserve for land (Note 6) | — | — | — | (4,637) | 4,637 | — | — | — |
| Decrease resulting from mergers | — | — | — | (529) | — | — | — | — |
| Increase due to revaluation of available-for-sale securities | — | — | — | — | — | 1,260 | — | — |
| Effect of change in interests of the Company | — | — | — | — | (7) | — | — | — |
| Surplus from sale of treasury stock | — | — | 1 | — | — | — | — | — |
| Sales of treasury stock, net | — | — | — | — | — | — | — | (14) |
| **Balance at March 31, 2005** | 631,705 | 51,887 | 34,093 | 115,161 | 20,076 | 7,862 | (1,103) | (79) |
| Issuance of common stock | 40,000 | 10,480 | 10,468 | — | — | — | — | — |
| Net income for the year | — | — | — | 61,795 | — | — | — | — |
| Adjustments from translation of foreign currency financial statements | — | — | — | — | — | — | 350 | — |
| Increase resulting from mergers | — | — | — | 979 | — | — | — | — |
| Cash dividends | — | — | — | (5,172) | — | — | — | — |
| Bonuses to directors and corporate auditors | — | — | — | (71) | — | — | — | — |
| Reversal of revaluation reserve for land (Note 6) | — | — | — | (6,543) | 6,543 | — | — | — |
| Increase due to revaluation of available-for-sale securities | — | — | — | — | — | 8,137 | — | — |
| Valuation allowance | — | — | — | — | (2,342) | — | — | — |
| Surplus from sale of treasury stock | — | — | 0 | — | — | — | — | — |
| Sales of treasury stock, net | — | — | — | — | — | — | — | (17) |
| **Balance at March 31, 2006** | 671,705 | ¥ 62,367 | ¥ 44,561 | ¥ 166,149 | ¥ 24,277 | ¥ 15,999 | ¥ (753) | ¥ (96) |

Thousands of U.S. dollars (Note 1)

| | Common stock | Capital surplus | Retained earnings | Revaluation reserve for land | Net unrealized gains(losses) on securities | Foreign currency translation adjustments | Treasury stock, at cost |
|---|---|---|---|---|---|---|---|
| **Balance at March 31, 2005** | $ 441,704 | $ 290,227 | $ 980,344 | $ 170,903 | $ 66,928 | $ (9,390) | $ (672) |
| Issuance of common stock | 89,215 | 89,111 | — | — | — | — | — |
| Net income for the year | — | — | 526,049 | — | — | — | — |
| Adjustments from translation of foreign currency financial statements | — | — | — | — | — | 2,980 | — |
| Increase resulting from mergers | — | — | 8,334 | — | — | — | — |
| Cash dividends | — | — | (44,028) | — | — | — | — |
| Bonuses to directors and corporate auditors | — | — | (605) | — | — | — | — |
| Reversal of revaluation reserve for land (Note 6) | — | — | (55,699) | 55,699 | — | — | — |
| Increase due to revaluation of available-for-sale securities | — | — | — | — | 69,268 | — | — |
| Valuation allowance | — | — | — | (19,936) | — | — | — |
| Surplus from sale of treasury stock | — | 1 | — | — | — | — | — |
| Sales of treasury stock, net | — | — | — | — | — | — | (145) |
| **Balance at March 31, 2006** | $ 530,919 | $ 379,339 | $ 1,414,395 | $ 206,666 | $ 136,196 | $ (6,410) | $ (817) |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

*Cosmo Oil Company, Limited and Consolidated Subsidiaries. Years ended March 31*

| | Millions of Yen | | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|---|
| | 2004 | 2005 | **2006** | **2006** |
| **Cash flows from operating activities:** | | | | |
| Income before income taxes and minority interests | ¥ 17,592 | ¥ 47,533 | ¥ 120,393 | $1,024,883 |
| Adjustments to reconcile income before income taxes and minority interests to net cash provided by (used in) operating activities: | | | | |
| Depreciation and amortization | 23,632 | 24,927 | 28,313 | 241,023 |
| Amortization of consolidation goodwill | 1 | (86) | 380 | 3,235 |
| Impairment loss on fixed assets | — | 11,330 | 1,976 | 16,821 |
| Increase (decrease) in allowance for doubtful accounts | 233 | 325 | (1,912) | (16,276) |
| Increase (decrease) in retirement and severance benefits | 321 | 2,574 | (2,795) | (23,793) |
| Interest and dividend income | (1,559) | (2,333) | (6,490) | (55,248) |
| Interest expenses | 11,867 | 11,484 | 10,747 | 91,487 |
| Equity in earnings of affiliates | (2,717) | (5,508) | (9,578) | (81,536) |
| Net loss on sale or disposal of property, plant and equipment | 2,315 | 2,481 | 1,141 | 9,713 |
| Write-down of marketable securities and investments in securities | 283 | 70 | — | — |
| Decrease (increase) in notes and accounts receivable | 28,541 | (9,374) | (35,713) | (304,018) |
| Decrease (increase) in inventories | 8,576 | (55,233) | (105,263) | (896,084) |
| Increase (decrease) in notes and accounts payable | (35,414) | 92,504 | (5,972) | (50,839) |
| Decrease (increase) in other current assets | 24,781 | (50,137) | 10,774 | 91,717 |
| Increase (decrease) in other current liabilities | 36,958 | (7,495) | 14,862 | 126,517 |
| Decrease (increase) in other investments | — | — | 5,712 | 48,625 |
| Other, net | 5,667 | (1,131) | (529) | (4,502) |
| Subtotal | 121,077 | 61,931 | 26,046 | 221,725 |
| Interest and dividend received | 1,649 | 2,918 | 10,193 | 86,771 |
| Interest paid | (11,884) | (11,259) | (10,804) | (91,972) |
| Income taxes paid | (9,015) | (13,096) | (46,120) | (392,612) |
| Net cash provided by (used in) operating activities | 101,827 | 40,494 | (20,685) | (176,088) |
| **Cash flows from investing activities:** | | | | |
| Payments for purchases of property, plant and equipment | (27,813) | (26,349) | (18,989) | (161,650) |
| Proceeds from sale or disposal of property, plant and equipment | 2,069 | 8,723 | 25,918 | 220,635 |
| Payments for purchases of marketable securities and investments in securities | (3,840) | (13,959) | (76) | (647) |
| Proceeds from sale of marketable securities and investments in securities | 5,545 | 11,721 | 2,139 | 18,209 |
| Payments for intangible assets and deferred charges | (8,232) | (2,692) | (11,885) | (101,175) |
| Decrease (increase) in short-term loans receivable | (482) | 943 | (535) | (4,554) |
| Payments for long-term loans receivable | (2,193) | (11,207) | (154) | (1,311) |
| Proceeds from long-term loans receivable | 1,690 | 6,148 | 1,428 | 12,156 |
| Proceeds from factoring | 498 | 1,283 | 514 | 4,376 |
| Payments for acquisition of shares of newly consolidated subsidiaries (Note 4) | — | (10,573) | — | — |
| Proceeds from acquisition of shares of newly consolidated subsidiary (Note 4) | — | 427 | — | — |
| Other, net | 49 | (1,042) | 292 | 2,486 |
| Net cash used in investing activities | (32,709) | (36,577) | (1,348) | (11,475) |
| **Cash flows from financing activities:** | | | | |
| Increase (decrease) in short-term loans payable | (16,266) | (47,854) | 47,750 | 406,487 |
| Proceeds from long-term loans payable | 116,159 | 77,087 | 29,794 | 253,631 |
| Repayments for long-term loans payable | (57,200) | (78,439) | (48,911) | (416,370) |
| Proceeds from issuance of common stock | — | — | 20,811 | 177,160 |
| Proceeds from issuance of convertible bonds | — | — | 17,971 | 152,984 |
| Redemptions of bonds | (46,100) | — | (21,500) | (183,025) |
| Redemptions of convertible bonds | (18) | (16,523) | — | — |
| Cash dividends paid | (3,792) | (3,790) | (5,172) | (44,028) |
| Cash dividends paid for minority shareholders | (513) | (510) | (498) | (4,239) |
| Proceeds from issuing shares for minority shareholders | 183 | 19 | — | — |
| Other, net | (132) | (153) | (637) | (5,425) |
| Net cash provided by (used in) financing activities | (7,679) | (70,163) | 39,608 | 337,175 |
| **Effect of exchange rate changes on cash and cash equivalents** | (1,171) | (212) | 895 | 7,620 |
| **Net increase (decrease) in cash and cash equivalents** | 60,268 | (66,458) | 18,470 | 157,232 |
| **Cash and cash equivalents at beginning of year** | 43,810 | 104,520 | 38,062 | 324,015 |
| **Cash and cash equivalents from newly consolidated subsidiaries** | 249 | — | 100 | 851 |
| **Cash and cash equivalents from mergers** | 193 | — | — | — |
| **Cash and cash equivalents at end of year** (Note 4) | ¥104,520 | ¥ 38,062 | ¥ 56,632 | $ 482,098 |

The accompanying notes are an integral part of these statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Cosmo Oil Company, Limited and Consolidated Subsidiaries. Years ended March 31*

## NOTE 1. SUMMARY OF ACCOUNTING POLICIES

### (1) Basis of presenting consolidated financial statements

Cosmo Oil Company, Limited (the "Company") and its consolidated domestic subsidiaries maintain their official accounting records in Japanese yen, and in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with and accounting principles and practices generally accepted in Japan which are different in certain respects as to application and disclosure requirements from International Financial Reporting Standards ("Japanese GAAP"). The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile.

The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of consolidated statements of shareholders' equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying consolidated financial statements.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of the reader outside Japan, using the prevailing exchange rate at March 31, 2006, which was ¥117.47 to US$1. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

### (2) Reporting entity

The consolidated financial statements include the accounts of the Company and its significant subsidiaries. All significant intercompany transactions and account balances are eliminated in consolidation.

In the elimination of investments in subsidiaries, the assets and liabilities of the subsidiaries, including the portion attributable to minority shareholders, are recorded based on the fair value at the time the Company acquired control of the respective subsidiaries.

The excess of cost over net assets of subsidiaries acquired ("Goodwill") is amortized on a straight-line basis over a period of five years. If the amounts are small, they are expensed as incurred.

Investments in non-consolidated subsidiaries and affiliates of which the Company has the ability to exercise significant influence over operating and financial policies are accounted for using the equity method.

