

## > FINANCIAL SECTION

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# CONSOLIDATED 11-YEAR SUMMARY

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

	Millions of yen				
	1994	1995	1996	1997	1998
<b>FOR THE YEAR:</b>					
Net sales	¥1,609,074	¥1,588,003	¥1,556,171	¥1,729,495	¥1,680,478
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	1,374,891	1,359,869	1,350,743	1,508,186	1,473,349
Selling, general and administrative expenses	162,638	177,552	173,359	185,900	179,228
Operating income	71,545	50,582	32,069	35,409	27,901
Income (loss) before income taxes and minority interests	46,167	35,088	14,473	18,060	14,466
Net income (loss)	8,697	13,065	6,545	8,839	5,340
Depreciation and amortization	36,049	36,144	37,700	35,738	34,228
Capital expenditures	47,542	51,549	41,613	31,021	34,175
Research and development costs	N.A.	N.A.	N.A.	N.A.	N.A.
Cash flows from operating activities	53,914	47,525	62,798	(25,553)	64,558
Cash flows from investing activities	(31,520)	(35,697)	(55,764)	13,972	(59,532)
Cash flows from financing activities	(9,943)	(31,633)	(584)	2,065	(5,295)
<b>AT YEAR-END:</b>					
Total shareholders' equity	158,337	183,472	185,836	189,790	190,716
Total assets	1,239,141	1,234,897	1,286,000	1,287,172	1,277,022
Interest-bearing debt	663,745	640,083	645,297	654,233	652,769
Yen					
<b>AMOUNTS PER SHARE:</b>					
Net income (loss) (Note)	¥ 14.98	¥ 21.12	¥ 10.36	¥ 13.99	¥ 8.45
Cash dividends	8.00	8.00	8.00	8.00	8.00
Shareholders' equity	266.62	290.43	294.18	300.44	301.91
<b>RATIOS:</b>					
Return on equity (ROE) (%)	5.9	7.6	3.5	4.7	2.8
Return on assets (ROA) (%)	0.7	1.1	0.5	0.7	0.4
Interest-bearing debt ratio (%)	53.6	51.8	50.2	50.8	51.1

Notes: 1. U.S. dollar amounts in this report have been translated, for convenience only, at the exchange rate of ¥105.69-\$1.00, the prevailing rate at March 31, 2004.

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 (Note)
1999	2000	2001	2002	2003	2004	2004
¥1,443,457	¥1,584,678	¥1,845,842	¥1,813,838	¥1,902,768	¥1,916,278	\$18,131,119
N.A.	N.A.	N.A.	1,746,659	1,830,940	1,862,554	17,622,802
N.A.	N.A.	N.A.	10,856	9,773	12,950	122,528
N.A.	N.A.	N.A.	56,323	62,055	40,774	385,789
1,265,443	1,427,640	1,664,757	1,659,438	1,754,853	1,758,858	16,641,669
155,154	140,373	144,503	132,343	123,748	132,174	1,250,582
22,860	16,665	36,582	22,057	24,167	25,246	238,868
4,351	13,313	22,460	(1,881)	12,966	17,592	166,449
839	4,841	8,674	(5,190)	3,426	8,179	77,387
21,773	23,436	24,672	23,492	22,843	23,632	223,597
31,325	22,593	17,108	25,430	24,132	36,573	346,040
N.A.	4,567	3,566	3,805	3,867	3,558	33,664
17,718	(42,698)	58,824	76,646	(26,975)	101,827	963,450
(17,806)	13,538	27,348	(13,944)	(12,811)	(32,709)	(309,481)
(14,592)	31,271	(87,229)	(88,546)	10,127	(7,679)	(72,656)
186,496	179,536	177,773	194,303	193,595	204,806	1,937,799
1,229,285	1,294,843	1,319,960	1,242,171	1,246,730	1,260,092	11,922,528
641,562	687,563	610,686	548,653	562,649	559,259	5,291,503
Yen						U.S. dollars (Note)
¥ 1.33	¥ 7.76	¥ 13.81	¥ (8.24)	¥ 5.42	¥ 12.95	\$0.12
6.00	6.00	6.00	6.00	6.00	6.00	0.06
295.23	286.75	282.09	308.65	306.67	324.43	3.07
0.4	2.6	4.9	—	1.8	4.1	
0.1	0.4	0.7	—	0.3	0.7	
52.2	53.1	46.3	44.2	45.1	44.4	

# FINANCIAL REVIEW

## OVERVIEW

In fiscal 2004, ended March 31, 2004, a warm winter and other factors discouraged oil demand in Japan, reducing the sales volume of oil products such as kerosene, diesel fuel and heavy fuel oil A, while the sales volume of gasoline and heavy fuel oil C was unaffected and increased strongly as a result. Crude oil prices, which began the year at \$23/barrel for Dubai crude, continued to trade between \$24-\$28 per barrel until November, when OPEC decided to reduce production. Thereafter, Dubai crude oil traded at more than \$28/barrel, peaking at \$31/barrel in March 2004. In foreign exchange markets, the yen began the fiscal year trading around ¥121/US\$1, and continued to slide downward to ¥103/US\$1 by the end of the fiscal year.

Fiscal 2004 was the initial year of our Medium-Term Management Plan, which will end in fiscal 2006. Under this plan, we are focusing all our efforts on rationalization and value creation throughout the Cosmo Oil Group to strengthen management.

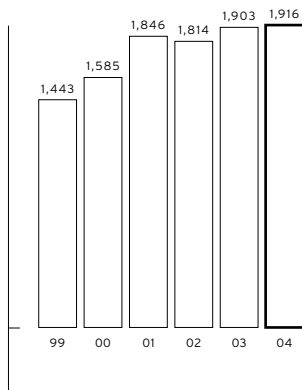
Consolidated net sales rose ¥13.5 billion, or 0.7% year on year, to ¥1,916.3 billion (US\$18,131.1 million) for fiscal 2004, while net income of ¥8.2 billion (US\$77.4 million) was posted, marking an improvement of ¥4.8 billion.

## SALES BY SEGMENT

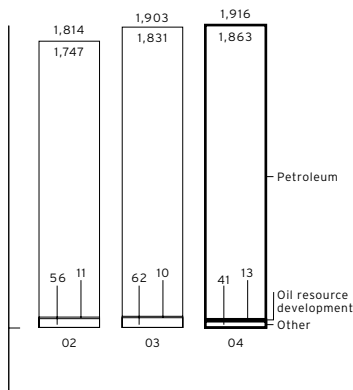
### > PETROLEUM

During fiscal 2004, demand for oil products was mixed. Demand for gasoline and heavy fuel oil C increased steadily, while demand for kerosene, diesel oil and heavy fuel oil A declined, adversely affected by a fall in domestic demand due to the unusually warm winter. In addition, market prices for oil products improved along with the upward trend in crude oil prices, reflecting efforts to shift higher costs onto consumers. On the whole, however, these efforts did not result in reasonable market prices corresponding to the higher cost of crude oil. As a result, total sales for the segment, including inter-segment sales, rose ¥30.5 billion, or 1.7%, to ¥1,863.1 billion (US\$17,627.9 million), reflecting higher selling prices. Operating income recovered, supported by value creation and rationalization measures in the Medium-Term Management Plan, which commenced in fiscal 2004. An improvement in market prices from the pre-

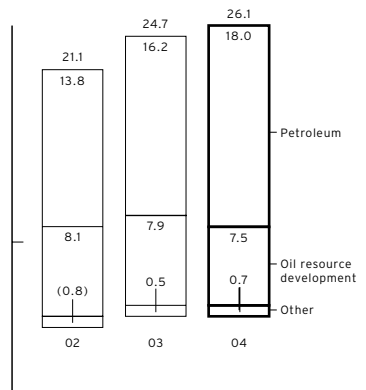
**Net sales**  
(billions of yen)



**Segment sales (net)**  
(billions of yen)



**Segment operating income (loss)**  
(billions of yen)



vious fiscal year also contributed to higher earnings. However, the impact of inventory valuation under the gross average method pushed up the cost of sales, adversely affecting operating income. Consequently, operating income for the petroleum segment increased ¥1.8 billion, or 10.8%, to ¥18.0 billion (US\$169.8 million).

> OIL RESOURCE DEVELOPMENT

Our oil resource development operations aim to achieve more stable and more highly developed supply capabilities by raising the ratio of oil that we directly develop, and by maintaining and expanding crude oil production volumes. Total sales for this segment declined ¥1.8 billion, or 5.2%, to ¥31.6 billion (US\$299.4 million), while operating income decreased ¥0.4 billion, or 5.3%, to ¥7.5 billion (US\$71.2 million).

