

TO OUR SHAREHOLDERS



> ESTABLISHING A FOOTHOLD FOR THE FUTURE

- > In the course of steering Cosmo Oil, we seek to fulfill our responsibility to society, and establish a more solid management foundation in accordance with the two central elements of our management vision: *creating future value*, and *harmony and symbiosis*. First, creating future value simply means providing value for all stakeholders in line with various needs through the stable provision of energy, the lifeblood of an economy. This also means building a business model that allows for sustainable growth, generating a stable cash flow to ensure that profits are not affected by such fluctuations in the macroeconomic environment as crude oil prices or exchange rates. Looking ahead, we feel that it is important for us to implement the measures of our Medium-Term Management Plan ahead of schedule, and make certain that we achieve our management goals.

Second, in accordance with the vision of harmony and symbiosis, and as a member of society, we seek to fulfill our corporate responsibilities in a number of ways, such as addressing environmental problems on both a global scale and within our business area. We will also continue to strictly comply with laws and regulations, while establishing as quickly as possible a highly transparent corporate structure. Successfully fulfilling this dual mission is a way of giving back to society and all stakeholders in Cosmo Oil, and we believe will lead to greater business stability and future growth.

BUSINESS ENVIRONMENT AND PERFORMANCE REVIEW

- > The business environment during fiscal 2004 (ended March 31, 2004), was extremely adverse. The wartime premium on crude oil, which had risen quickly at the end of fiscal 2003 along with the growing tension over the situation in Iraq, fell off sharply at the start of the fiscal year, with Dubai crude (see graph 1) trading at around \$23/barrel. OPEC's subsequent production cutback and an upturn in the global economy pushed up prices, which reached the \$30/barrel range by the end of the term. Exchange rates (see graph 2) at the beginning of the fiscal year were around ¥121/U.S. dollar, falling to a three-year low at the end of the term of ¥103/U.S. dollar, the result of the growing U.S. trade deficit, and yen buying prompted by hints of a slight recovery of demand from private companies in Japan.

Yaichi Kimura, President (left)
Keiichiro Okabe, Chairman (right)

Looking at Cosmo Oil's earnings, although sales volumes of heavy fuel oil C and gasoline were strong, a record-setting warm winter prompted a decline in the sales volume of heating fuel, resulting in an overall decrease of 1.4% from the previous fiscal year. However, the improvement in product prices, and the positive effects of the Medium-Term Management Plan led to a 0.7% rise in consolidated net sales to ¥1,916,278 million, a 4.5% increase in operating income (see graph 3) to ¥25,246 million, and net income that more than doubled, rising 138.7% to ¥8,179 million.

Particularly notable were the positive results of the business restructuring carried out under the Medium-Term Management Plan (covering the period from fiscal 2004 through fiscal 2006), indicating a gradual improvement in an earnings structure that is able to effectively generate profits without being subject to such external factors as fluctuations in crude oil prices or exchange rates.

In fiscal 2005, the petroleum industry is beginning to benefit from the reductions in refining capacity. The supply and demand balance in Japan is also expected to tighten, owing to periodical shutdown maintenance of refineries across the industry and healthy sales of petroleum products overseas, and the business environment will gradually shift to one in which crude oil prices are more readily reflected in the market. It will finally be an environment in which value creation and rationalization will contribute directly to earnings. Such an environment will certainly be to our advantage, and we are confident that successful implementation of the Medium-Term Management Plan will put us on a stable growth track.

COSMO OIL'S COMPETITIVE ADVANTAGE

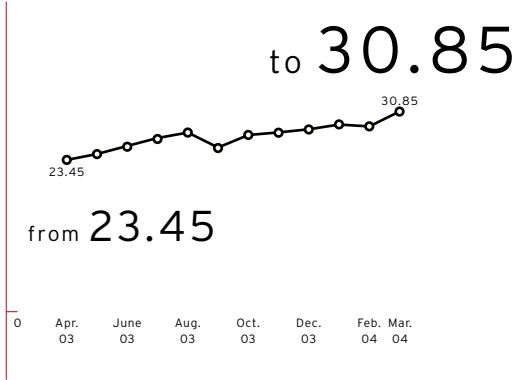
- › We would now like to discuss the competitive advantages that are the driving force behind the implementation of the various measures in our Medium-Term Management Plan. These can be divided into three main areas: stable production in the oil exploration and production division, placement and operation of our four refineries, and high earnings capacity in our marketing subsidiaries.