The numbers of consolidated subsidiaries and affiliates accounted for using the equity method at March 31, 2004, 2005 and 2006 are as follows:

| | 2004 | 2005 | **2006** |
|---|---|---|---|
| Consolidated subsidiaries | 31 | 31 | **30** |
| Subsidiaries using the equity method | 38 | 34 | **34** |
| Affiliates using the equity method | 5 | 4 | **4** |

Investments in unconsolidated subsidiaries and affiliates not accounted for using the equity method are carried at cost (adjusted for any substantial and non-recoverable decline in value). The effect on consolidated net income and retained earnings of not applying the equity method for these investments is not material in the aggregate.

### (3) Statements of cash flows

In preparing the consolidated statements of cash flows, cash on hand, readily available deposits and short-term highly liquid investments with maturities of not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

### (4) Conversion of foreign currencies and translation of statements

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end exchange rates with resulting gains or losses included in the current statements of income.

All the items of financial statements of subsidiaries, which are stated in currencies other than Japanese yen, are translated at the year-end exchange rate of each subsidiary, except for shareholders' equity which is translated at historical rates. The resulting foreign currency translation adjustments are included in foreign currency translation adjustments in shareholders' equity.

### (5) Allowance for doubtful accounts

Allowance for doubtful accounts is provided based on the amount calculated at the actual ratio of bad debt for ordinary receivables, and an amount recognized for the uncollectible account for specific doubtful receivables.

### (6) Marketable securities and investments in unconsolidated subsidiaries, affiliates and other securities

Held-to-maturity debt securities are stated at amortized cost. Equity securities issued by subsidiaries and affiliates that are not consolidated or accounted for using the equity method are stated at cost, as determined by the moving-average method. Available-for-sale securities with fair market values are stated at fair market value with unrealized gains and losses reported, net of applicable income taxes, as a separate component of shareholders' equity. Realized gains and losses on sale of such securities are computed using the moving-average method. Other securities with no available fair market value are stated at cost, as determined by the moving-average method.

### (7) Inventories

Inventories are stated principally at cost determined by the average method.

In-transit inventory is stated at cost determined by the specific identification method.

### (8) Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed primarily using the straight-line method over the estimated useful lives of the assets.

The cost and accumulated depreciation applicable to assets retired or otherwise disposed of are eliminated from the related accounts and the gain or loss on sale and disposal is credited or charged to income.

Expenditures for new facilities and those that substantially increase the useful lives of existing property, plant and equipment are capitalized. Maintenance, repair and minor renewals are expensed as incurred.

### (9) Research and development costs

Research and development costs for the improvement of existing skills and technologies or the development of new skills and technologies, including basic research and fundamental development costs, are expensed as incurred.

### (10) Retirement and severance benefits and pension costs

(a) Retirement and severance benefits and pension costs for employees

The Company and its consolidated subsidiaries provided allowance for retirement and severance benefits for employees at the balance sheet date based on the estimated amounts of projected benefit obligation and the fair value of the plan assets at that date.

The net transition obligation of ¥24,222 million, has been recognized in expenses in equal amounts primarily over five years commencing with the year ended March 31, 2001. Actuarial gains and losses are recognized in expenses in equal amounts over 10 years, which is the average of the estimated remaining service lives, commencing with the following period.

(b) Retirement benefits for directors and corporate auditors

The Company and its domestic consolidated subsidiaries recognize liabilities for retirements benefits for directors and corporate auditors at the amounts required, if all directors and corporate auditors had retired at the balance sheet date (See Note 2(2)).

### (11) Allowance for special repair works

The Company and its consolidated subsidiaries provide an allowance for special repair works in an amount equal to the estimated cost of periodically required repairs for oil tanks.

### (12) Finance leases

Finance leases except for those leases under which the ownership of the leased assets is considered to be transferred to the lessee are accounted for in the same manner as operating leases.

### (13) Shareholders' equity

Under the Japanese laws and regulations, the entire amount of payment for new shares is required to be designated as common stock, although, generally, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one-half of the price of the new shares as additional paid-in capital, which is included in capital surplus.

Japanese Company Law ("the Law") became effective on May 1, 2006, and, at the same time, the Japanese Commercial Code was repealed ("the Code").

Under the Code, companies were required to set aside an amount equal to at the least 10% of cash dividends and other cash appropriations as legal earnings reserve until the total of legal earnings reserve and additional paid-in capital equaled 25% of common stock. Under the Law, in cases when dividends are paid, an amount equal to 10% of the dividends or the excess of 25% of common stock over the total of additional paid-in-capital and legal earnings reserve, whichever is the smaller, must be set aside as additional paid-in capital or legal earnings reserve. Under the Code, additional paid-in capital and legal earnings reserve were available for distribution by the resolution of the shareholders' meeting as long as the total amount of legal earnings reserve and additional paid-in capital remained equal to or exceeded 25% of common stock. Under the Law, even when the total amount of additional paid-in capital and legal earnings reserve is less than 25% of common stock, additional paid-in-capital and legal earnings reserve may be available for dividends if there are sufficient distributable surplus. Under the Code, legal earnings reserve and additional paid-in capital could be used to eliminate or reduce a deficit by a resolution of the shareholders' meeting or may be capitalized by a resolution of the Board of Directors. Under the Law, both of those appropriations require a resolution of the shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Japanese laws and regulations.

### (14) Derivative transactions and hedge accounting

The Company and its consolidated subsidiaries state derivative financial instruments at fair value and recognize changes in the fair value as gains or losses unless derivative financial instruments are used for hedging purposes.

If derivative financial instruments are used as hedges and meet certain hedging criteria, the Company defers recognition of gains or losses resulting from changes in fair value of derivative financial instruments until the related losses or gains on the hedged items are recognized.

Also, if interest rate swap contracts are used as hedges and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed.

### (15) Income taxes

The Company and its consolidated subsidiaries provide for income taxes payable on the basis of current tax liabilities and reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for tax purposes and those for financial reporting purposes.

### (16) Revenue Recognition

Revenue from sales of finished products is generally recognized when such products are shipped to customers. Some of its consolidated subsidiaries recognize their construction revenue by using the completed contract method, except for the long-term and large engineering contracts which are more than one year term and of which contract amount is more than ¥100 million ($851 thousand). Such long-term and large engineering contracts are recognized by the percentage of completion method.

### (17) Earning per share

Net income per share is computed based upon the weighted-average number of shares of common stock outstanding during each year.

Diluted net income per share was not disclosed for the year ended March 31, 2005, because no potentially dilutive securities have been issued.

### (18) Allowance for loss on engineering contracts

Cosmo Engineering Company, Limited, the Company's consolidated subsidiary, (hereinafter referred to as Cosmo Engineering) provides for an estimated amount of probable losses to be incurred in the future on certain engineering.

### (19) Reclassifications

Certain prior year amounts have been reclassified to conform to the 2006 presentation.

These changes had no impact on previously reported results of operations or shareholders' equity.

## NOTE 2. CHANGES IN ACCOUNTING POLICY

### (1) Change of classification of logistics expense and subcontracting work expense

For the year ended March 31, 2004, some of the Company's consolidated subsidiaries changed classification of logistics expense and subcontracting work expense from cost of sales to selling, general and administrative expenses.

Changes have been made in order for the group accounting principles to be homogeneous among all consolidated companies.

As a result of the changes, gross profit increased by ¥11,027 million; however, operating income, and income before income taxes and minority interests were not affected.

The change did not have any effect on segment information.

### (2) Change of retirement benefits for directors and corporate auditors

Retirement benefits for directors and corporate auditors are subject to approval at a meeting of shareholders. Previously, retirement benefits for directors and corporate auditors were recorded by the Company as expense when paid. However, for the purpose of more accurately matching them with the period in which they arise and reflecting better the financial position, the amounts required if all directors and corporate auditors had retired at the balance sheet date are fully accrued from the fiscal year ended March 31,2005.

Since the current year portion of the provision for the retirement benefits of ¥146million is represented in selling general and administrative expenses and the cumulative effect on prior years' portion is represented individually in the other income (expense) section, the effect of this change was to decrease operating income by ¥146million and to decrease income before income taxes and minority interests by ¥606 million. (See Note 11)

The effect of the changes in segment information is not material.

### (3) Adoption of impairment on fixed assets

Effective April 1, 2004, the Company and its consolidated subsidiaries adopted a new accounting standard for impairment on fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and "Implementation Guidance for the Accounting Standard for Impairment of Fixed Assets" (the Financial Accounting Standard Implementation Guidance No.6 issued by the Accounting Standards Board of Japan on October 31, 2003) with early adoption permitted from the year ended March 31, 2004 or thereafter.

The effect of the adoption of this new standard was to decrease income before income taxes and minority interests by ¥11,330 million for the year ended March 31, 2005.

The effect of the change in segment information is disclosed in Note 14.

## NOTE 3. INVENTORIES

Inventories at March 31, 2005 and 2006 were summarized as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| Finished products | ¥ 53,867 | **¥ 90,777** | **$ 772,768** |
| Semi-finished products | 36,580 | **45,661** | **388,703** |
| Materials-crude oil, auxiliary materials, etc. | 63,649 | **80,994** | **689,487** |
| Supplies-spare parts, etc. | 4,907 | **5,582** | **47,519** |
| In-transit crude oil and oil products | 71,483 | **112,480** | **957,521** |
| Land for sale | 737 | **387** | **3,294** |
| Others | 1,854 | **2,459** | **20,933** |
| Total | ¥ 233,077 | **¥ 338,340** | **$ 2,880,225** |

## NOTE 4. NOTES TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS

(a) Cash and deposits, and cash equivalents

Reconciliation between cash and deposits in the consolidated balance sheets with cash and cash equivalents in the consolidated statements of cash flows at March 31, 2005 and 2006 were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| Cash and deposits | ¥ 28,987 | **¥ 56,646** | **$ 482,217** |
| **Add:** | | | |
| Marketable securities | 5,896 | **2,247** | **19,128** |
| Other current assets | 5,479 | **—** | **—** |
| **Less:** | | | |
| Deposits with maturities exceeding three months | 197 | **14** | **119** |
| Bonds with maturities exceeding three months included in marketable securities above | 2,103 | **2,247** | **19,128** |
| Cash and cash equivalents | ¥ 38,062 | **¥ 56,632** | **$ 482,098** |

(b) Assets and liabilities of the newly consolidated subsidiaries by acquisition of shares at the inception of their consolidation for the year ended March 31, 2005, related acquisition cost and net expenditure for acquisition of shares are as follows:

| | Millions of yen |
|---|---|
| | 2005 |
| Current assets | ¥ 8,144 |
| Fixed assets | 11,003 |
| Current liabilities | (4,709) |
| Fixed liabilities | (15,990) |
| Consolidation differences | 1,655 |
| Acquisition cost of shares | 103 |
| Acquisition cost of receivables under Civil Rehabilitation Law | 15,400 |
| Cash and cash equivalents of the acquired companies | 4,930 |
| Payments for acquisition of shares of newly consolidated subsidiaries | ¥ (10,573) |