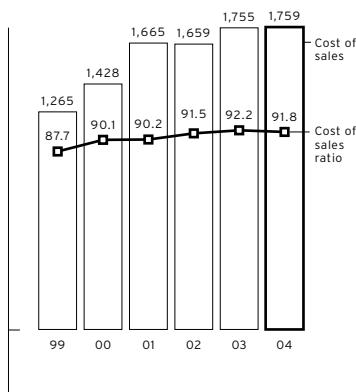
> OTHER

The other businesses segment consists mainly of the purchase, sale and rental of real estate properties, construction and leasing of petroleum-related facilities, and insurance operations. Total sales for this segment declined ¥7.2 billion, or 9.7%, to ¥66.7 billion (US\$631.4 million). However, efforts to rationalize and make operations more efficient resulted in operating income of ¥0.7 billion (US\$6.4 million), an increase of ¥0.1 billion, or 25.3%, compared with the previous fiscal year.

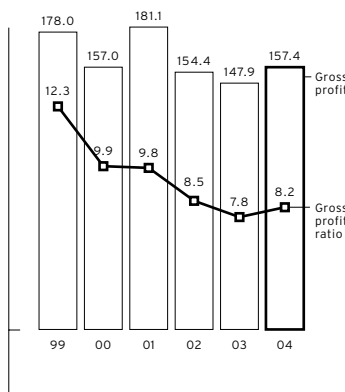
**COSTS, EXPENSES AND EARNINGS**

On a consolidated basis, the cost of sales increased 0.2% year on year, or ¥4.0 billion, to ¥1,758.9 billion (US\$16,641.7 million), while the gross profit ratio improved by 0.4 percentage point to 8.2%. On a non-consolidated basis, the Company achieved reductions of 0.1%, or ¥1.8 billion, in the cost of sales compared with the previous fiscal year. This reflects cost reductions of ¥7.4 billion from a decline in supply costs and ¥21.2 billion from lower sales volume, which was mostly offset by a net increase in costs of ¥26.8 billion from inventory valuations pushing up the cost of sales by ¥9.5 billion in the fiscal year under review, while they lowered the cost of sales by ¥17.3 billion in the previous fiscal year.

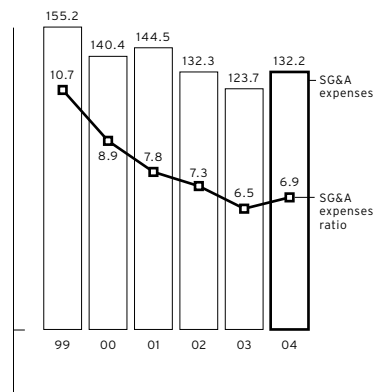
**Cost of sales and cost of sales ratio**  
(billions of yen) (%)



**Gross profit and gross profit ratio**  
(billions of yen) (%)



**SG&A expenses and SG&A expenses ratio**  
(billions of yen) (%)

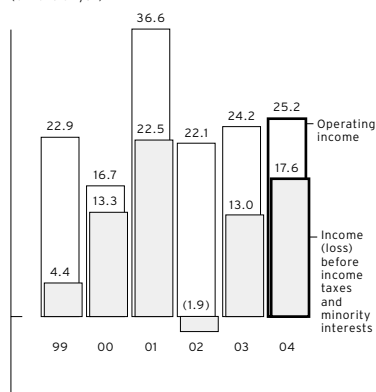


cal year. At consolidated subsidiaries, the cost of sales increased ¥5.8 billion from the previous fiscal year, as these companies changed the classification of logistics expense and subcontracting work expense from cost of sales to SG&A expenses, effectively lowering the cost of sales by ¥11.0 billion and increasing SG&A expenses by ¥8.4 billion. As a result, operating income was not affected by this accounting change, and selling, general and administrative (SG&A) expenses increased 6.8% to ¥132.2 billion (US\$1,250.6 million). The SG&A ratio to net sales increased by 0.4 percentage point to 6.9%. Excluding the impact of the change in accounting method, SG&A expenses would have declined 2.1%, or ¥2.6 billion.

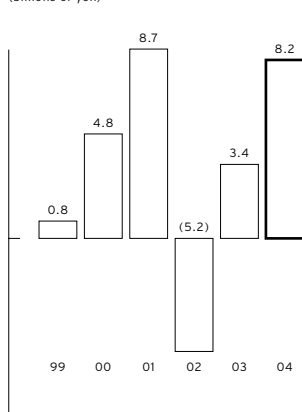
Operating income rose 4.5%, or ¥1.1 billion, to ¥25.2 billion (US\$238.9 million) from the previous fiscal year, reflecting an increase of 5.9%, or ¥0.7 billion, in non-consolidated operating income. Although operating income was adversely affected by warm winter temperatures lowering sales volume by ¥1.7 billion, this decline was more than offset by an earnings improvement of ¥14.5 billion under the Medium-Term Management Plan from rationalization effects of ¥6.8 billion and value creation of ¥7.7 billion, as well as an increase of ¥14.7 billion from better market prices. These factors contributed ¥27.5 billion to non-consolidated operating income, but were undermined by inventory revaluation effects of ¥26.8 billion (¥17.3 billion in fiscal 2003 and negative ¥9.5 billion in fiscal 2004) in cost of sales. As a result, operating income edged up ¥0.7 billion overall on a non-consolidated basis. Consolidated subsidiaries contributed ¥0.4 billion to operating income.

Net other expenses declined by ¥3.5 billion to ¥7.7 billion (US\$72.4 million), reflecting a significant decline in write-down of marketable securities and investments in securities, and an increase in equity in earnings of affiliates. Net interest expense declined 8.6%, or ¥1.0 billion, to ¥11.1 billion due to a decline in debt interest rates and interest payments in line with the early repayment of corporate bonds. Net loss on foreign currency exchange was ¥18 million in fiscal 2004, compared with a net gain of ¥0.4 billion in fiscal 2003. Equity in earnings of affiliates totaled a gain of ¥2.7 billion, compared with ¥1.0 billion in the previous fiscal year, owing to an increase in profits from better market prices at petrochemical subsidiaries. Net extraordinary expenses decreased 67.8%, or ¥3.9 billion, compared with the previous fiscal year, reflecting the absence of a ¥4.3 billion write-down of marketable securities and invest-

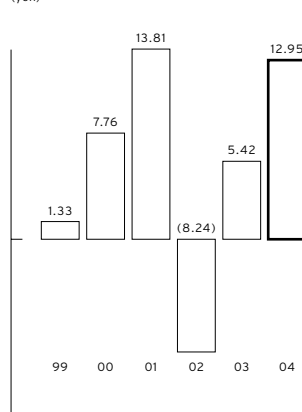
**Operating income and income (loss) before income taxes and minority interests**  
(billions of yen)



**Net income (loss)**  
(billions of yen)



**Net income (loss) per share**  
(yen)



ments in securities recorded in fiscal 2003, the absence of a gain of ¥1.1 billion on contribution of securities to retirement benefit trust recorded in fiscal 2003, and an increase of ¥0.5 billion in net loss on sale and disposal of property, plant and equipment.

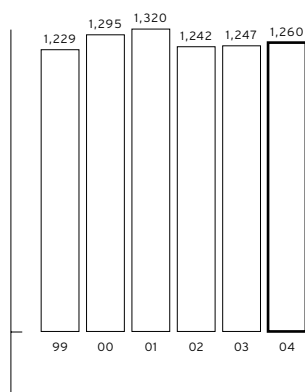
Reflecting the above, the Company recorded income before income taxes and minority interests of ¥17.6 billion (US\$166.4 million), representing an increase of 35.7%, or ¥4.6 billion, compared with the previous fiscal year. As a result, net income totaled ¥8.2 billion (US\$77.4 million), an increase of ¥4.8 billion compared with the previous fiscal year. Net income per share was ¥12.95 (US\$0.12), compared with net income per share of ¥5.42 in the previous fiscal year.

## FINANCIAL POSITION

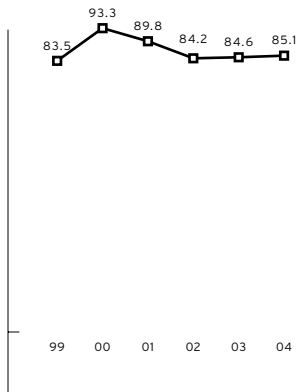
The Company is working to improve its balance sheet as part of its strategy of increasing the efficiency of total capital employed. As of March 31, 2004, total assets were ¥1,260.1 billion (US\$11,922.5 million), an increase of 1.1%, or ¥13.4 billion year on year. Total current assets rose 0.6% to ¥560.8 billion (US\$5,306.5 million). Cash and deposits climbed by ¥63.3 billion to ¥99.5 billion, owing to the deferred payment of gasoline excise and petroleum taxes since the due date fell on a holiday. Notes and accounts receivable, trade decreased by ¥28.2 billion. The decrease of ¥24.1 billion in other current assets reflected a decrease in accrued revenues due to crude oil consumption debit and credit transaction settlements, which also caused a decline in accounts payable under current liabilities. Net property, plant and equipment grew by ¥5.9 billion to ¥561.5 billion (US\$5,312.3 million), mainly owing to a ¥30.7 billion increase in machinery and equipment, which was partially offset by a ¥15.0 billion decline in construction in progress. In other assets, investments in securities rose by ¥9.5 billion as book value increased along with a rise in general stock prices.