OIL EXPLORATION AND PRODUCTION DIVISION

- › In order to ensure a stable supply of petroleum products—one of our most important corporate responsibilities—it is essential that we make efforts with regard to the upstream business of crude oil development. Currently, crude oil production at Abu Dhabi Oil Co., Ltd. and other affiliated companies in Abu Dhabi (UAE) is approximately 50,000 barrels/day, slightly less than 10% of our total import volume. Along with Qatar Petroleum Development Co., Ltd., which is expected to begin production in fiscal 2006, we are seeking to

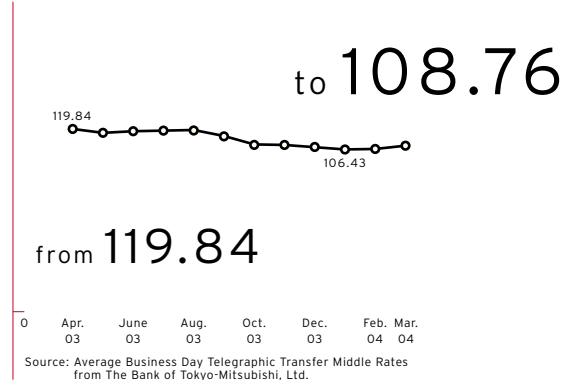
graph 1:

Crude oil prices (Dubai)
(US\$/b)



graph 2:

Currency exchange rates
(yen/US\$)



Source: Average Business Day Telegraphic Transfer Middle Rates from The Bank of Tokyo-Mitsubishi, Ltd.

graph 3:

Operating income / Net income (loss)
(billions of yen)

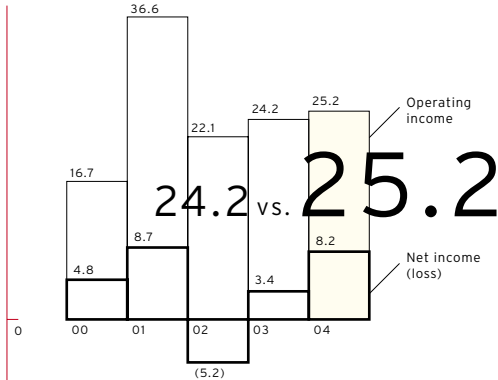
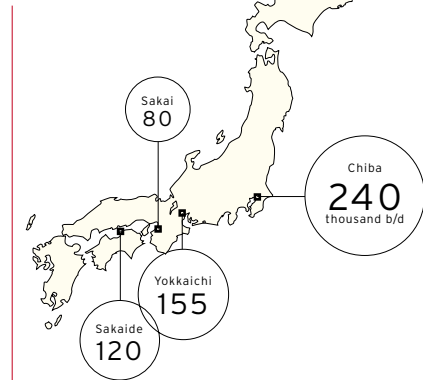


chart 1:

Location and capacity of refineries
(thousand b/d)



Cosmo Oil's refineries are located near cities with large consumer bases, allowing production to respond in a timely and appropriate manner.

maintain and expand a stable supply from existing fields in the Middle East, the core area for crude oil development. We are also making a concerted effort to address environmental problems in producing countries, through such initiatives as the Zero-Flare Project at Abu Dhabi Oil Co., Ltd.'s oil fields, in which the sulfur-tainted gas that is emitted during the production of crude oil is re-injected into the ground, rather than burned in the "flare," reducing the amount of sulfur released into the atmosphere. This project has been highly praised by the Abu Dhabi government. More generally, the mutual trust built up through approximately 40 years of personal exchanges that extend beyond business is also an invaluable asset.

SUPPLY DIVISION

- › Cosmo Oil's strength in terms of supply stems from its four, highly competitive refineries located in regions adjacent to large consumer bases (see chart 1).

Also, sophisticated catalyst development technology and flexible facility operations allow us to produce environmentally friendly products or match the demand for light petroleum products without large-scale investment. In particular, we have strengthened supply chain management (SCM) with an optimal operating structure that utilizes enterprise resource planning (ERP), allowing us to improve low-cost operations and value-added production.