(c) Assets and liabilities of the newly consolidated subsidiary by acquisition of shares allocated to the Company at the inception of their consolidation for the year ended March 31, 2005, related acquisition cost and proceeds (net) from acquisition of shares are as follows:

| | Millions of yen |
|---|---|
| | 2005 |
| Current assets | ¥ 1,149 |
| Fixed assets | 13,785 |
| Current liabilities | (1,937) |
| Fixed liabilities | (11,188) |
| Minority interests | (268) |
| Consolidation differences | 367 |
| Acquisition cost of shares | 1,908 |
| Payment during the previous year | (1,338) |
| Cash and cash equivalents of the acquired companies | 997 |
| Proceeds from acquisition of shares of newly consolidated subsidiaries | ¥ 427 |

## NOTE 5. SHORT-TERM LOANS AND LONG-TERM DEBT

The short-term loans from banks of ¥101,923 million and ¥149,166 million ($1,269,822 thousand), as of March 31, 2005 and 2006, bear interest ranging from 0.20% to 3.37% and from 0.10% to 5.36% per annum, respectively. The banks have basic agreements with the Company and its consolidated subsidiaries to the effect that, with respect to all present or future loans with the banks, the Company and its consolidated subsidiaries shall provide collateral (including sums on deposit with such banks) or guarantees immediately upon request from the banks and that any collateral furnished, pursuant to such agreement or otherwise, will be applicable to all indebtedness to the banks.

Short-term loans and current maturities of long-term debt at March 31, 2005 and 2006 consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| Short-term loans | ¥ 101,923 | **¥ 149,166** | **$ 1,269,822** |
| Current maturities of long-term debt | 69,690 | **48,631** | **413,987** |
| Total | ¥ 171,613 | **¥ 197,797** | **$ 1,683,809** |

Long-term debts at March 31, 2005 and 2006 consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| Loans from banks, insurance companies and other financial institutions, secured, with interest at 0.00% - 4.15%, due serially through 2016 | ¥ 338,581 | **¥ 319,464** | **$ 2,719,537** |
| 3.3% unsecured straight yen bonds due in 2007 | 9,500 | **9,500** | **80,872** |
| 3.15% unsecured straight yen bonds due in 2007 | 7,800 | **7,800** | **66,400** |
| 3.50% unsecured straight yen bonds due in 2005 | 4,200 | **—** | **—** |
| 3.10% unsecured straight yen bonds due in 2005 | 4,700 | **—** | **—** |
| 3.00% unsecured straight yen bonds due in 2006 | 4,500 | **—** | **—** |
| 3.05% unsecured straight yen bonds due in 2006 | 3,800 | **—** | **—** |
| 2.84% unsecured straight yen bonds due in 2005 | 2,800 | **—** | **—** |
| 1.34% unsecured straight yen bonds due in 2007 | 10,000 | **10,000** | **85,128** |
| 1.60% unsecured straight yen bonds due in 2008 | 10,000 | **8,500** | **72,359** |
| Unsecured zero coupon convertible bonds due in 2010 (bonds with stock acquisition rights) | — | **18,000** | **153,231** |
| | 395,881 | **373,264** | **3,177,527** |
| Less current maturities | (69,690) | **(48,631)** | **(413,987)** |
| Total | ¥ 326,191 | **¥ 324,633** | **$ 2,763,540** |

The aggregate annual maturities of long-term debt at March 31, 2006 were as follows:

| Year ending March 31, | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|
| 2007 | ¥ 48,631 | $ 413,987 |
| 2008 | 83,069 | 707,151 |
| 2009 | 79,569 | 677,356 |
| 2010 | 36,596 | 311,535 |
| 2011 and thereafter | 125,399 | 1,067,498 |
| Total | ¥ 373,264 | $ 3,177,527 |

Information with respect to the Company's convertible bonds (bonds with stock acquisition rights) is as follows:

| | |
|---|---|
| a. Issued on | September 26, 2005 |
| b. Initial principal | ¥18,000 million |
| c. Maturity | September 30, 2010 |
| d. Term of conversion | November 1, 2005 to September 29, 2010 |
| e. Conversion price per share at March 31, 2006 | ¥624 ($5.31) |
| f. Balance of debt at March 31, 2006 | ¥18,000 million ($153,231 thousand) |
| g. Accumulated number of shares issued upon conversion in exchange for treasury stock through March 30, 2006 | — |
| h. Number of additional shares that would be issued upon conversion at March 31, 2006 | 28,846,153 shares |

## NOTE 6. REVALUATION RESERVE FOR LAND

Pursuant to Article 2, Paragraphs 4 and 5 of the Enforcement Ordinance for the Law concerning Revaluation Reserve for Land (the "Law"), enacted on March 31, 1998, and partial revision to the Law on March 31, 2001, the Company and two of its consolidated subsidiaries recorded their own lands used for business at fair value as of March 31, 2002 and the related unrealized gain, net of income taxes, was credited to "Revaluation reserve for land" in the shareholders' equity section, and the applicable income tax portion was reported as "Deferred taxes for revaluation reserve for land" in liabilities. According to the Law, the Company and two of its consolidated subsidiaries are not permitted to revalue the land at any time in the future, even in case the fair value of the land declines.

Differences between the fair value and carrying amount of the revalued land as of March 31, 2005 and 2006 were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| Difference between the fair value and carrying amount of the revalued land | ¥ (75,701) | **¥ (84,686)** | **$ (720,916)** |

## NOTE 7. LEASE TRANSACTIONS

A. Lessee leases

Lease payments of finance leases under which the ownership of the leased assets is not transferred to lessees for the years ended March 31, 2004, 2005 and 2006 were ¥4,080 million, ¥3,958 million and ¥3,618 million ($30,799 thousand), respectively.

Total lease obligations as of March 31, 2005 and 2006 with interest portion under such leases were ¥9,824 million and ¥8,987 million ($76,505 thousand), including ¥3,609 million and ¥3,356 million ($28,569 thousand) due within one year. Included in the total lease obligation as of March 31, 2006 is the obligation for a sub-lease payment of ¥3,961 million ($33,719 thousand).

Equivalent of acquisition cost, accumulated depreciation, and net book value of leased properties for the years ended March 31, 2005 and 2006 were as follows:

| | Millions of yen | | |
|---|---|---|---|
| Year ended March 31, 2005 | Machinery & equipment | Other | Total |
| Acquisition cost equivalent | ¥ 3,962 | ¥ 6,656 | ¥ 10,618 |
| Accumulated depreciation equivalent | (2,272) | (3,314) | (5,586) |
| Net book value equivalent | ¥ 1,690 | ¥ 3,342 | ¥ 5,032 |

| | Millions of yen | | |
|---|---|---|---|
| Year ended March 31, 2006 | Machinery & equipment | Other | Total |
| Acquisition cost equivalent | **¥ 3,892** | **¥ 7,206** | **¥ 11,098** |
| Accumulated depreciation equivalent | **(2,231)** | **(3,841)** | **(6,072)** |
| Net book value equivalent | **¥ 1,661** | **¥ 3,365** | **¥ 5,026** |

| | Thousands of U.S. dollars (Note 1) | | |
|---|---|---|---|
| Year ended March 31, 2006 | Machinery & equipment | Other | Total |
| Acquisition cost equivalent | **$ 33,132** | **$ 61,343** | **$ 94,475** |
| Accumulated depreciation equivalent | **(18,992)** | **(32,698)** | **(51,690)** |
| Net book value equivalent | **$ 14,140** | **$ 28,645** | **$ 42,785** |

B. Lessor leases

Rental income from finance leases under which the ownership of the leased assets is not transferred to lessees for the years ended March 31, 2004, 2005 and 2006 were ¥2,285 million, ¥2,163 million and ¥1,745 million ($14,855 thousand).

Total lease obligations as of March 31, 2005 and 2006, inclusive of interest income under such leases, were ¥5,015 million and ¥4,141 million ($35,252 thousand), including ¥1,924 million and ¥1,609 million ($13,697 thousand) due within one year. Included in the total lease obligation as of March 31, 2006 is the obligation for a sub-lease payment of ¥4,132 million ($35,175 thousand).

Acquisition cost, accumulated depreciation and net book value of leased properties for the years ended March 31, 2005 and 2006, were as follows:

| | Millions of yen | | |
|---|---|---|---|
| Year ended March 31, 2005 | Machinery & equipment | Other | Total |
| Acquisition cost | ¥ 5 | ¥ 216 | ¥ 221 |
| Accumulated depreciation | (5) | (205) | (210) |
| Net book value | ¥ 0 | ¥ 11 | ¥ 11 |

| | Millions of yen | | |
|---|---|---|---|
| Year ended March 31, 2006 | Machinery & equipment | Other | Total |
| Acquisition cost | ¥ 5 | ¥ 179 | ¥ 184 |
| Accumulated depreciation | (5) | (170) | (175) |
| Net book value | ¥ 0 | ¥ 9 | ¥ 9 |

| | Thousands of U.S. dollars (Note 1) | | |
|---|---|---|---|
| Year ended March 31, 2006 | Machinery & equipment | Other | Total |
| Acquisition cost | $ 43 | $ 1,523 | $ 1,566 |
| Accumulated depreciation | (43) | (1,446) | (1,489) |
| Net book value | $ 0 | $ 77 | $ 77 |

## NOTE 8. CONTINGENCIES

Contingencies for loans guaranteed by the Company and its consolidated subsidiaries, mainly for unconsolidated subsidiaries, affiliates, employees of the Company and its consolidated subsidiaries and its sales agents at March 31, 2006 were ¥3,954 million ($33,660 thousand).