Excluding minority interests, total liabilities increased by ¥2.0 billion to ¥1,030.4 billion. As with total assets, the deferred payment of gasoline excise and petroleum taxes increased accrued expenses and other current liabilities, while decreasing notes and accounts payable. Current liabilities increased slightly to ¥659.4 billion (US\$6,239.0 million). Notes and accounts payable, trade fell by ¥35.2 billion, which was partially offset by an increase of ¥33.7 bil-

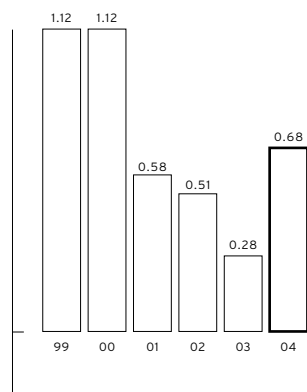
**Total assets**  
(billions of yen)



**Current ratio**  
(%)



**Liquidity**  
(times)



lion in income, excise and other taxes payable. Total shareholders' equity expanded by ¥11.2 billion, or 5.8%, to ¥204.8 billion (US\$1,937.8 million), mainly as the result of net unrealized gains on securities of ¥6.6 billion and an increase of ¥4.3 billion in retained earnings. The shareholders' equity ratio was 16.3%.

Capital expenditures totaled ¥36.6 billion, compared with ¥24.1 billion in the previous fiscal year. Capital expenditures in the petroleum segment were ¥28.4 billion. Capital expenditures in the oil resource development segment were ¥8.7 billion.

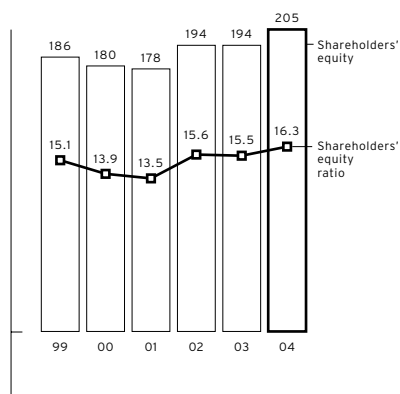
## CASH FLOWS

Cash and cash equivalents at the end of the fiscal year totaled ¥104.5 billion (US\$988.9 million), ¥60.7 billion higher than at the end of the previous fiscal year. The fiscal year under review included cash and cash equivalents from newly consolidated and merged companies of ¥0.4 billion. Net cash provided by operating activities was ¥101.8 billion (US\$963.5 million), compared with net cash used in operating activities of ¥27.0 billion in the previous fiscal year. Main sources of cash in the fiscal year under review included a decrease in notes and accounts receivable, a decrease in other current assets and an increase in other current liabilities.

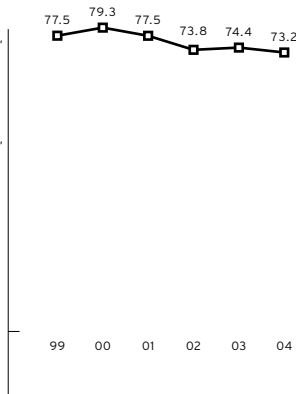
Net cash used in investing activities totaled ¥32.7 billion (US\$309.5 million), compared with ¥12.8 billion in the previous fiscal year. Cash outflows from payments for purchases of property, plant and equipment, payments for purchases of marketable securities and investments in securities, as well as payments for intangible assets and deferred charges far exceeded cash inflows from proceeds from sale or disposal of property, plant and equipment as well as proceeds from sale of marketable securities and investments in securities.

Net cash used in financing activities was ¥7.7 billion (US\$72.7 million), compared with net cash provided by financing activities of ¥10.1 billion in the previous fiscal year. This cash outflow was mainly due to a decrease in short-term loans payable, repayments for long-term loans payable and redemptions of bonds, which more than offsetting proceeds from long-term loans payable.

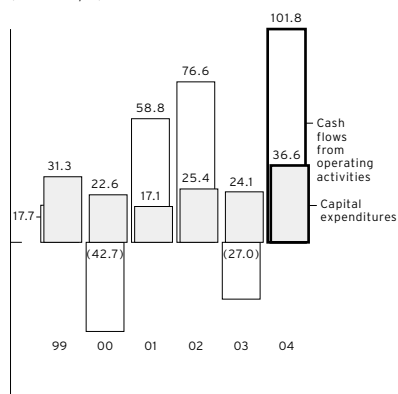
**Shareholders' equity and shareholders' equity ratio**  
(billions of yen) (%)



**Debt-to-total capital ratio**  
(%)



**Cash flows from operating activities and capital expenditures**  
(billions of yen)



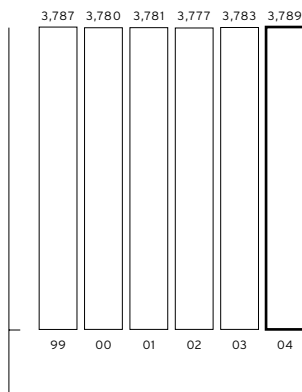
## DIVIDENDS

Cosmo Oil's basic dividend policy is to set dividend levels commensurate with performance. The Company determines dividend levels giving due consideration to financial improvement needs, capital investment needs for facility maintenance and renewal as well as strategic investments that promote rationalization, and value-added cash flow creation. In consideration of the above, the parent company maintained its cash dividends for the fiscal year at ¥6.00 (\$0.06) per share, unchanged from the previous fiscal year. Consequently, the dividends paid to shareholders' equity ratio decreased slightly to 1.85% from 1.95% in the previous year.

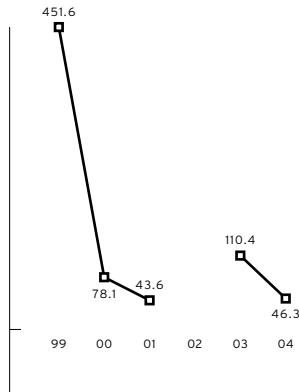
## OUTLOOK

Cosmo Oil's Medium-Term Management Plan (from fiscal 2004 through fiscal 2006) provides specific goals for improving earnings through rationalization and value creation, while at the same time facilitating further diversification into electric power generation, expanding oil exploration and production, and LNG operations. Our earnings goals for fiscal 2006 (ending March 31, 2006) are for ¥66 billion in operating income and ¥31 billion in net income. The main financial goals under the plan are for a shareholders' equity ratio of 20.3%, a return on equity ratio of 12.4%, and an interest-bearing debt dependency ratio of 42.0%. These goals include strategic capital investment of a total ¥111.0 billion yen over three years, which will be funded by internal cash flows consisting of three-year cumulative net income of ¥69.8 billion and three-year cumulative depreciation and amortization of ¥79.3 billion.

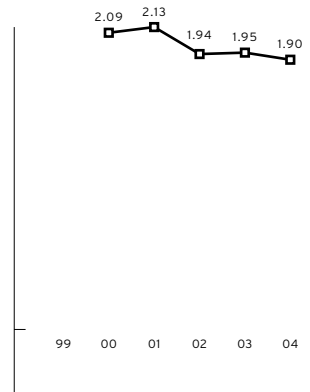
**Cash dividends**  
(millions of yen)



**Payout ratio**  
(%)



**Dividends on equity**  
(%)



## BUSINESS RISK

The Cosmo Oil Group's business performance and financial position are exposed to the following risks. Forward-looking statements are based on information current as of June 29, 2004.

### **CHANGES IN DEMAND**

Gasoline, kerosene and diesel oil, which make up the main portion of the Cosmo Oil Group's revenues, are strongly influenced by consumer demand. Moreover, demand trends in the petrochemical industry affect naphtha, transport industry impact diesel oil, and the electric power and marine transport industrial influence fuel oil. Accordingly, the Cosmo Oil Group's sales volume may be affected by changes in demand depending on economic conditions.

Depending on the weather, demand also changes for gasoline, diesel oil, kerosene and fuel oil, and this may adversely affect the sales volume of the Cosmo Oil Group.

### **CHANGES IN CRUDE OIL PRICES**

Crude oil prices change significantly with demand and production trends. Demand is largely determined by consumption in the United States and fast-growing countries in Asia, especially China. Production is largely controlled by OPEC nations, but attention should be paid to the production volumes of non-OPEC nations as well. In addition, political instability, such as wars in countries neighboring oil-producing nations, has a significant impact on crude oil prices.

Since crude oil prices make up most of the cost of sales, changes in global demand and oil prices could have a major impact on the Cosmo Oil Group's costs.

The Cosmo Oil Group uses the gross average method to value the fair price of its crude oil stockpiles. As a result, in the event that crude oil prices decline, the Cosmo Oil Group's costs may be affected by changes in crude oil prices, such as a higher cost burden than prevailing market prices.

### **EXCHANGE RATE FLUCTUATIONS**

The Cosmo Oil Group imports oil from overseas, and oil payments are generally denominated in U.S. dollars, so fluctuations in exchange rates cause disparities. The Cosmo Oil Group engages in foreign currency hedging transactions to minimize the adverse effects of fluctuations in exchange rates. Nevertheless, fluctuations in exchange rates may have a negative influence on the costs of the Cosmo Oil Group, such as driving up oil procurement costs amid a strong yen.