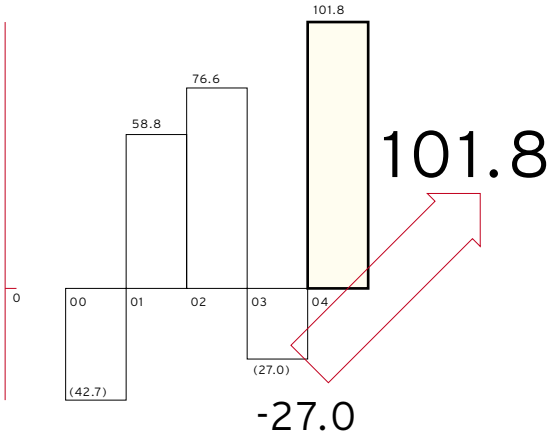
MARKETING DIVISION

- › The strengths of our marketing division are the marketing strategies of our sales subsidiaries and their high earnings capacity. Average monthly sales volume at self-service stations that are operated directly or by sales subsidiaries is 391kl/month, nearly four times the volume at our general service stations (106kl/month), and approximately twice the industry average for self-service stations (193kl/month). Auto B-cle service stations, which offer car repair and maintenance facilities, are also able to contribute earnings from car care directly to consolidated earnings because a majority are operated by sales subsidiaries, helping to maintain a high level of earnings. At the same time, the expertise we've acquired in operating self-service stations and car care sales accumulated at directly operated and sales subsidiary outlets is being shared with affiliated stores in which we have no ownership interests (designated independent dealers). We believe that strengthening the competitiveness of the entire Cosmo Oil network in this way will result in a stable earnings base. Specific measures and targets for this sales strategy are detailed in the Medium-Term Management Plan section of this report.



graph 4:

Cash flows from operating activities
(billions of yen)



graph 5 :

Interest-bearing debt target
(billions of yen)

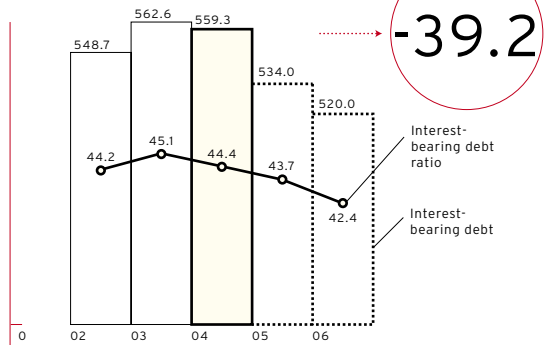
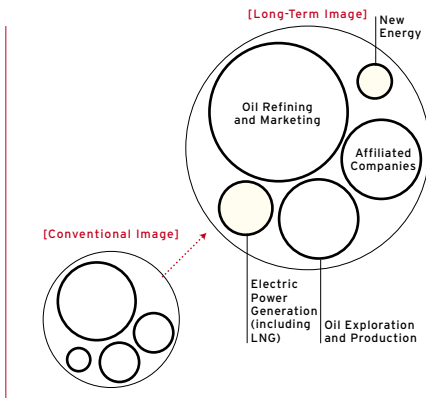


chart 2:

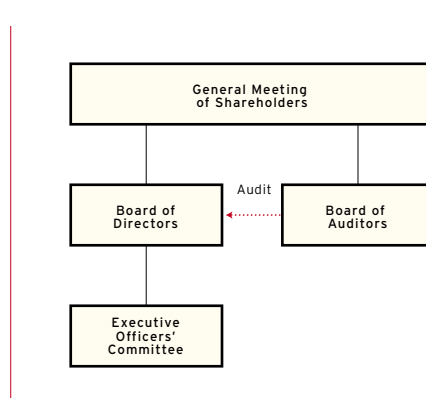
Our future business portfolio



Expand the electric power generation, oil exploration and production, LNG and new energy businesses, as well as affiliated companies to build profitable growth.

chart 3:

New corporate governance structure



Cosmo Oil abolished the former Executive Committee and established the Executive Officers' Committee.

Finally, another of our strengths is the driving force behind the operational management, which allows us to efficiently utilize these three management resources to their fullest extent. Through decision making that is both top-down and bottom-up, we possess the ability to respond flexibly to the external environment. We take pride in this "harmonious organization," a structure that generates synergies from the combination of individual abilities and structural capability.

MANAGEMENT ISSUES

- › Now we would like to report on the progress of the management issues identified in last year's annual report. We would also like to address the initiatives outlined in the Medium-Term Management Plan—reforms to the distribution structure, our response to the changing demand structure, and our plan with regard to liberalization in the energy sector—which are detailed in the Medium-Term Management Plan section of this report and under "Our Future Business Portfolio as a Comprehensive Energy Company" on the next page.