## NOTE 9. SECURITIES

The following tables summarize acquisition costs, book value, and fair value of securities as of March 31, 2005 and 2006:

As of March 31, 2005

(a) Held to maturity debt securities

Bonds with fair value

| | Millions of yen | | |
|---|---|---|---|
| | Book value | Fair value | Difference |
| Fair value exceeding book value | ¥ — | ¥ — | ¥ — |
| Fair value not exceeding book value | 1,615 | 1,579 | (36) |
| Total | ¥ 1,615 | ¥ 1,579 | ¥ (36) |

(b) Available-for-sale securities with fair values

| | Millions of yen | | |
|---|---|---|---|
| | Acquisition cost | Book value | Difference |
| Book value exceeding acquisition cost: | | | |
| Equity securities | ¥ 11,255 | ¥ 23,392 | ¥ 12,137 |
| Bonds | 2,574 | 2,591 | 17 |
| Others | 4 | 4 | 0 |
| Subtotal | 13,833 | 25,987 | 12,154 |
| Book value not exceeding acquisition cost: | | | |
| Equity securities | 5,513 | 5,089 | (424) |
| Bonds | 104 | 104 | (0) |
| Subtotal | 5,617 | 5,193 | (424) |
| Total | ¥ 19,450 | ¥ 31,180 | ¥ 11,730 |

(c) Available-for-sale securities sold during year ended March 31, 2005

| | Millions of yen | | |
|---|---|---|---|
| | Amount of sales | Gain | Loss |
| | ¥ 6,456 | ¥ 1,974 | ¥ 26 |

The following table summarizes book values of securities without fair value:

| | Millions of yen |
|---|---|
| | Book value |
| (a) Held to maturity debt securities | |
| Non-listed bonds | ¥ 67 |
| (b) Shares issued by unconsolidated subsidiaries and affiliates | |
| Non-listed securities | ¥ 33,380 |
| (c) Available-for-sale securities | |
| Money management fund | ¥ 1,767 |
| Free financial fund | 2,026 |
| Non-listed securities | 12,593 |
| Total | ¥ 16,386 |

Schedule of redemption for available-for-sale securities with maturities and held-to-maturity debt securities are as follows:

| | Millions of yen | | | |
|---|---|---|---|---|
| | Within 1 year | 1 to 5 years | 5 to 10 years | Over 10 years |
| Government bonds and municipal bonds | ¥ 266 | ¥ 435 | ¥ 10 | ¥ — |
| Corporate bonds | 1,917 | 1,781 | — | — |
| Total | ¥ 2,183 | ¥ 2,216 | ¥ 10 | ¥ — |

**As of March 31, 2006**

(a) Held-to-maturity debt securities

Bonds with fair value

| | Millions of yen | | | Thousands of U.S. dollars (Note 1) | | |
|---|---|---|---|---|---|---|
| | Book value | Fair value | Difference | Book value | Fair value | Difference |
| Fair value exceeding book value | ¥ — | ¥ — | ¥ — | $ — | $ — | $ — |
| Fair value not exceeding book value | 1,799 | 1,751 | (48) | 15,315 | 14,906 | (409) |
| Total | ¥ 1,799 | ¥ 1,751 | ¥ (48) | $ 15,315 | $ 14,906 | $ (409) |

(b) Available-for-sale securities with fair value

| | Millions of yen | | | Thousands of U.S. dollars (Note 1) | | |
|---|---|---|---|---|---|---|
| | Acquisition cost | Book value | Difference | Acquisition cost | Book value | Difference |
| Book value exceeding acquisition cost: | | | | | | |
| Equity securities | ¥ 15,182 | ¥ 39,946 | ¥ 24,764 | $ 129,242 | $ 340,053 | $ 210,811 |
| Bonds | 1,000 | 1,003 | 3 | 8,512 | 8,538 | 26 |
| Others | 3 | 6 | 3 | 26 | 51 | 25 |
| Subtotal | 16,185 | 40,955 | 24,770 | 137,780 | 348,642 | 210,862 |
| Book value not exceeding acquisition cost: | | | | | | |
| Equity securities | 1,567 | 1,403 | (164) | 13,339 | 11,944 | (1,395) |
| Bonds | — | — | — | — | — | — |
| Subtotal | 1,567 | 1,403 | (164) | 13,339 | 11,944 | (1,395) |
| Total | ¥ 17,752 | ¥ 42,358 | ¥ 24,606 | $ 151,119 | $ 360,586 | $ 209,467 |

(c) Available-for-sale securities sold during year ended March 31, 2006

| | Millions of yen | | | Thousands of U.S. dollars (Note 1) | | |
|---|---|---|---|---|---|---|
| | Amount of sales | Gain | Loss | Amount of sales | Gain | Loss |
| | ¥ 512 | ¥ 344 | ¥ 24 | $ 4,359 | $ 2,928 | $ 204 |

The following table summarizes book values of securities without fair value:

| | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|
| | Book value | Book value |
| (a) Held to maturity debt securities | | |
| Non-listed bonds | ¥ 65 | $ 553 |
| (b) Shares issued by unconsolidated subsidiaries and affiliates | | |
| Non-listed securities | ¥ 43,919 | $ 373,874 |
| (c) Available-for-sale securities | | |
| Non-listed securities | 12,230 | 104,112 |
| Total | ¥ 12,230 | $ 104,112 |

Schedule of redemption for available-for-sale securities with maturities and held-to-maturity debt securities are as follows:

| | Millions of yen | | | |
|---|---|---|---|---|
| | Within 1 year | 1 to 5 years | 5 to 10 years | Over 10 years |
| Government bonds and municipal bonds | ¥ 1,480 | ¥ 11 | ¥ 9 | ¥ — |
| Corporate bonds | 217 | 1,064 | — | — |
| Total | ¥ 1,697 | ¥ 1,075 | ¥ 9 | ¥ — |

| | Thousands of U.S. dollars (Note 1) | | | |
|---|---|---|---|---|
| | Within 1 year | 1 to 5 years | 5 to 10 years | Over 10 years |
| Government bonds and municipal bonds | $ 12,599 | $ 94 | $ 77 | $ — |
| Corporate bonds | 1,847 | 9,057 | — | — |
| Total | $ 14,446 | $ 9,151 | $ 77 | $ — |

## NOTE 10. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING TRANSACTIONS

### (1) Nature and objective of derivative transactions

The Company uses foreign currency forward contracts and currency option contracts to hedge risks due to the effect of currency exchange rate fluctuations on U.S.-dollar-denominated imports of crude oil and petroleum products. The Company uses interest rate swap contracts to exchange floating-rate payment obligations for fixed-rate payment obligations. The Company also uses crude oil and petroleum product swap contracts and commodity forward contracts to hedge risks stemming from commodity price fluctuations. If these derivative transactions are used as hedges and meet certain hedging criteria, the Company undertakes hedge accounting for the derivatives.

A. Hedging instruments and hedged items

| Hedging instruments | Hedged items |
|---|---|
| Interest rate swaps | Borrowings |
| Crude oil and petroleum products forward contracts | Purchases and sales of crude oil and petroleum products |

B. Hedge policy

In accordance with internal rules that determine derivative transaction-related authority levels and transaction value limits, hedging activities are undertaken within specified limits to hedge fluctuation risks of interest rate and commodity prices.

C. Method of evaluating hedge effectiveness

The Company evaluates hedge effectiveness semi-annually by comparing cumulative changes in cash flows from or changes in fair value of hedged items and the corresponding changes in the hedging derivative instruments. The evaluation of hedge effectiveness is not considered necessary for certain interest rate swaps, which are used to hedge and meet certain hedging criteria.

### (2) Operating policy of derivative transactions

In accordance with internal rules that determine derivative transaction-related authority levels and transaction value limits, fluctuation risks of foreign currency exchange rate, interest rate and commodity prices are hedged within a fixed range. Each derivative transaction is based on the actual business transactions, and the Company has a policy of not executing speculative derivative transactions.

### (3) Risks related to derivative transactions

The Company incurs exchange rate fluctuation risks related to foreign currency forward contracts and currency option contracts, and also incurs interest rate fluctuation risks related to interest rate swaps associated with interest rate-related transactions. In addition, the Company faces price fluctuation risks and exchange rate fluctuation risks related to crude oil and petroleum product swap transactions. In all these types of transactions, the Company deals with large banks, trading companies and oil companies, and therefore considers that there is insignificant credit risk associated with these derivative transactions.

### (4) Management of risks related to derivative transactions

Currency and interest-related derivative transactions are implemented and controlled by the Finance Department in accordance with internally authorized rules. The General Manager of the Finance Department reports the results of transactions to, and obtains authorization of the basic transaction policy from, the meeting of the Executive Officers' Committee on a quarterly basis.

Regarding commodity-related derivative transactions, the Demand & Supply Coordination Department, International Business Department, Industrial Fuel Department, and Corporate Planning Department consult with each other and obtain approval of the annual basic transaction policy from the meeting of the Executive Officers' Committee, and implement and control transactions in accordance with internally authorized rules. Regarding control, the Demand & Supply Coordination Department, International Business Department, and Industrial Fuel

Department control derivative transactions on a single-department basis and the Corporate Planning Department controls derivative transactions on a Company wide basis. General managers of the Demand & Supply Coordination Department, International Business Department, and Industrial Fuel Department report the results of transactions to the meeting of the Executive Officers' Committee semi-annually.

### (5) Other

The contract amount, notional amounts and other figures shown in the items related to derivative transaction market prices do not necessarily indicate the magnitude of market risk associated with derivative transactions.

The following tables summarize market value information as of March 31, 2005 and 2006 of derivative transactions for which hedge accounting has not been applied:

(1) Currency related

| | | | | | Millions of yen |
|---|---|---|---|---|---|
| | Contract amounts | | | Market value | Unrealized gains |
| Year ended March 31, 2005 | Due within 1 year | Due after 1 year | Total | | |
| Forward exchange contracts | | | | | |
| Buy | | | | | |
| U.S. dollars | ¥ 51,385 | ¥ — | ¥ 51,385 | ¥ 52,398 | ¥ 1,013 |
| Currency option contracts | | | | | |
| Buy | | | | | |
| Call U.S. dollars | 30,069 | — | 30,069 | 615 | 516 |

| | | | | | Millions of yen |
|---|---|---|---|---|---|
| | Contract amounts | | | Market value | Unrealized gains (losses) |
| Year ended March 31, 2006 | Due within 1 year | Due after 1 year | Total | | |
| Forward exchange contracts | | | | | |
| Buy | | | | | |
| U.S. dollars | ¥ 82,487 | ¥ — | ¥ 82,487 | ¥ 83,232 | ¥ 745 |
| Currency option contracts | | | | | |
| Buy | | | | | |
| Call U.S. dollars | 22,319 | — | 22,319 | 46 | (58) |
| Sell | | | | | |
| Put U.S. dollars | 5,874 | — | 5,874 | 28 | 28 |

| | | | | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|---|---|
| Year ended March 31, 2006 | Contract amounts | | | Market value | Unrealized gains (losses) |
| | Due within 1 year | Due after 1 year | Total | | |
| Forward exchange contracts | | | | | |
| Buy | | | | | |
| U.S. dollars | $ 702,196 | $ — | $ 702,196 | $ 708,538 | $ 6,342 |
| Currency option contracts | | | | | |
| Buy | | | | | |
| Call U.S. dollars | 189,997 | — | 189,997 | 392 | (494) |
| Sell | | | | | |
| Put U.S. dollars | 50,004 | — | 50,004 | 238 | 238 |