#### **MARKET RISK**

As mentioned above, the primary cost of the Company's oil products is determined by oil prices and exchange rates on the international market. Meanwhile, sales activities are mainly carried out in Japan, so sales prices are determined based on domestic market conditions. In the event that a gap or time lag is formed between international and domestic market conditions, the Cosmo Oil Group's earnings may be adversely affected.

#### **CHANGES IN INTEREST RATES**

In the event that interest on borrowings increases in the future due to changes in interest rates, the Company's interest payments on borrowings may be adversely affected by changes in interest rates, such as higher borrowing costs.

#### **CHANGES IN ASSET VALUE**

Based on economic conditions, changes in asset value may negatively impact the earnings of the Cosmo Oil Group, such as the occurrence of valuation losses from a decline in the value of assets held by the Cosmo Oil group, including land and securities.

#### **IMPACT OF DISASTERS AND ACCIDENTS**

Since oil refineries handle large volumes of flammable material, Cosmo Oil takes various safety measures to prevent accidents caused by human error and to prevent workplace injuries. However, unforeseen accidents and natural disasters such as earthquakes may cause operations to halt. Accidents involving storage tanks, service stations, tanker trucks may adversely affect the earnings of the Cosmo Oil Group.

#### **MANAGEMENT OF INDIVIDUAL INFORMATION**

In managing and handling a customer's personal information, Cosmo Oil takes every precaution to protect their privacy through internal rules and regulations and other measures. In the event that individual information is leaked, however, Cosmo Oil may lose customer trust and tarnish its brand name. This may lead to a detrimental impact on the sales volume and earnings of the Cosmo Oil Group.

## CONSOLIDATED BALANCE SHEETS

Cosmo Oil Company, Limited and its Consolidated Subsidiaries March 31, 2003 and 2004

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
<b>ASSETS</b>			
Current assets:			
Cash and deposits (Notes 4 and 14)	¥ 36,185	¥ 99,451	\$ 940,969
Marketable securities (Notes 4, 9 and 14)	7,425	8,412	79,591
Notes and accounts receivable, trade	208,858	180,687	1,709,594
Less allowance for doubtful accounts	(528)	(590)	(5,582)
	208,330	180,097	1,704,012
Inventories (Notes 2 and 3)	185,461	176,889	1,673,659
Other current assets (Note 12)	120,059	95,994	908,260
Total current assets	557,460	560,843	5,306,491
Property, plant and equipment (Notes 6 and 14):			
Land	349,958	350,170	3,313,180
Buildings and structures	363,631	369,199	3,493,225
Machinery and equipment	331,376	362,057	3,425,650
Construction in progress	28,779	13,771	130,297
	1,073,744	1,095,197	10,362,352
Less accumulated depreciation	(518,154)	(533,742)	(5,050,071)
Net property, plant and equipment	555,590	561,455	5,312,281
Other assets:			
Investments in securities (Notes 9 and 14)	73,177	82,674	782,231
Long-term loans receivable	9,874	9,561	90,463
Other (Note 12)	54,325	48,631	460,128
Less allowance for doubtful accounts	(2,800)	(3,072)	(29,066)
Reserve for loss on investments in unconsolidated subsidiaries and affiliates	(896)	—	—
Total other assets	133,680	137,794	1,303,756
Total	¥1,246,730	¥1,260,092	\$11,922,528

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities:			
Short-term loans and current maturities of long-term debts (Notes 5 and 14)	¥ 248,367	¥ 244,289	\$ 2,311,373
Notes and accounts payable, trade (Note 14)	221,791	186,569	1,765,247
Income, excise and other taxes payable	87,499	121,177	1,146,532
Accrued expenses and other current liabilities (Note 12)	101,566	107,367	1,015,868
Total current liabilities	659,223	659,402	6,239,020
Long-term debts, less current maturities (Note 5)	314,282	314,970	2,980,131
Deferred tax for revaluation reserve for land (Note 6)	10,272	10,593	100,227
Retirement and severance benefits (Note 11)	4,083	4,516	42,729
Other long-term liabilities (Notes 12 and 14)	40,502	40,918	387,150
Minority interests	24,773	24,887	235,472
Contingencies (Note 8)			
Shareholders' equity:			
Common stock			
Authorized—1,700,000,000 shares:			
Issued—631,705,087 shares	51,887	51,887	490,936
Capital surplus			
Additional paid-in capital	34,092	34,092	322,566
Retained earnings	93,568	97,883	926,133
Revaluation reserve for land (Note 6)	15,528	15,446	146,144
Net unrealized gains (losses) on securities	(658)	6,602	62,466
Foreign currency translation adjustments	(746)	(1,039)	(9,831)
Less treasury stock, at cost	(76)	(65)	(615)
Total shareholders' equity	193,595	204,806	1,937,799
Total	¥1,246,730	¥1,260,092	\$11,922,528

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF OPERATIONS

Cosmo Oil Company, Limited and its Consolidated Subsidiaries Years ended March 31, 2002, 2003 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2002	2003	2004	2004
<b>NET SALES</b> (Note 13)	¥1,813,838	¥1,902,768	¥1,916,278	\$18,131,119
<b>COST OF SALES</b> (Note 2)	1,659,438	1,754,853	1,758,858	16,641,669
Gross profit	154,400	147,915	157,420	1,489,450
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b> (Note 2)	132,343	123,748	132,174	1,250,582
Operating income (Note 13)	22,057	24,167	25,246	238,868
<b>OTHER INCOME (EXPENSES):</b>				
Interest and dividend income	3,192	1,906	1,559	14,751
Interest expenses (Note 5)	(14,220)	(12,928)	(11,867)	(112,281)
Foreign currency exchange gain (loss), net	2,373	426	(18)	(170)
Net gain (loss) on sale and disposal of property, plant and equipment	661	(1,315)	(1,864)	(17,636)
Equity in earnings of affiliates	268	973	2,717	25,707
Write-down of marketable securities and investments in securities	(15,484)	(4,587)	(283)	(2,678)
Gain on contribution of securities to retirement benefit trust	—	1,120	—	—
Gain on sale of investments in securities	3,392	246	1,321	12,499
Loss on sale of investments in securities	(2,763)	(102)	(69)	(653)
Other, net	(1,357)	3,060	850	8,042
	(23,938)	(11,201)	(7,654)	(72,419)
Income (loss) before income taxes and minority interests	(1,881)	12,966	17,592	166,449
<b>INCOME TAXES:</b>				
Current	7,122	6,981	11,375	107,626
Deferred (Note 12)	(6,262)	1,139	(2,641)	(24,988)
	860	8,120	8,734	82,638
Income (loss) before minority interests	(2,741)	4,846	8,858	83,811
<b>MINORITY INTERESTS</b>	(2,449)	(1,420)	(679)	(6,424)
<b>NET INCOME (LOSS)</b>	¥ (5,190)	¥ 3,426	¥ 8,179	\$ 77,387
			Yen	U.S. dollars (Note 1)
<b>EARNINGS PER SHARE:</b>				
Basic	¥ (8.24)	¥ 5.42	¥ 12.95	\$ 0.12
Diluted	—	—	12.74	0.12
Cash dividends (Note 15)	6.00	6.00	6.00	0.06

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Cosmo Oil Company, Limited and its Consolidated Subsidiaries Years ended March 31, 2002, 2003 and 2004

	Millions of yen							
	Number of shares of common stock (Thousands)	Common stock	Additional paid-in capital	Retained earnings	Revaluation reserve for land	Net unrealized gains (losses) on securities	Foreign currency translation adjustments	Treasury stock, at cost
<b>BALANCE AT MARCH 31, 2001</b>	631,705	¥51,887	¥34,092	¥92,848	¥ —	¥ —	¥ (693)	¥(361)
Net loss for the year	—	—	—	(5,190)	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	185	—
Cash dividends paid	—	—	—	(3,774)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	—	(9)	—	—	—	—
Increase resulting from increase in consolidated subsidiaries	—	—	—	1,186	—	—	—	(263)
Increase due to adjustment to land as a result of revaluation of land (Note 6)	—	—	—	10,476	12,067	—	—	—
Decrease resulting from mergers	—	—	—	(313)	—	—	—	—
Adoption of new accounting standard for financial instruments	—	—	—	—	—	2,060	—	—
Sales of treasury stock, net	—	—	—	—	—	—	—	105
<b>BALANCE AT MARCH 31, 2002</b>	631,705	51,887	34,092	95,224	12,067	2,060	(508)	(519)
Net income for the year	—	—	—	3,426	—	—	—	—
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	—	(238)	—
Cash dividends paid	—	—	—	(3,777)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	—	(12)	—	—	—	—
Increase resulting from increase in consolidated subsidiaries	—	—	—	202	—	—	—	—
Increase resulting from increase in affiliates on equity method	—	—	—	1,696	—	—	—	—
Increase due to adjustment to land as a result of revaluation of land (Note 6)	—	—	—	(3,116)	3,116	—	—	—
Changes in effective tax rate	—	—	—	—	345	—	—	—
Increase resulting from mergers	—	—	—	0	—	—	—	—
Decrease due to revaluation of available-for-sale securities	—	—	—	—	—	(2,718)	—	—
Loss on retirement of treasury stock	—	—	—	(75)	—	—	—	—
Sales of treasury stock, net	—	—	—	—	—	—	—	443
<b>BALANCE AT MARCH 31, 2003</b>	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 paid	—	—	—	(3,792)	—	—	—	—
Bonuses to directors and corporate auditors	—	—	—	(13)	—	—	—	—
Increase resulting from increase in consolidated subsidiaries	—	—	—	73	—	—	—	—
Increase resulting from increase in affiliates on equity method	—	—	—	—	—	—	—	—
Increase due to adjustment to land as a result of revaluation of 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
<b>BALANCE AT MARCH 31, 2004</b>	631,705	¥51,887	¥34,092	¥97,883	¥15,446	¥6,602	¥(1,039)	¥ (65)