ISSUES RESOLVED OR CLOSE TO RESOLUTION

PETROLEUM PRODUCTS COMPLIANT WITH ENVIRONMENTAL STANDARDS

- › In order to comply with new government regulations under consideration regarding the sulfur content in gasoline and diesel oil (less than 10ppm), we have pushed forward with our plan for installation of desulfurization equipment at the Chiba, Yokkaichi and Sakai refineries, and expect to be able to supply compliant products from these refineries from January 2005, ahead of the 2008 start date. We believe the Sakaide refinery is currently able to operate within the new regulations using existing equipment. Total investment was as forecast at ¥13.9 billion, and with our advanced desulfurization catalyst development technology we were able to realize savings of approximately ¥10.0 billion.

EXCESS CAPACITY

- › Cosmo Oil's topper capacity ratio during fiscal 2004 was 87.8%, significantly higher than the industry average of 83.0%. This was because, although there was a slight falloff in demand (excluding a special procurement of heavy fuel oil C by Tokyo Electric Power Co., Inc.), growing refining margins allowed for more crude oil treatment, and we cut back product imports and domestic purchasing. Along with our plan to cut topper capacity by 50,000 barrels per day, closures of refineries throughout the industry helped resolve the excess capacity problem. However, considering the recent temporary shutdown of nuclear power plants and accidents at refineries, and that providing a stable supply of petroleum products is our most critical mission, we believe that it is necessary to maintain an optimum level of refining capacity.

Tariffs on petroleum products are due to be eliminated some time around 2006, and we are often asked if competitive imports from countries like South Korea and Singapore will negatively impact domestic demand or markets. We are looking at this as not so much a threat as an opportunity. Demand for petroleum products in China and Southeast Asia is growing quickly along with rapid economic development. Moreover, considering the demand structure in nominally export-oriented countries like Singapore and South Korea, the focus of import/export will be on covering the shortages of products on both sides, and on the pursuit of benefits in export costs, which means that it will not be one-sided import into Japan. Also, regulations on the amount of sulfur in gasoline and diesel oil will act as a nontariff barrier, and coupled with continued streamlining initiatives, Japanese refiners' competitiveness will improve in a relative sense. Consequently, though our export of petroleum products is currently around 500,000kl annually, we expect that the volume of both exports and imports will increase. This will also help resolve the problem of overcapacity in domestic refinery equipment.

ISSUES STILL BEING ADDRESSED

REDUCTION IN INTEREST-BEARING DEBT

- › Interest-bearing debt (see graph 5) as of March 31, 2004 totaled ¥559.3 billion. This represented a slight reduction of ¥3.3 billion from the previous fiscal year, the result of advanced procurement of funds for a planned redemption of corporate bonds in fiscal 2005. Looking at trends in declining interest-bearing debt, import financing (short-term debt) will tend to swell reflecting crude oil sales, but long-term debt will steadily be reduced. The reduction in interest-bearing debt was one of our earnest desires even before the merger that established Cosmo Oil in April 1986, and by drawing on stable operating cash flow (see graph 4) we plan to achieve our target of ¥520.0 billion by the end of fiscal 2006.

OUR FUTURE BUSINESS PORTFOLIO AS A COMPREHENSIVE ENERGY COMPANY

- › The 21st century will almost certainly be a time of great changes for mankind. Industrial structures are changing significantly along with the progress of technological innovation, and debate over the means of coping with finite energy resources and preservation of the global environment continues. Faced with this environment, Cosmo Oil has already begun to examine its existence and policies as a comprehensive energy company, and it is necessary for us to establish our management direction.

In order to accomplish this, using generated cash we need to reinforce our financial foundation as quickly as possible to establish an earnings structure, while at the same time build a business portfolio from a long-term perspective.

According to long-term energy demand forecasts compiled by the Japanese government, by the year 2010 oil will account for approximately 45% of total demand (currently around 50%), with coal in second place at 18%. Liquid natural gas (LNG), which is expected to replace heavy fuel oil C, will account for no more than 15%. Oil will remain the main source of energy.

In addition, considering long-term energy demand, and regarding liberalization of the energy sector as a business opportunity, we must build a business portfolio appropriate to a comprehensive energy company. In addition to the oil exploration and production business and the electric power generation (gas) business, which are currently generating steady earnings, we are planning to cultivate new energy businesses and the LNG business that will in the future stand alongside oil refining and marketing as a core business (see chart 2).