(2) Interest rate related

| Year ended March 31, 2005 | Contract amounts: Due within 1 year | Contract amounts: Due after 1 year | Contract amounts: Total | Market value | Unrealized gains |
|---|---|---|---|---|---|
| | | | | Millions of yen | |
| Swap transaction of interest rate | | | | | |
| Receive-fixed; pay-variable | ¥ 2,500 | ¥ 19,500 | ¥ 22,000 | ¥ 165 | ¥ 153 |
| Receive-variable; pay-fixed | 2,500 | 19,500 | 22,000 | (2,563) | 107 |

| **Year ended March 31, 2006** | Contract amounts: Due within 1 year | Contract amounts: Due after 1 year | Contract amounts: Total | Market value | Unrealized losses |
|---|---|---|---|---|---|
| | | | | Millions of yen | |
| Swap transaction of interest rate | | | | | |
| Receive-fixed; pay-variable | **¥ 3,000** | **¥ 16,500** | **¥ 19,500** | **¥ (298)** | **¥ (745)** |
| Receive-variable; pay-fixed | **3,000** | **16,500** | **19,500** | **(1,538)** | **(97)** |

| **Year ended March 31, 2006** | Contract amounts: Due within 1 year | Contract amounts: Due after 1 year | Contract amounts: Total | Market value | Unrealized losses |
|---|---|---|---|---|---|
| | | | | Thousands of U.S. dollars (Note 1) | |
| Swap transaction of interest rate | | | | | |
| Receive-fixed; pay-variable | **$25,538** | **$140,462** | **$166,000** | **$ (2,537)** | **$(6,342)** |
| Receive-variable; pay-fixed | **25,538** | **140,462** | **166,000** | **(13,093)** | **(826)** |

(3) Commodity related

| Year ended March 31, 2005 | Contract amounts: Due within 1 year | Contract amounts: Due after 1 year | Contract amounts: Total | Market value | Unrealized losses |
|---|---|---|---|---|---|
| | | | Thousands of ton | | Millions of yen |
| Swap transaction of petroleum products | | | | | |
| Receive-fixed; pay-variable | — | — | — | ¥ — | ¥ — |
| Receive-variable; pay-fixed | 21 | — | 21 | (14) | (14) |

## NOTE 11. RETIREMENT AND SEVERANCE BENEFITS

The Company and its domestic consolidated subsidiaries provide unfunded lump-sum payment plans and funded non-contributory pension plans, under which all eligible employees are entitled to benefits based on the level of wages and salaries at the time of retirement or termination, length of service and certain other factors.

The liabilities for retirement and severance benefits included in the liability section of the consolidated balance sheets as of March 31, 2005 and 2006 consist of the following:

| March 31, 2005 | Millions of yen |
|---|---|
| Projected benefit obligation | ¥ (87,093) |
| Pension assets | 73,470 |
| Unrecognized actuarial differences | 6,322 |
| Subtotal | (7,301) |
| Retirement benefits for directors and corporate auditors | (933) |
| Liabilities for retirement and severance benefits | ¥ (8,234) |

| March 31, 2006 | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|
| Projected benefit obligation | ¥ (93,006) | $ (791,743) |
| Pension assets | 88,676 | 754,882 |
| Unrecognized actuarial differences | (176) | (1,498) |
| Subtotal | (4,506) | (38,359) |
| Retirement benefits for directors and corporate auditors | (1,059) | (9,015) |
| Liabilities for retirement and severance benefits | ¥ (5,565) | $ (47,374) |

Included in the consolidated statements of income for the years ended March 31, 2004, 2005 and 2006 are retirement and severance benefit expenses comprised of the following:

| March 31, 2004 | Millions of yen |
|---|---|
| Service costs | ¥ 3,027 |
| Interest cost on projected benefit obligation | 2,081 |
| Expected return on plan assets | (2,029) |
| Amortization of net transition obligation | 4,740 |
| Amortization of net actuarial loss | 2,206 |
| Retirement and severance benefit expenses | ¥ 10,025 |

| March 31, 2005 | Millions of yen |
|---|---|
| Service costs | ¥ 2,541 |
| Interest cost on projected benefit obligation | 2,031 |
| Expected return on plan assets | (2,309) |
| Amortization of net transition obligation | 4,739 |
| Amortization of net actuarial loss | 1,373 |
| Retirement and severance benefit expenses | ¥ 8,375 |

| March 31, 2006 | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|
| Service costs | ¥ 2,651 | $ 22,567 |
| Interest cost on projected benefit obligation | 2,026 | 17,247 |
| Expected return on plan assets | (2,440) | (20,771) |
| Amortization of net actuarial loss | 1,286 | 10,948 |
| Retirement and severance benefit expenses | ¥ 3,523 | $ 29,991 |

Actuarial assumptions used in computation of retirement and severance liabilities for the year ended March 31, 2006 were as follows:

| | |
|---|---|
| a.Allocation of expected benefit obligation | Straight-line method by equal allocation to each year |
| b.Discount rate | Primarily 1.5%<br>(2.5% at the beginning of the year) |
| c.Expected rate of return on plan assets | Primarily 3.5% |
| d.Amortization of actuarial gains/losses | Primarily 10 years (will be amortized by the straight-line method starting from the next year based on periods less than the estimated average remaining service period of employees.) |

## NOTE 12. INCOME TAXES

The following table summarizes the significant differences between the statutory tax rate and the Company's effective tax rate for financial statement purposes for the year ended March 31, 2006:

| Year ended March 31, 2006 | |
|---|---|
| Statutory income tax rate | 40.44% |
| **Increase (decrease) in taxes resulting from:** | |
| Non-Japanese taxes | 7.80 |
| Non-deductible revenue | (1.04) |
| Non-deductible expenses | 0.63 |
| Effect on equity in earnings of affiliates | (3.22) |
| Other | 1.32 |
| Effective income tax rate | 45.93% |

Significant components of the Company and its consolidated subsidiaries' deferred tax assets and liabilities as of March 31, 2005 and 2006 are as follows:

| Year ended March 31, 2005 | Millions of yen |
|---|---|
| **Current deferred tax assets:** | |
| Excess bonuses accrued | ¥ 2,167 |
| Accrued business tax | 1,636 |
| Unrealized gains | 1,105 |
| Other | 2,250 |
| Total current deferred tax assets | 7,158 |
| Valuation allowance | (5) |
| Total current deferred tax assets, net of valuation allowance | 7,153 |
| Account offset against deferred tax liabilities | (104) |
| Net current deferred tax assets | ¥ 7,049 |
| **Current deferred tax liabilities:** | |
| Allowance for doubtful accounts | ¥ (93) |
| Other | (13) |
| Total current deferred tax liabilities | (106) |
| Account offset against deferred tax assets | 104 |
| Net current deferred tax liabilities | ¥ (2) |
| **Non-current deferred tax assets:** | |
| Impairment loss on fixed assets | ¥ 6,241 |
| Investments in securities | ¥ 4,282 |
| Depreciation | 2,450 |
| Allowance for special repair works | 1,918 |
| Costs for retirement and severance benefits | 2,554 |
| Unrealized gains | 929 |
| Golf-club membership | 968 |
| Allowance for doubtful accounts | 1,102 |
| Net operating loss carry forward | 539 |
| Other | 2,174 |
| Total non-current deferred tax assets | 23,157 |
| Valuation allowance | (1,050) |
| Total non-current deferred tax assets, net of valuation allowance | 22,107 |
| Account offset against deferred tax liabilities | (17,220) |
| Net non-current deferred tax assets | ¥ 4,887 |
| **Non-current deferred tax liabilities:** | |
| Reserve for deferred gains on sales of fixed assets for tax purposes | ¥ (12,378) |
| Non-Japanese taxes | (8,155) |
| Net unrealized gains on securities | (4,690) |
| Other | (1,876) |
| Total non-current deferred tax liabilities | (27,099) |
| Account offset against deferred tax assets | 17,220 |
| Net non-current deferred tax liabilities | ¥ (9,879) |

In addition, deferred tax liability related to land revaluation of ¥13,705 million was included in the consolidated balance sheet other than the above mentioned items.

| Year ended March 31, 2006 | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|
| **Current deferred tax assets:** | | |
| Unrealized gains | ¥ 2,765 | $ 23,538 |
| Excess bonuses accrued | 2,455 | 20,899 |
| Accrued business tax | 1,618 | 13,774 |
| Other | 2,955 | 25,155 |
| Total current deferred tax assets | 9,793 | 83,366 |
| Valuation allowance | (2) | (17) |
| Total current deferred tax assets, net of valuation allowance | 9,791 | 83,349 |
| Account offset against deferred tax liabilities | (116) | (988) |
| Net current deferred tax assets | ¥ 9,675 | $ 82,361 |
| **Current deferred tax liabilities:** | | |
| Allowance for doubtful accounts | ¥ (89) | $ (758) |
| Other | (32) | (273) |
| Total current deferred tax liabilities | (121) | (1,031) |
| Account offset against deferred tax assets | 116 | 988 |
| Net current deferred tax liabilities | ¥ (5) | $ (43) |
| **Non-current deferred tax assets:** | | |
| Impairment loss on fixed assets | ¥ 6,045 | $ 51,460 |
| Investments in securities | 4,283 | 36,460 |
| Depreciation | 2,380 | 20,260 |
| Allowance for special repair works | 2,013 | 17,136 |
| Costs for retirement and severance benefits | 1,521 | 12,948 |
| Allowance for doubtful accounts | 881 | 7,500 |
| Golf-club membership | 855 | 7,278 |
| Unrealized gains | 855 | 7,278 |
| Other | 2,449 | 20,850 |
| Total non-current deferred tax assets | 21,282 | 181,170 |
| Valuation allowance | (1,466) | (12,480) |
| Total non-current deferred tax assets, net of valuation allowance | 19,816 | 168,690 |
| Account offset against deferred tax liabilities | (15,916) | (135,490) |
| Net non-current deferred tax assets | ¥ 3,900 | $ 33,200 |
| **Non-current deferred tax liabilities:** | | |
| Reserve for deferred gains on sales of fixed assets for tax purposes | ¥ (11,780) | $ (100,281) |
| Non-Japanese taxes | (9,896) | (84,243) |
| Net unrealized gains on securities | (9,879) | (84,098) |
| Other | (1,336) | (11,373) |
| Total non-current deferred tax liabilities | (32,891) | (279,995) |
| Account offset against deferred tax assets | 15,916 | 135,490 |
| Net non-current deferred tax liabilities | ¥ (16,975) | $ (144,505) |
| **Deferred tax asset and liability related to land revaluation:** | | |
| Deferred tax asset related to land revaluation | ¥ 16,211 | $ 138,001 |
| Valuation allowance | (2,289) | (19,486) |
| Total deferred tax asset related to land revaluation, net of valuation allowance | 13,922 | 118,515 |
| Deferred tax liability related to land revaluation | (34,254) | (291,597) |
| Net deferred tax liability related to land revaluation | ¥ (20,332) | $ (173,082) |

## NOTE 13. IMPAIRMENT ON FIXED ASSETS

The Company and its consolidated subsidiaries ("the Company") classified fixed assets into groups by the type of respective business, which are the minimum units generating cash flows. For fixed assets in the petroleum business, each SS operated by the Company is considered to constitute a group and other assets are classified as one group. For fixed assets in the oil resource development business, IPP business, buildings for rent business and non-performing assets, each property is considered to constitute a group.