	Thousands of U.S. dollars (Note 1)							
	Common stock	Additional paid-in capital	Retained earnings	Revaluation reserve for land	Net unrealized gains (losses) on securities	Foreign currency translation adjustments	Treasury stock, at cost	
<b>BALANCE AT MARCH 31, 2003</b>	\$490,936	\$322,566	\$885,306	\$146,920	\$(6,226)	\$(7,058)	\$(719)	
Net income for the year	—	—	77,387	—	—	—	—	
Adjustments from translation of foreign currency financial statements	—	—	—	—	—	(2,773)	—	
Cash dividends paid	—	—	(35,879)	—	—	—	—	
Bonuses to directors and corporate auditors	—	—	(123)	—	—	—	—	
Increase resulting from increase in consolidated subsidiaries	—	—	691	—	—	—	—	
Increase resulting from increase in affiliates on equity method	—	—	—	—	—	—	—	
Increase due to adjustment to land as a result of revaluation of land (Note 6)	—	—	(350)	350	—	—	—	
Changes in effective tax rate	—	—	—	(2,224)	—	—	—	
Adjustment to revaluation reserve for land	—	—	—	1,098	—	—	—	
Increase resulting from mergers	—	—	596	—	—	—	—	
Decrease resulting from mergers	—	—	(1,438)	—	—	—	—	
Increase due to revaluation of available-for-sale securities	—	—	—	—	68,692	—	—	
Loss on retirement of treasury stock	—	—	(57)	—	—	—	—	
Sales of treasury stock, net	—	—	—	—	—	—	104	
<b>BALANCE AT MARCH 31, 2004</b>	\$490,936	\$322,566	\$926,133	\$146,144	\$62,466	\$(9,831)	\$(615)	

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

Cosmo Oil Company, Limited and its Consolidated Subsidiaries Years ended March 31, 2002, 2003 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2002	2003	2004	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Income (loss) before income taxes and minority interests	¥ (1,881)	¥ 12,966	¥ 17,592	\$ 166,449
Adjustments to reconcile income (loss) before income taxes and minority interests to net cash provided by (used in) operating activities:				
Depreciation and amortization	23,492	22,843	23,632	223,597
Amortization of consolidation goodwill	138	147	1	9
Increase (decrease) in allowance for doubtful accounts	1,658	(1,841)	233	2,205
Interest and dividend income	(3,192)	(1,906)	(1,559)	(14,751)
Interest expense	14,220	12,928	11,867	112,281
Equity in earnings of affiliates	(268)	(973)	(2,717)	(25,707)
Net loss (gain) on sale or disposal of property, plant and equipment	(661)	1,315	2,315	21,904
Write-down of marketable securities and investments in securities	15,484	4,587	283	2,678
Gain on contribution of securities to retirement benefit trust	—	(1,120)	—	—
Transfer of securities to retirement benefit trust	—	5,218	—	—
Decrease (increase) in notes and accounts receivable	62,189	(14,568)	28,541	270,044
Decrease (increase) in inventories	10,622	(5,791)	8,576	81,143
Increase (decrease) in notes and accounts payable	(16,146)	23,110	(35,414)	(335,074)
Increase (decrease) in other allowance reserves	1,480	(487)	—	—
Decrease (increase) in other current assets	1,691	(33,072)	24,781	234,469
Increase (decrease) in other current liabilities	(8,112)	(34,774)	36,958	349,683
Other, net	(3,892)	2,416	5,988	56,656
Subtotal	96,822	(9,002)	121,077	1,145,586
Interest and dividend received	1,820	1,194	1,649	15,602
Interest paid	(14,260)	(12,720)	(11,884)	(112,442)
Income taxes paid	(7,736)	(6,447)	(9,015)	(85,296)
Net cash provided by (used in) operating activities	76,646	(26,975)	101,827	963,450
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Payments for purchases of property, plant and equipment	(21,742)	(19,626)	(27,813)	(263,156)
Proceeds from sale or disposal of property, plant and equipment	9,332	11,062	2,069	19,576
Payments for purchases of marketable securities and investments in securities	(14,609)	(9,113)	(3,840)	(36,333)
Proceeds from sale of marketable securities and investments in securities	18,704	6,492	5,545	52,465
Payments for intangible assets and deferred charges	(3,885)	(3,297)	(8,232)	(77,888)
Decrease (increase) in short-term loans receivable	1,831	(373)	(482)	(4,561)
Payments for long-term loans receivable	(1,952)	(573)	(2,193)	(20,749)
Proceeds from long-term loans receivable	2,396	1,276	1,690	15,990
Payments for factoring	(3,866)	—	—	—
Proceeds from factoring	—	1,571	498	4,712
Other, net	(153)	(230)	49	463
Net cash provided by (used in) investing activities	(13,944)	(12,811)	(32,709)	(309,481)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Increase (decrease) in short-term loans payable	(66,298)	7,887	(16,266)	(153,903)
Proceeds from long-term loans payable	30,430	63,264	116,159	1,099,054
Repayments for long-term loans payable	(37,462)	(58,918)	(57,200)	(541,205)
Issuance of bonds	—	19,876	—	—
Redemptions of bonds	(10,200)	(16,071)	(46,100)	(436,181)
Redemptions of convertible bonds	(1,332)	(1,924)	(18)	(170)
Cash dividends paid	(3,774)	(3,777)	(3,792)	(35,879)
Cash dividends paid for minority shareholders	—	—	(513)	(4,854)
Proceeds from issuing shares for minority shareholders	—	—	183	1,731
Other, net	90	(210)	(132)	(1,249)
Net cash provided by (used in) financing activities	(88,546)	10,127	(7,679)	(72,656)
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	1,078	(845)	(1,171)	(11,079)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(24,766)	(30,504)	60,268	570,234
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	97,788	74,000	43,810	414,514
<b>CASH AND CASH EQUIVALENTS FROM NEWLY CONSOLIDATED SUBSIDIARIES</b>	934	283	249	2,356
<b>CASH AND CASH EQUIVALENTS FROM MERGERS</b>	44	31	193	1,826
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 4)</b>	¥ 74,000	¥ 43,810	¥ 104,520	\$ 988,930

The accompanying notes are an integral part of these statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cosmo Oil Company, Limited and its Consolidated Subsidiaries Years ended March 31, 2002, 2003 and 2004

## 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 Commercial Code and accounting principles and practices generally accepted in Japan ("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. Certain accounting principles and practices generally accepted in Japan are different from International Accounting Standards and standards in other countries in certain respects as to application and disclosure requirements. Accordingly, the accompanying consolidated financial statements are intended for use by those who are informed about Japanese accounting principles and practices.

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 translations 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, 2004, which was ¥105.69 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 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, 2002, 2003 and 2004 were as follows:

	2002	2003	2004
Consolidated subsidiaries	24	27	31
Subsidiaries using the equity method	9	37	38
Affiliates using the equity method	3	5	5

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 (loss) 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 each balance sheet date with resulting gains or losses included in the current statements of operation.

Assets and liabilities, revenue, and expense accounts of consolidated overseas subsidiaries are translated into Japanese yen at exchange rate of each balance sheet date of the subsidiaries. The resulting foreign currency translation adjustments are included in foreign currency translation adjustments in shareholders' equity.

**(5) ALLOWANCE FOR DOUBTFUL ACCOUNTS**

Allowances for doubtful accounts are provided based on the amount calculated at the actual ratio of bad debt for ordinary receivables, and an amount recognized for 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 moving-average method. Effective April 1, 2001, Cosmo Matsuyama Oil Company, Limited, the Company's consolidated subsidiary (hereinafter referred to as Cosmo Matsuyama Oil), changed its inventory costing method for finished products, semi-finished products and materials from the last-in, first-out (LIFO) method to the gross average method as discussed in Note 2.

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**

The Company and its consolidated subsidiaries provided allowance for retirement and severance benefits 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, ¥24,222 million (\$229,180 thousand), 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.

**(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) RESERVE FOR LOSS ON INVESTMENT IN UNCONSOLIDATED SUBSIDIARIES AND AFFILIATES**

Reserve for loss on investment in unconsolidated subsidiaries and affiliates is provided for based on the review of the investee's financial condition and operating performance as well as its future recoverability.