OIL EXPLORATION AND PRODUCTION BUSINESS

- › Although the oil exploration and production business is one of our strengths, it carries risks, and investment amounts are substantial. Consequently, our basic strategy with regard to development investment emphasizes selection and concentration, along with safety. We invest in the core areas of Abu Dhabi and Qatar, and the secondary area of Australia. In Abu Dhabi, we have maintained steady production since the 1960s through Abu Dhabi Oil Co., Ltd. (51.1% ownership) and United Petroleum Development Co., Ltd. (35% ownership). In addition to this, we plan to begin commercial production in Qatar in fiscal 2006.

DEREGULATION OF ELECTRIC UTILITIES

- › Our independent power producer (IPP) facility, which uses residual oil from the Yokkaichi refinery, has been operating steadily since July 2003 (200,000kw), and provides stable earnings. We have also formulated business plans for thermoelectric power sales, retail sale of surplus electricity from refineries, and wind power generation.

TO OUR SHAREHOLDERS

16:51



ENTRY INTO THE LNG BUSINESS

- › In June 2004, utilizing an area of the Sakaide refinery, we formed Sakaide LNG K.K. (20.0% ownership) jointly with Shikoku Electric Power Co., Inc. and Shikoku Gas Co., Ltd., to receive, store, vaporize and deliver LNG. Along with LNG Chubu Corporation (15.0% ownership), which is already operating, and Sakai LNG K.K. (12.5% ownership), which is due to commence business in 2005, we now have in place an infrastructure that will be able to meet future energy demand. We plan to cultivate this business to become one of the key elements of our future operations.

NEW ENERGY

- › In anticipation of the widespread use of automotive fuel cells, we are taking steps toward trial operation of hydrogen fueling stations. This business holds great potential for the future, and is an exciting business sector.

COSMO OIL'S CSR PROGRAM

- › In order to discover a social value in our existence, we are building a foundation for sustainable growth through our business activities, while at the same time seeking a highly transparent structure rooted in corporate ethics. In addition, we are committed to fulfilling our social responsibilities by contributing to environmental preservation and society at large.

As a comprehensive energy company, Cosmo Oil is actively involved in environmental activities, both on a global scale and within its business areas. We hope to strengthen our environmental and social efforts to be a step beyond simply complying with laws and regulations, such as with our voluntary establishment, ahead of government regulations, of a supply structure for gasoline and diesel with sulfur content less than 10ppm.

During fiscal 2004, we established a CSR & Environmental Affairs Office. The CSR & Environmental Affairs Office controls three committees, the existing Global Environment Committee and Comprehensive Safety Action Headquarters, and the newly established Human Rights Committee, and provides a structure for implementation.

In terms of compliance, in fiscal 2003 we established a Corporate Ethics Committee, directly linked to the Board of Directors, which sets strict guidelines and ensures that they are adopted and adhered to throughout the Group. For more details, see the Corporate Social Responsibility Section of this report.

In terms of the corporate governance structure (see chart 3), in a move to separate management auditing and business execution, we abolished the Executive Committee and established the Executive Officers' Committee in July 2004 to clarify the position of the Board of Directors in overseeing operations and strengthen decision-making capabilities in business execution. Auditing functions are carried out under the auditing system, with the aim of ensuring a structure suited to our corporate culture and commensurate with Japanese companies. Auditors sit on the Board of Directors, Executive Officers' Committee and many other types of management committees, strengthening the auditing of directors.

In pursuit of corporate social responsibility (CSR) management, during fiscal years 2003 and 2004 we made many efforts regarding policy formation and structural development for corporate governance and compliance. One of our issues for the future is how to make this structure more practical, and to this end education of top management, related departments and all employees is crucial.

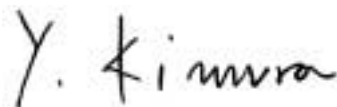
Regarding the incident during fiscal 2004 in which customer information from Cosmo The Card—the key component of our sales strategy—was leaked by the system development outsource company, we sincerely apologize to all our card members, as well as our shareholders and investors, for the concern we have caused. We will further strengthen our crisis management structure, and so that we can be a company that continually provides safety and reliability to all stakeholders, will enhance our information disclosure to remain sincerely committed to maintaining the public trust.

We seek to improve corporate value through the establishment of a stronger earnings base while delivering long-term, stable dividends. We will also continue to provide timely and appropriate information disclosure, and make diligent efforts to respond to any manner of question or concern, and reflect these valued opinions in our management. Thank you for your continued support.

July 1, 2004



Keiichiro Okabe
Chairman



Yaichi Kimura
President