Due to the significant decrease in the market value of the Company's land as well as to the overall deterioration of its business environment, book value of these fixed assets was reduced to recoverable amounts and impairment losses of ¥11,330 million and ¥1,976 million ($16,821 thousand), consisting of the following, were recognized for the years ended March 31, 2005 and 2006.

| Year ended March 31, 2005 | | Impairment loss | |
|---|---|---|---|
| Use | Location | Type of assets | Millions of yen |
| Petroleum | Cosmo Oil Sales Co., Ltd. | | |
| | service stations | Land | ¥ 1,043 |
| | Tokorozawa-shi, Saitama and 7 others | Other | 166 |
| | | | 1,209 |
| Buildings for rent | Cosmo Oil Co., Ltd. | Land | 321 |
| | Sakai-shi, Osaka and 11 others | Other | 511 |
| | | | 832 |
| Non-performing assets | Cosmo Oil Co., Ltd. | Land | 6,329 |
| | Kobe-shi, Hyogo and 115 others | Other | 2,960 |
| | | | 9,289 |
| Total | | | ¥ 11,330 |

Recoverable amounts of petroleum business and buildings for rent business are primarily determined by value in use, which is the present value of expected future cash flows from on-going utilization based on a discount rate of 4%.

Recoverable amounts of idle assets are primarily determined by their estimated fair values. Such fair values were determined by real estate appraisal standards in case of material assets.

| Year ended March 31, 2006 | | Impairment loss | | |
|---|---|---|---|---|
| Use | Location | Type of assets | Millions of yen | Thousands of U.S. dollars (Note 1) |
| Petroleum | Cosmo Oil Sales Co., Ltd. | | | |
| | service stations | Land | ¥ 40 | $ 341 |
| | Sendai-shi, Miyagi and 5 others | Other | 187 | 1,591 |
| | | | 227 | 1,932 |
| Buildings for rent | Cosmo Oil Co., Ltd. | Land | 90 | 766 |
| | Fukuoka-shi, Fukuoka and 2 others | Other | 2 | 17 |
| | | | 92 | 783 |
| Non-performing assets | Cosmo Oil Co., Ltd. | Land | 1,100 | 9,364 |
| | Kobe-shi, Hyogo and 63 others | Other | 557 | 4,742 |
| | | | 1,657 | 14,106 |
| Total | | | ¥ 1,976 | $ 16,821 |

Recoverable amounts of petroleum business and buildings for rent business are primarily determined by value in use, which is the present value of expected future cash flows from on-going utilization based on a discount rate of 5%.

Recoverable amounts of idle assets are primarily determined by their estimated fair values. Such fair values were determined by real estate appraisal standards in case of material assets.

## NOTE 14. SEGMENT INFORMATION

### (1) Business segment information

The Company and its consolidated subsidiaries primarily operate in the oil business, importing and refining crude oil to produce and distribute a variety of petroleum products and oil resource development.

For the years ended March 31, 2004, 2005 and 2006, summarized product group business operations of the Company and its consolidated subsidiaries were as follows:

Millions of yen

| Year ended March 31, 2004 | Petroleum | Oil Resource Development | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|---|
| **Net sales:** | | | | | | |
| Outside customers | ¥ 1,862,554 | ¥ 12,950 | ¥ 40,774 | ¥ 1,916,278 | ¥ — | ¥ 1,916,278 |
| Inter-segment | 537 | 18,697 | 25,960 | 45,194 | (45,194) | — |
| Total | 1,863,091 | 31,647 | 66,734 | 1,961,472 | (45,194) | 1,916,278 |
| Operating expenses | 1,845,141 | 24,121 | 66,061 | 1,935,323 | (44,291) | 1,891,032 |
| Operating income | ¥ 17,950 | ¥ 7,526 | ¥ 673 | ¥ 26,149 | ¥ (903) | ¥ 25,246 |
| **Identifiable assets, depreciation and amortization and capital expenditures:** | | | | | | |
| Assets | ¥ 1,079,880 | ¥ 63,900 | ¥ 31,065 | ¥ 1,174,845 | ¥ 85,247 | ¥ 1,260,092 |
| Depreciation and amortization | ¥ 20,845 | ¥ 3,267 | ¥ 118 | ¥ 24,230 | ¥ (598) | ¥ 23,632 |
| Capital expenditures | ¥ 28,427 | ¥ 8,671 | ¥ 144 | ¥ 37,242 | ¥ (669) | ¥ 36,573 |

Millions of yen

| Year ended March 31, 2005 | Petroleum | Oil Resource Development | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|---|
| **Net sales:** | | | | | | |
| Outside customers | ¥ 2,104,737 | ¥ 11,544 | ¥ 38,278 | ¥ 2,154,559 | ¥ — | ¥ 2,154,559 |
| Inter-segment | 520 | 25,359 | 44,728 | 70,607 | (70,607) | — |
| Total | 2,105,257 | 36,903 | 83,006 | 2,225,166 | (70,607) | 2,154,559 |
| Operating expenses | 2,050,523 | 24,942 | 83,063 | 2,158,528 | (69,667) | 2,088,861 |
| Operating income (loss) | ¥ 54,734 | ¥ 11,961 | ¥ (57) | ¥ 66,638 | ¥ (940) | ¥ 65,698 |
| **Identifiable assets, depreciation and amortization, impairment loss on fixed assets and capital expenditures:** | | | | | | |
| Assets | ¥ 1,165,700 | ¥ 95,668 | ¥ 41,533 | ¥ 1,302,901 | ¥ 20,248 | ¥ 1,323,149 |
| Depreciation and amortization | ¥ 21,724 | ¥ 3,606 | ¥ 107 | ¥ 25,437 | ¥ (510) | ¥ 24,927 |
| Impairment loss on fixed assets | ¥ 11,330 | ¥ — | ¥ — | ¥ 11,330 | ¥ — | ¥ 11,330 |
| Capital expenditures | ¥ 25,758 | ¥ 4,627 | ¥ 100 | ¥ 30,485 | ¥ (372) | ¥ 30,113 |

| Year ended March 31, 2006 | Petroleum | Oil Resource Development | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|---|
| | | | | | | Millions of yen |
| **Net sales:** | | | | | | |
| Outside customers | ¥ 2,616,887 | ¥ 17,030 | ¥ 36,711 | ¥ 2,670,628 | ¥ — | ¥ 2,670,628 |
| Inter-segment | 559 | 33,446 | 32,658 | 66,663 | (66,663) | — |
| Total | 2,617,446 | 50,476 | 69,369 | 2,737,291 | (66,663) | 2,670,628 |
| Operating expenses | 2,533,910 | 21,109 | 68,365 | 2,623,384 | (64,004) | 2,559,380 |
| Operating income | ¥ 83,536 | ¥ 29,367 | ¥ 1,004 | ¥ 113,907 | ¥ (2,659) | ¥ 111,248 |
| **Identifiable assets, depreciation and amortization, impairment loss on fixed assets and capital expenditures:** | | | | | | |
| Assets | ¥ 1,277,205 | ¥ 127,946 | ¥ 32,422 | ¥ 1,437,573 | ¥ 26,006 | ¥ 1,463,579 |
| Depreciation and amortization | ¥ 22,828 | ¥ 5,744 | ¥ 135 | ¥ 28,707 | ¥ (394) | ¥ 28,313 |
| Impairment Loss on Fixed assets | ¥ 1,855 | ¥ 121 | ¥ — | ¥ 1,976 | ¥ — | ¥ 1,976 |
| Capital expenditures | ¥ 19,550 | ¥ 12,405 | ¥ 144 | ¥ 32,099 | ¥ (337) | ¥ 31,762 |

| Year ended March 31, 2006 | Petroleum | Oil Resource Development | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|---|
| | | | | | | Thousands of U.S. dollars (Note 1) |
| **Net sales:** | | | | | | |
| Outside customers | $ 22,277,067 | $ 144,973 | $ 312,514 | $ 22,734,554 | $ — | $22,734,554 |
| Inter-segment | 4,758 | 284,720 | 278,011 | 567,489 | (567,489) | — |
| Total | 22,281,825 | 429,693 | 590,525 | 23,302,043 | (567,489) | 22,734,554 |
| Operating expenses | 21,570,699 | 179,697 | 581,978 | 22,332,374 | (544,853) | 21,787,521 |
| Operating income | $ 711,126 | $ 249,996 | $ 8,547 | $ 969,669 | $ (22,636) | $ 947,033 |
| **Identifiable assets, depreciation and amortization, impairment loss on fixed assets and capital expenditures:** | | | | | | |
| Assets | $ 10,872,606 | $ 1,089,180 | $ 276,002 | $ 12,237,788 | $ 221,385 | $12,459,173 |
| Depreciation and amortization | $ 194,330 | $ 48,898 | $ 1,149 | $ 244,377 | $ (3,354) | $ 241,023 |
| Impairment Loss on Fixed assets | $ 15,791 | $ 1,030 | $ — | $ 16,821 | $ — | $ 16,821 |
| Capital expenditures | $ 166,425 | $ 105,601 | $ 1,226 | $ 273,252 | $ (2,868) | $ 270,384 |