**(13) 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.

**(14) SHAREHOLDERS' EQUITY**

Under the Commercial Code of Japan, the entire amount of the issue price of shares is required to be accounted for as capital, although a company may, by resolution of its Board of Directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

Effective October 1, 2001, the Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earning reserve until the total amount of legal earning reserve and additional paid-in capital equals 25% of common stock. The total amount of legal earnings reserve and additional paid-in capital of the Company has reached 25% of common stock, and therefore the Company is not required to provide legal earnings reserve anymore. The legal earning reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalized by resolution of the Board of Directors. On condition that the total amount of legal earning reserve and additional paid-in capital remains equal to or exceeds 25% of common stock, it is available for distributions by the resolution of the shareholders' meeting. Legal earning reserve is included in retained earnings in the accompanying financial statements.

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 Commercial Code of Japan and is subject to certain covenant regarding convertible bonds (see Note 5).

**(15) DERIVATIVE TRANSACTION 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.

**(16) INCOME TAXES**

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

**(17) 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 1 year term and of which contract amount is more than ¥100 million (\$946 thousand). Such long-term and large engineering contracts are recognized by the percentage of completion method.

**(18) 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 years ended March 31, 2002 and 2003, as net income per share, assuming all potential shares were converted, was not diluted for those years.

**(19) ALLOWANCE FOR LOSS ON ENGINEERING CONTRACTS**

Cosmo Engineering Company, Limited, the Company's consolidated subsidiary, (hereinafter referred to as Cosmo Engineering) accrued losses on certain engineering contracts since they are probable and estimable.

**(20) RECLASSIFICATIONS**

Certain prior year amounts have been reclassified to conform to the 2004 presentation.

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

**2 CHANGES IN ACCOUNTING POLICIES**

**(1) CHANGE OF RECOGNITION OF CONSTRUCTION REVENUE**

Effective January 1, 2002, Cosmo Engineering changed its revenue recognition from the completed contract method to the percentage of completion method on the long-term and large engineering contracts which are more than 1 year term and of which contract amount is more than ¥100 million (\$946 thousand). The reason for this change is to match revenue against expenses more accurately, by adopting the percentage of completion method, which is more reasonable, in view of the trend of international accounting standard.

As a result of the change, net sales for the year ended March 31, 2003 increased by ¥312 million (\$2,952 thousand) and operating income, income before income taxes and minority interests increased by ¥9 million (\$85 thousand), respectively.

The effect of the changes in segment information is described in Note 13.

**(2) CHANGE OF THE INVENTORY COSTING METHOD**

Effective April 1, 2001, Cosmo Matsuyama Oil changed from the last-in, first out (LIFO) method to the method of costing inventories under which the inventories are stated at cost determined by aggregate average method.

As a result of the change, operating income for the year ended March 31, 2002 decreased by ¥81 million (\$766 thousand), and loss before income taxes and minority interests increased by the same amount. The effect of the change on segment information is described in Note 13.

### (3) 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 (\$104,333 thousand); however, operating income, income before income taxes and minority interests were not affected.

The change did not have any effect on segment information.

### 3 INVENTORIES

Inventories at March 31, 2003 and 2004 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Finished products	¥ 49,140	¥ 49,240	\$ 465,891
Semi-finished products	29,620	31,981	302,592
Materials—crude oil, auxiliary materials, etc.	51,583	42,588	402,952
Supplies—spare parts, etc.	5,281	5,013	47,431
In-transit crude oil and oil products	43,807	45,140	427,098
Land for sale	1,102	1,102	10,427
Others	4,928	1,825	17,268
Total	¥ 185,461	¥ 176,889	\$ 1,673,659

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

#### 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, 2003 and 2004 is as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Cash and deposits	¥ 36,185	¥ 99,451	\$ 940,969
<b>ADD:</b>			
Marketable securities	7,425	8,412	79,591
Other current assets	2,054	499	4,722
<b>LESS:</b>			
Deposits with maturities exceeding three months	221	223	2,110
Bonds with maturities exceeding three months included in marketable securities above	1,633	3,619	34,242
Cash and cash equivalents	¥ 43,810	¥ 104,520	\$ 988,930

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

Included in short-term loans at March 31, 2003 and 2004 were import bills payable and import financing bills payable to banks aggregating ¥3,284 million and ¥1,519 million (\$14,372 thousand), respectively. These bills bear interest ranging from 1.72% to 2.43% and that of 1.54% per annum, respectively, and mature in various days, mainly 45 days after issuance. The remaining short-term loans from banks of ¥165,962 million and ¥149,731 million (\$1,416,700 thousand), as of March 31, 2003 and 2004, bear interest ranging from 0.20% to 2.28% and from 0.20% to 1.99% 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 debts at March 31, 2003 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Short-term loans	¥ 165,962	¥ 149,731	\$ 1,416,700
Current maturities of long-term debt	82,405	94,558	894,673
<b>Total</b>	<b>¥ 248,367</b>	<b>¥ 244,289</b>	<b>\$ 2,311,373</b>

Long-term debts at March 31, 2003 and 2004 consisted of the following:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Loans from banks, insurance companies and other financial institutions, secured, with interest at			
1.0% - 7.5%, due serially through 2015	¥ 276,746	¥ 335,705	\$ 3,176,318
1.1% unsecured convertible yen bonds due in 2005	16,541	16,523	156,335
2.8% unsecured straight yen bonds due in 2003	14,600	—	—
3.3% unsecured straight yen bonds due in 2007	9,500	9,500	89,886
3.15% unsecured straight yen bonds due in 2007	7,800	7,800	73,801
2.72% unsecured straight yen bonds due in 2003	2,000	—	—
3.08% unsecured straight yen bonds due in 2004	4,000	—	—
3.50% unsecured straight yen bonds due in 2005	4,200	4,200	39,739
3.10% unsecured straight yen bonds due in 2005	4,700	4,700	44,470
2.34% unsecured straight yen bonds due in 2003	4,500	—	—
2.70% unsecured straight yen bonds due in 2004	4,400	—	—
3.00% unsecured straight yen bonds due in 2006	4,500	4,500	42,577
2.45% unsecured straight yen bonds due in 2004	4,700	—	—
2.83% unsecured straight yen bonds due in 2005	4,700	—	—
3.05% unsecured straight yen bonds due in 2006	3,800	3,800	35,954
2.86% unsecured straight yen bonds due in 2005	2,600	—	—
2.50% unsecured straight yen bonds due in 2004	4,600	—	—
2.84% unsecured straight yen bonds due in 2005	2,800	2,800	26,492
1.34% unsecured straight yen bonds due in 2007	10,000	10,000	94,616
1.60% unsecured straight yen bonds due in 2008	10,000	10,000	94,616
	396,687	409,528	3,874,804
Less current maturities	(82,405)	(94,558)	(894,673)
<b>Total</b>	<b>¥ 314,282</b>	<b>¥ 314,970</b>	<b>\$ 2,980,131</b>

The aggregate annual maturities of long-term debts at March 31, 2004 were as follows:

Year ending March 31,	Millions of yen	Thousands of U.S. dollars (Note 1)
2005	¥ 94,558	\$ 894,673
2006	69,271	655,417
2007	45,062	426,360
2008	78,019	738,187
2009 and thereafter	122,618	1,160,167
Total	¥ 409,528	\$ 3,874,804

The 1.1% unsecured convertible yen bonds in the original principal amount of ¥30,000 million were issued in March 1994. The bonds are subject to conversion currently at ¥877 (\$8.30) for one share of the common stock of the Company from April 1, 1994 to March 30, 2005. At March 31, 2004, 18,850 thousand additional shares of common stock of the Company would have been issued upon full conversion at the current conversion price. The bonds may be redeemed, at the option of the Company, beginning April 1, 2000, in whole or in part at prices that range from 104% to 100% of the principal amount plus interest accrued. The Company redeemed a part of the bonds from the market in this fiscal year.

So long as the 1.1% bonds are outstanding, the cumulative amount of payments of cash dividends must not exceed ¥7,300 million (\$69,070 thousand) plus the Company's cumulative net income for the fiscal years following March 31, 1994.

## 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 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.

Difference between the fair value and carrying amount of the revalued land as of March 31, 2003 and 2004 was as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Difference between the fair value and carrying amount of the revalued land	¥ (24,638)	¥ (62,233)	\$ (588,826)

## 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, 2002, 2003 and 2004 were ¥4,208 million, ¥4,391 million and ¥4,080 million (\$38,603 thousand), respectively.

Total lease obligation as of March 31, 2003 and 2004 with interest portion under such leases was ¥10,690 million and ¥10,499 million (\$99,338 thousand), including ¥3,792 million and ¥3,716 million (\$35,159 thousand) due within one year. Included in the total lease obligation as of March 31, 2004 is obligation for sub-lease payment of ¥5,224 million (\$49,428 thousand).

Equivalents of acquisition cost, accumulated depreciation, and net book value of leased properties for the years ended March 31, 2003 and 2004, were as follows:

Year ended March 31, 2003	Millions of yen		
	Machinery & equipment	Other	Total
Acquisition cost equivalent	¥ 4,026	¥ 7,341	¥ 11,367
Accumulated depreciation equivalent	(2,074)	(4,476)	(6,550)
Net book value equivalent	¥ 1,952	¥ 2,865	¥ 4,817

Year ended March 31, 2004	Millions of yen		
	Machinery & equipment	Other	Total
Acquisition cost equivalent	¥ 4,237	¥ 6,757	¥ 10,994
Accumulated depreciation equivalent	(2,327)	(3,393)	(5,720)
Net book value equivalent	¥ 1,910	¥ 3,364	¥ 5,274

Year ended March 31, 2004	Thousands of U.S. dollars (Note 1)		
	Machinery & equipment	Other	Total
Acquisition cost equivalent	\$ 40,089	\$ 63,932	\$ 104,021
Accumulated depreciation equivalent	(22,017)	(32,103)	(54,120)
Net book value equivalent	\$ 18,072	\$ 31,829	\$ 49,901

### 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, 2002, 2003 and 2004 was ¥2,503 million, ¥2,502 million and ¥2,285 million (\$21,620 thousand).

Total lease obligation as of March 31, 2003 and 2004, inclusive of interest income under such leases, was ¥6,184 million and ¥5,487 million (\$51,916 thousand), including ¥2,181 million and ¥2,006 million (\$18,980 thousand) due within one year. Included in the total lease obligation as of March 31, 2004 is obligation for sub-lease payment of ¥5,466 million (\$51,717 thousand).

Acquisition cost, accumulated depreciation and net book value of lease properties for the years ended March 31, 2003 and 2004, were as follows:

Year ended March 31, 2003	Millions of yen		
	Machinery & equipment	Other	Total
Acquisition cost	¥ 7	¥ 467	¥ 474
Accumulated depreciation	(7)	(444)	(451)
Net book value	¥ 0	¥ 23	¥ 23

Year ended March 31, 2004	Millions of yen		
	Machinery & equipment	Other	Total
Acquisition cost	¥ 6	¥ 408	¥ 414
Accumulated depreciation	(6)	(388)	(394)
Net book value	¥ 0	¥ 20	¥ 20

Year ended March 31, 2004	Thousands of U.S. dollars (Note 1)		
	Machinery & equipment	Other	Total
Acquisition cost	\$ 57	\$ 3,860	\$ 3,917
Accumulated depreciation	(57)	(3,671)	(3,728)
Net book value	\$ 0	\$ 189	\$ 189

## 8 CONTINGENCIES

(a) Contingent liabilities for notes receivable discounted with banks with recourse at March 31, 2004 were ¥330 million (\$3,122 thousand).

(b) 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, 2004 were ¥7,205 million (\$68,171 thousand).

(c) Based on debt assumption agreements with financial institutions, the Company has transferred the debt repayment obligation for certain bonds to such financial institutions.

As of March 31, 2004, the Company had contingent obligations in respect to the following bonds.

	Thousands of U.S. dollars (Note 1)	
	Millions of yen	
3.08% unsecured straight yen bonds due in 2004	¥ 4,000	\$ 37,846
2.70% unsecured straight yen bonds due in 2004	4,400	41,631
2.83% unsecured straight yen bonds due in 2005	4,700	44,470
2.86% unsecured straight yen bonds due in 2005	2,600	24,600
2.50% unsecured straight yen bonds due in 2004	4,600	43,524
Total	¥20,300	\$192,071

## 9 SECURITIES

The following tables summarize acquisition costs, book value, and fair value of securities as of March 31, 2003 and 2004:

### As of March 31, 2003

(a) Held-to-maturity debt securities

Bonds with fair value

	Millions of yen		
	Book value	Fair value	Difference
Fair value exceeding book value	¥ 630	¥ 640	¥ 10
Fair value not exceeding book value	312	311	(1)
Total	¥ 942	¥ 951	¥ 9

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

	Millions of yen		
	Acquisition cost	Book value	Difference
<b>BOOK VALUE EXCEEDING ACQUISITION COST:</b>			
Equity securities	¥ 940	¥ 1,447	¥ 507
Bonds	4,157	4,244	87
Subtotal	¥ 5,097	¥ 5,691	¥ 594
<b>BOOK VALUE NOT EXCEEDING ACQUISITION COST:</b>			
Equity securities	¥ 13,436	¥ 11,375	¥ (2,061)
Bonds	1,733	1,726	(7)
Other	7	6	(1)
Subtotal	¥ 15,176	¥ 13,107	¥ (2,069)
Total	¥ 20,273	¥ 18,798	¥ (1,475)

## (c) Available-for-sale securities sold during year ended March 31, 2003:

	Millions of yen		
	Amount of sales	Gain	Loss
	¥ 654	¥ 246	¥ 101

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	¥ 70
(b) Shares issued by unconsolidated subsidiaries and affiliates	
Non-listed securities	¥ 25,734
(c) Available-for-sale securities	
Money management fund	¥ 1,766
Free financial fund	3,025
Non-listed securities	18,990
Total	¥ 23,781

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

	Millions of yen			
	Within 1 year	1 to 5 years	5 to 10 years	Over 10 years
Government bonds and municipal bonds	¥ 624	¥ 3,073	¥ 14	¥ —
Corporate bonds	2,232	959	—	—
Total	¥ 2,856	¥ 4,032	¥ 14	¥ —

**As of March 31, 2004**

## (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	¥ 449	¥ 450	¥ 1	\$ 4,248	\$ 4,258	\$ 10
Fair value not exceeding book value	—	—	—	—	—	—
Total	¥ 449	¥ 450	¥ 1	\$ 4,248	\$ 4,258	\$ 10

(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
<b>BOOK VALUE EXCEEDING ACQUISITION COST:</b>						
Debt securities	¥ 7,894	¥18,123	¥10,229	\$ 74,690	\$171,473	\$96,783
Bonds	4,197	4,254	57	39,710	40,250	540
Other	4	4	0	38	38	0
Subtotal	¥12,095	¥22,381	¥10,286	\$114,438	\$211,761	\$97,323
<b>BOOK VALUE NOT EXCEEDING ACQUISITION COST:</b>						
Debt securities	¥ 6,099	¥ 5,711	¥ (388)	\$ 57,707	\$ 54,035	\$(3,672)
Bonds	1,303	1,303	(0)	12,329	12,329	(0)
Subtotal	¥ 7,402	¥ 7,014	¥ (388)	\$ 70,036	\$ 66,364	\$(3,672)
Total	¥19,497	¥29,395	¥9,898	\$184,474	\$278,125	\$93,651

(c) Available-for-sale securities sold during year ended March 31, 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)		
	Amount of sales	Gain	Loss	Amount of sales	Gain	Loss
	¥ 2,672	¥ 1,321	¥ 69	\$ 25,281	\$ 12,499	\$ 653

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	¥ 69	\$ 653
(b) Shares issued by unconsolidated subsidiaries and affiliates		
Non-listed securities	¥ 27,578	\$ 260,933
(c) Available-for-sale securities		
Money management fund	¥ 1,766	\$ 16,709
Free financial fund	3,026	28,631
Non-listed securities	17,207	162,806
Total	¥ 21,999	\$ 208,146

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

	Millions of yen			
	Within 1 year	1 to 5 years	5 to 10 years	Over 10 years
Government bonds and municipal bonds	¥ 2,257	¥ 1,765	¥ 13	¥ —
Corporate bonds	1,654	321	—	—
Total	¥ 3,911	¥ 2,086	¥ 13	¥ —

	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	\$ 21,355	\$ 16,700	\$ 123	\$ —
Corporate bonds	15,650	3,037	—	—
Total	\$ 37,005	\$ 19,737	\$ 123	\$ —

## 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

Interest rate swaps

Crude oil and petroleum forward contracts

##### Hedged items

Borrowings

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 faces exchange rate fluctuation risks related to foreign currency forward contracts and currency option contracts, and also faces 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 Committee on a quarterly basis.