### (2) Geographic segment information

Geographic segment information of the Company and its consolidated subsidiaries for the years ended March 31, 2004, 2005 and 2006 is disclosed as follows;

| Year ended March 31, 2004 | Japan | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|
| | Millions of yen | | | | |
| **Net sales:** | | | | | |
| Outside customers | ¥ 1,871,453 | ¥ 44,825 | ¥ 1,916,278 | ¥ — | ¥ 1,916,278 |
| Inter-segment | 9,673 | 175,055 | 184,728 | (184,728) | — |
| Total | 1,881,126 | 219,880 | 2,101,006 | (184,728) | 1,916,278 |
| Operating expenses | 1,863,114 | 212,315 | 2,075,429 | (184,397) | 1,891,032 |
| Operating income | ¥ 18,012 | ¥ 7,565 | ¥ 25,577 | ¥ (331) | ¥ 25,246 |
| Assets | ¥ 1,106,750 | ¥ 89,923 | ¥ 1,196,673 | ¥ 63,419 | ¥ 1,260,092 |

| Year ended March 31, 2005 | Japan | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|
| | Millions of yen | | | | |
| **Net sales:** | | | | | |
| Outside customers | ¥ 2,121,279 | ¥ 33,280 | ¥ 2,154,559 | ¥ — | ¥ 2,154,559 |
| Inter-segment | 12,267 | 203,122 | 215,389 | (215,389) | — |
| Total | 2,133,546 | 236,402 | 2,369,948 | (215,389) | 2,154,559 |
| Operating expenses | 2,079,013 | 224,422 | 2,303,435 | (214,574) | 2,088,861 |
| Operating income | ¥ 54,533 | ¥ 11,980 | ¥ 66,513 | ¥ (815) | ¥ 65,698 |
| Assets | ¥ 1,215,644 | ¥104,159 | ¥ 1,319,803 | ¥ 3,346 | ¥ 1,323,149 |

| **Year ended March 31, 2006** | Japan | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|
| | Millions of yen | | | | |
| **Net sales:** | | | | | |
| Outside customers | **¥ 2,605,884** | **¥ 64,744** | **¥ 2,670,628** | **¥ —** | **¥ 2,670,628** |
| Inter-segment | **57,245** | **292,528** | **349,773** | **(349,773)** | **—** |
| Total | **2,663,129** | **357,272** | **3,020,401** | **(349,773)** | **2,670,628** |
| Operating expenses | **2,579,276** | **327,564** | **2,906,840** | **(347,460)** | **2,559,380** |
| Operating income | **¥ 83,853** | **¥ 29,708** | **¥ 113,561** | **¥ (2,313)** | **¥ 111,248** |
| Assets | **¥ 1,318,790** | **¥142,977** | **¥ 1,461,767** | **¥ 1,812** | **¥ 1,463,579** |

| **Year ended March 31, 2006** | Japan | Other | Total | Elimination or corporate | Consolidated |
|---|---|---|---|---|---|
| | Thousands of U.S. dollars (Note 1) | | | | |
| **Net sales:** | | | | | |
| Outside customers | **$ 22,183,400** | **$ 551,154** | **$ 22,734,554** | **$ —** | **$ 22,734,554** |
| Inter-segment | **487,316** | **2,490,235** | **2,977,551** | **(2,977,551)** | **—** |
| Total | **22,670,716** | **3,041,389** | **25,712,105** | **(2,977,551)** | **22,734,554** |
| Operating expenses | **21,956,891** | **2,788,491** | **24,745,382** | **(2,957,861)** | **21,787,521** |
| Operating income | **$ 713,825** | **$ 252,898** | **$ 966,723** | **$ (19,690)** | **$947,033** |
| Assets | **$ 11,226,611** | **$ 1,217,136** | **$ 12,443,747** | **$ 15,426** | **$ 12,459,173** |

### (3) Export sales information

Export sales information is not disclosed, as export sales from Japan represent less than 10% of the consolidated net sales for the years ended March 31, 2004, 2005 and 2006.

## NOTE 15. PLEDGED ASSETS

Assets pledged as collateral at March 31, 2005 and 2006 were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| Land | ¥ 267,484 | ¥ 237,593 | $ 2,022,584 |
| Buildings and structures at net book value | 35,358 | 36,650 | 311,995 |
| Machinery and equipment at net book value | 54,409 | 66,208 | 563,616 |
| Investments in securities | 2,763 | 110 | 937 |
| Cash and deposits | 280 | — | — |
| Total | ¥ 360,294 | ¥ 340,561 | $ 2,899,132 |

Secured liabilities at March 31, 2005 and 2006 were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| Notes and accounts payable, trade | ¥ 5 | ¥ 3 | $ 26 |
| Short-term loans | 6,058 | — | — |
| Long-term debts | 171,401 | 156,904 | 1,335,694 |
| Debts relating to transactions with banks | 20,905 | 20,996 | 178,735 |
| Other long-term liabilities | 471 | — | — |
| Total | ¥ 198,840 | ¥ 177,903 | $ 1,514,455 |

Other pledged assets at March 31, 2005 and 2006 were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2005 | **2006** | **2006** |
| **Deposits as security for dealing:** | | | |
| Marketable securities | ¥ 54 | ¥ 54 | $ 460 |
| Investments in securities | 9 | 9 | 76 |
| Total | ¥ 63 | ¥ 63 | $ 536 |

## NOTE 16. SUBSEQUENT EVENTS

On June 29, 2006, the Company's annual shareholders' meeting approved the year-end cash dividend payment of ¥7.00 (US$0.06) per share, or a total of ¥4,701 million ($40,019 thousand) to shareholders of record at March 31, 2006.

On April 16, 2006, a fire broke out in the Company's Chiba oil refinery, causing the temporary suspension of one of the two series of oil refining equipment at the refinery. While operations were partially resumed on June 12 following an investigation into the cause of the fire, the vacuum desulfurization unit and the hydrogen manufacturing unit No. 1 are now scheduled to be repaired and resume operations in mid-December of 2006.

While the Cosmo Oil Group will incur losses from the fiscal year ending March 2007 on the facilities and expenses in restoring the facilities to normal operation, the book value of the damaged assets is approximately ¥70 million and these assets were insured, while the actual realized losses including repair expenses have not been confirmed at this time.

In addition, the Cosmo Oil Group plans to purchase products to replace the supply capacity lost because of reduced production due to a partial interruption of operations.

# INDEPENDENT AUDITORS' REPORT

To Board of Directors of
COSMO OIL COMPANY, LIMITED:

We have audited the accompanying consolidated balance sheets of COSMO OIL COMPANY, LIMITED and its consolidated subsidiaries as of March 31, 2005 and 2006, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended March 31, 2006, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of COSMO OIL COMPANY, LIMITED and its consolidated subsidiaries as of March 31, 2005 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following.

(1) As discussed in Note 2 to the consolidated financial statements, for the year ended March 31, 2004, some of consolidated subsidiaries of COSMO OIL COMPANY, LIMITED changed classification of logistics expense and subcontracting work expense from cost of sales to selling, general and administrative expense.

(2) As discussed in Note 2 to the consolidated financial statements, effective from the fiscal year ended March 31, 2005, COSMO OIL COMPANY, LIMITED changed the method of the accounting for retirement benefits for directors and corporate auditors.

(3) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2004, COSMO OIL COMPANY, LIMITED and its consolidated subsidiaries adopted the new accounting standard for impairment on fixed assets.

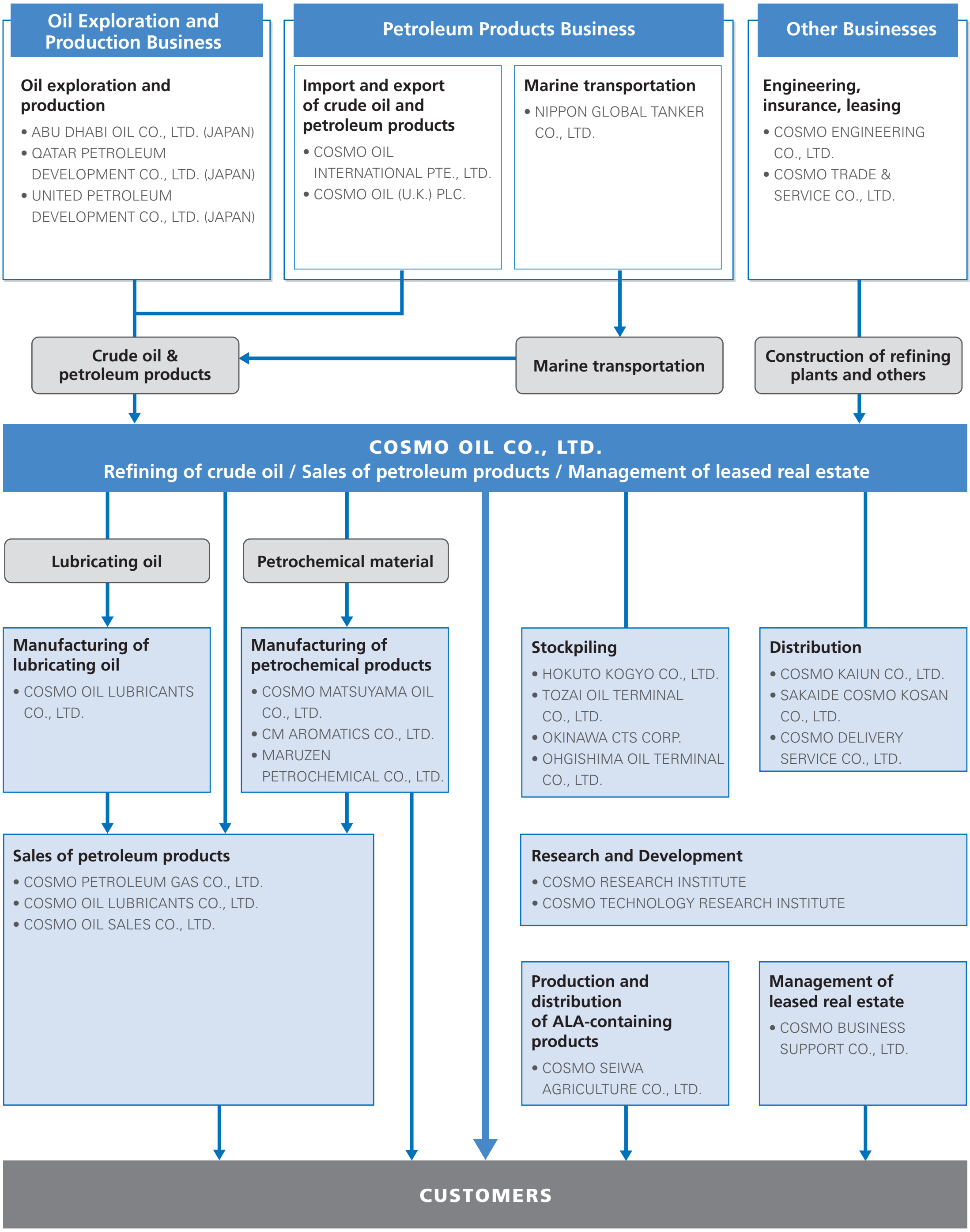
(4) As discussed in Note 16, on April 16, 2006 a fire broke out in the Chiba oil refinery of COSMO OIL COMPANY, LIMITED.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

KPMG AZSA & Co.

Tokyo, Japan
June 29, 2006

# MAJOR SUBSIDIARIES AND AFFILIATES



# GLOBAL NETWORK

## JAPAN

### OIL EXPLORATION & PRODUCTION

Cosmo Energy Exploration and Development Co., Ltd.*
- Tokyo
- ¥200 million
- 100.00%
- Oil exploration and development

Abu Dhabi Oil Co., Ltd.*
- Tokyo
- ¥10,090 million
- 62.62%
- Oil exploration and production

Cosmo Oil Ashmore Ltd.*
- Tokyo
- ¥1,784 million
- 51.00%
- Oil exploration and development

United Petroleum Development Co., Ltd.#
- Tokyo
- ¥2,010 million
- 35.00%
- Oil exploration and production

Qatar Petroleum Development Co., Ltd.*
- Tokyo
- ¥3,148 million
- 85.83%
- Oil exploration and development

### MARINE TRANSPORTATION

Nippon Global Tanker Co., Ltd.
- Tokyo
- ¥50 million
- 35.00%
- Marine transportation

### PETROCHEMICAL PRODUCTION

Cosmo Matsuyama Oil Co., Ltd.*
- Ehime Prefecture
- ¥3,500 million
- 100.00%
- Manufacture and sales of petrochemical products

CM Aromatics Co., Ltd. *
- Tokyo
- ¥100 million
- 65.00%
- Manufacture and sales of mixed xylene

Maruzen Petrochemical Co., Ltd.#
- Tokyo
- ¥10,000 million
- 40.00%
- Manufacture and sales of petrochemical products

### DISTRIBUTION & STOCKPILING

Cosmo Delivery Service Co., Ltd.*
- Chiba Prefecture
- ¥50 million
- 100%
- Trucking and transportation services

Cosmo Kaiun Co., Ltd.*
- Tokyo
- ¥330 million
- 100%
- Marine transportation and shipping agency

Tozai Oil Terminal Co., Ltd.#
- Tokyo
- ¥480 million
- 50.00%
- Contracts for oil receiving and shipping works

Okinawa CTS Corp.#
- Okinawa Prefecture
- ¥495 million
- 35.00%
- Oil storage, receiving and shipping works

Hokuto Kogyo Co., Ltd.*
- Hokkaido
- ¥20 million
- 100.00%
- Oil receiving and shipping works

## OVERSEAS

## SALES OF PETROLEUM PRODUCTS

Cosmo Oil Lubricants Co., Ltd.*
- Tokyo
- ¥1,620 million
- 100.00%
- Manufacturing, research, and sales of lubricating oil and other products

Cosmo Petroleum Gas Co., Ltd.*
- Tokyo
- ¥3,500 million
- 100.00%
- Import and sales of LPG

Cosmo Oil Sales Co., Ltd.*
- Tokyo
- ¥585 million
- 100%
- Marketing and sales of oil products

## RESEARCH & DEVELOPMENT

Cosmo Research Institute*
- Tokyo
- ¥50 million
- 100.00%
- Research and technical corporation

Cosmo Technology Research Institute*
- Tokyo
- ¥10 million
- 100%
- Research and development of petroleum refining technology, etc.

## ENGINEERING

Cosmo Engineering Co,. Ltd.*
- Tokyo
- ¥385 million
- 88.92%
- General plant and equipment engineering

## OTHERS

Cosmo Business Support Co., Ltd.*
- Tokyo
- ¥300 million
- 100.00%
- Integrated human resources services and management of leased real estate

Cosmo Trade & Service Co., Ltd.*
- Tokyo
- ¥200 million
- 100.00%
- Service-station-related business and other services

Cosmo Oil International Pte., Ltd.*
- Singapore
- S$19,500,000
- 100%
- Purchase and sale of crude oil and finished products

Cosmo Oil of U.S.A., Inc.*
- California
- US$250,000
- 100.00%
- Support for sales of petroleum products

Cosmo Oil (U.K.) Plc.*
- London
- US$4,982,342
- 100.00%
- Purchase and sale of crude oil and finished products

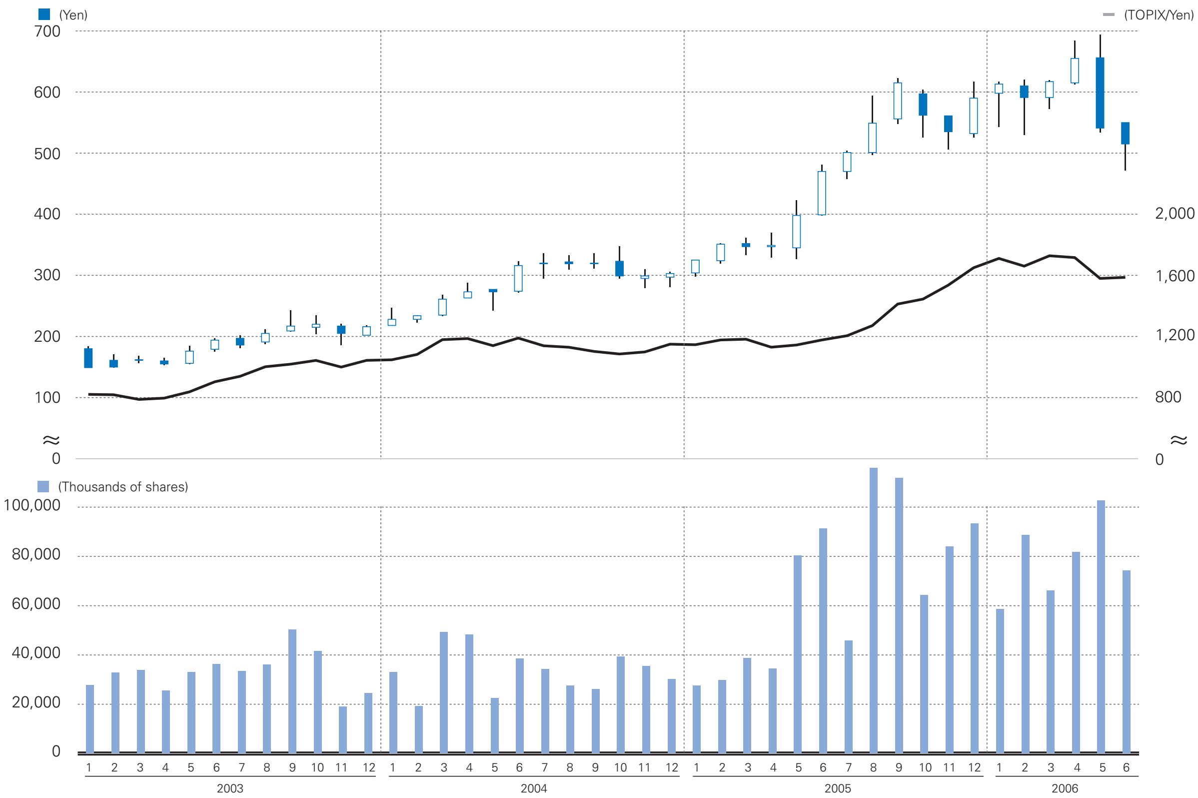
- Location
- Paid-in Capital
- Shareholding
- Principal Business

* Consolidated

\# Accounted for by the equity method

# INVESTOR INFORMATION

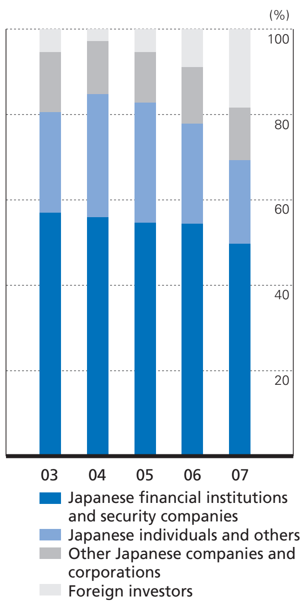
## Price Range of Stock & Trading Volume




## Principal Shareholders

| | Number of shares owned (Thousands) | Percentage of total shares issued |
|---|---|---|
| Japan Trustee Services Bank, Ltd. (trust account) | 61,678 | 9.18 |
| Mizuho Corporate Bank, Ltd. | 31,320 | 4.66 |
| The Master Trust Bank of Japan, Ltd. (trust account) | 26,236 | 3.90 |
| Mitsui Sumitomo Insurance Co., Ltd. | 21,878 | 3.25 |
| The Bank of Tokyo-Mitsubishi UFJ, Ltd. | 19,750 | 2.94 |
| The Kansai Electric Power Co., Inc. | 18,600 | 2.76 |
| Tokio Marine & Nichido Fire Insurance Co., Ltd. | 17,335 | 2.58 |
| Sompo Japan Insurance Inc. | 15,792 | 2.35 |
| Trust & Custody Services Bank, Ltd. (trust account) | 13,052 | 1.94 |
| Nissay Dowa General Insurance Co., Ltd. | 12,000 | 1.78 |

## Shares by Type of Shareholder



# CORPORATE DATA

| | |
|---|---|
| HEAD OFFICE | Shibaura 1-chome, Minato-ku,<br>Tokyo 105-8528, Japan<br>Phone: +81-3-3798-3211<br>Fax: +81-3-3798-3841<br>URL: http://www.cosmo-oil.co.jp |
| ESTABLISHED | April 1, 1986 |
| COMMON SHARES | Authorized: 1,700,000,000 |
| PAID-IN CAPITAL | ¥62,366,816,126 |
| TYPE OF BUSINESS | Refining and sales of oil products |
| FISCAL YEAR-END | March 31 |
| NUMBER OF EMPLOYEES | 1,718 |
| NUMBER OF DEALERS | 303 |
| REFINERIES | Chiba, Yokkaichi, Sakai, Sakaide |
| NUMBER OF COMMON SHARES ISSUED | 631,705,087 shares |
| TRANSFER AGENT | The Chuo Mitsui Trust & Banking Co., Ltd. |

**Inquiries:**

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