Regarding commodity-related derivative transactions, the Demand & Supply Coordination Department, International Petroleum Department, Industrial Fuel Department, and the second Corporate Planning Department

consult with each other and obtain approval of the annual basic transaction policy from the meeting of the Executive Committee, and implement and control transactions in accordance with internally authorized rules. Regarding control, the Demand & Supply Coordination Department, International Petroleum Department, and Industrial Fuel Department control derivative transactions on a single-department basis and the second Corporate Planning Department controls derivative transactions on a Companywide basis. General managers of the Demand & Supply Coordination Department, International Petroleum Department, and Industrial Fuel Department report the results of transactions to the meeting of the Executive 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, 2003 and 2004 of derivative transactions for which hedge accounting has not been applied:

(1) Currency related

Year ended March 31, 2003	Contract amounts		Market value	Millions of yen Unrealized gains	
	Due within 1 year	Due after 1 year		Total	
Forward exchange contracts					
Buy					
U.S. dollars	¥ 50,691	¥ —	¥ 50,691	¥ 51,445	¥ 754
Currency option contracts					
Buy					
Call U.S. dollars	6,611	—	6,611	92	33

Year ended March 31, 2004	Contract amounts		Market value	Millions of yen Unrealized gains (losses)	
	Due within 1 year	Due after 1 year		Total	
Forward exchange contracts					
Buy					
U.S. dollars	¥ 50,049	¥ —	¥ 50,049	¥ 48,300	¥ (1,749)
Currency option contracts					
Buy					
Call U.S. dollars	8,455	—	8,455	39	(46)

Year ended March 31, 2004	Contract amounts		Market value	Thousands of U.S. dollars (Note 1) Unrealized gains (losses)	
	Due within 1 year	Due after 1 year		Total	
Forward exchange contracts					
Buy					
U.S. dollars	\$ 473,545	\$ —	\$ 473,545	\$ 456,997	\$ (16,548)
Currency option contracts					
Buy					
Call U.S. dollars	79,998	—	79,998	369	(435)

## (2) Commodity related

Year ended March 31, 2003	Contract amounts			Market value	Millions of yen Unrealized gains (losses)
	Due within 1 year	Due after 1 year	Total		
Swap transaction of petroleum products					
Receive-fixed;					
pay-variable	¥ 10	¥ —	¥ 10	¥ (1)	¥ (1)
Receive-variable;					
pay-fixed	10	—	10	45	45

## 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, 2003 and 2004 consist of the following:

March 31, 2003	Millions of yen	
Projected benefit obligation	¥ (88,979)	
Pension assets	60,204	
Unrecognized net transition obligation	9,479	
Unrecognized actuarial differences	19,104	
Less prepaid pension costs	(3,891)	
<b>Liabilities for retirement and severance benefits</b>	<b>¥ (4,083)</b>	

March 31, 2004	Millions of yen	Thousands of U.S. dollars (Note 1)
Projected benefit obligation	¥ (87,168)	\$ (824,752)
Pension assets	69,340	656,070
Unrecognized net transition obligation	4,740	44,848
Unrecognized actuarial differences	8,572	81,105
Less prepaid pension costs	—	—
<b>Liabilities for retirement and severance benefits</b>	<b>¥ (4,516)</b>	<b>\$ (42,729)</b>

Included in the consolidated statements of operation for the years ended March 31, 2001, 2002 and 2003 are retirement and severance benefit expenses comprised of the following:

March 31, 2002	Millions of yen
Service costs	¥ 3,192
Interest cost on projected benefit obligation	2,076
Expected return on plan assets	(1,916)
Amortization of net transition obligation	5,079
Amortization of net actuarial loss	1,195
<b>Retirement and severance benefit expenses</b>	<b>¥ 9,626</b>

March 31, 2003	Millions of yen	
Service costs		¥ 2,846
Interest cost on projected benefit obligation		2,137
Expected return on plan assets		(2,004)
Amortization of net transition obligation		4,739
Amortization of net actuarial loss		1,718
Retirement and severance benefit expenses		¥ 9,436

March 31, 2004	Millions of yen	Thousands of U.S. dollars (Note 1)
Service costs	¥ 3,027	\$ 28,640
Interest cost on projected benefit obligation	2,081	19,690
Expected return on plan assets	(2,029)	(19,198)
Amortization of net transition obligation	4,740	44,848
Amortization of net actuarial loss	2,206	20,872
Retirement and severance benefit expenses	¥10,025	\$ 94,852

Actuarial assumptions used in computation of retirement and severance liabilities were as follows:

- |   |  |
|---|--|
| a. Attribution of expected benefit obligation | Straight-line method   |
| b. Discount rate                              | 2.5%   |
| c. Expected rate of return on plan assets     | Primarily 3.5%   |
| d. Amortization of net transition obligation  | 5 years  |
| e. 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.) |

## 12 INCOME TAXES

The statutory income tax rates used for calculation of deferred tax assets and liabilities were 40.87% and 39.54% for current items and non-current items, respectively, at March 31, 2003. Effective for years commencing on April 1, 2004, according to the revised local tax law, income tax rates for enterprise taxes were changed as a result of introducing the assessment by estimation on the basis of the size of business. Based on the change of income tax rates, for calculation of deferred income tax assets and liabilities, the Company and consolidated domestic subsidiaries used the aggregate statutory income tax rate of 40.44% for the year ended March 31, 2004.

As a result of the change in the statutory income tax rates, deferred income tax liabilities after being netted with tax assets increased by ¥209 million (\$1,977 thousand), provision for deferred income taxes increased by ¥127 million (\$1,202 thousand) and unrealized gains (losses) on securities decreased by ¥82 million (\$776 thousand) compared with what would have been recorded under the previous local tax law. Also, deferred tax for revaluation reserve for land decreased by ¥235 million (\$2,223 thousand) and revaluation reserve for land increased by the same amount.

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, 2004:

Year ended March 31, 2004

Statutory income tax rate	40.87%
<b>INCREASE (DECREASE) IN TAXES RESULTING FROM:</b>	
Non-Japanese taxes	10.29
Non-deductible expenses	4.99
Effect on equity in earnings (losses) of affiliates	(6.31)
Effect on change in enacted tax rate	0.72
Other	(0.91)
Effective income tax rate	49.65%

Significant components of the Company and its consolidated subsidiaries' deferred tax assets and liabilities as of March 31, 2003 and 2004 are as follows:

Year ended March 31, 2003

Millions of yen

**CURRENT DEFERRED TAX ASSETS:**

Excess bonuses accrued	¥ 1,571
Accounts receivable	995
Other	799
Total current deferred tax assets	3,365
Valuation allowance	(9)
Total current deferred tax assets, net of valuation allowance	3,356
Account offset against deferred tax liabilities	(74)
Net current deferred tax assets	¥ 3,282

**CURRENT DEFERRED TAX LIABILITIES:**

Allowance for doubtful accounts	¥ (51)
Other	(24)
Total current deferred tax liabilities	(75)
Account offset against deferred tax assets	74
Net current deferred tax liabilities	¥ (1)

**NON-CURRENT DEFERRED TAX ASSETS:**

Marketable securities	¥ 5,216
Depreciation	2,410
Unrealized gains	1,410
Allowance for special repair works	1,269
Net operating loss carry forward	1,142
Costs for retirement and severance benefits	1,110
Golf-club membership	1,033
Allowance for doubtful accounts	942
Other	3,980
Total non-current deferred tax assets	18,512
Valuation allowance	(1,168)
Total non-current deferred tax assets, net of valuation allowance	17,344
Account offset against deferred tax liabilities	(13,902)
Net non-current deferred tax assets	¥ 3,442

**NON-CURRENT DEFERRED TAX LIABILITIES:**

Reserve for deferred gains on sales of fixed assets for tax purposes	¥(12,630)
Non-Japanese taxes	(5,673)
Retirement and severance benefits	(1,538)
Reserve for losses on overseas investments	(765)
Special depreciation	(210)
Other	(3,465)
Total non-current deferred tax liabilities	(24,281)
Account offset against deferred tax assets	13,902
Net non-current deferred tax liabilities	¥(10,379)

Year ended March 31, 2004	Millions of yen	Thousands of U.S. dollars (Note 1)
<b>CURRENT DEFERRED TAX ASSETS:</b>		
Accounts receivable	¥ 1,914	\$ 18,110
Excess bonuses accrued	1,788	16,917
Other	1,661	15,716
Total current deferred tax assets	5,363	50,743
Valuation allowance	(210)	(1,987)
Total current deferred tax assets, net of valuation allowance	5,153	48,756
Account offset against deferred tax liabilities	(104)	(984)
Net current deferred tax assets	¥ 5,049	\$ 47,772
<b>CURRENT DEFERRED TAX LIABILITIES:</b>		
Allowance for doubtful accounts	¥ (85)	\$ (804)
Other	(33)	(312)
Total current deferred tax liabilities	(118)	(1,116)
Account offset against deferred tax assets	104	984
Net current deferred tax liabilities	¥ (14)	\$ (132)
<b>NON-CURRENT DEFERRED TAX ASSETS:</b>		
Marketable securities	¥ 4,828	\$ 45,681
Depreciation	2,262	21,402
Allowance for special repair works	1,783	16,870
Costs for retirement and severance benefits	1,251	11,837
Unrealized gains	1,205	11,401
Golf-club membership	982	9,291
Allowance for doubtful accounts	646	6,112
Net operating loss carry forward	449	4,248
Other	1,435	13,578
Total non-current deferred tax assets	14,841	140,420
Valuation allowance	(952)	(9,007)
Total non-current deferred tax assets, net of valuation allowance	13,889	131,413
Account offset against deferred tax liabilities	(10,651)	(100,776)
Net non-current deferred tax assets	¥ 3,238	\$ 30,637

**NON-CURRENT DEFERRED TAX LIABILITIES:**

Reserve for deferred gains on sales of fixed assets for tax purposes	¥ (13,389)	\$ (126,682)
Non-Japanese taxes	(5,225)	(49,437)
Reserve for losses on overseas investments	(617)	(5,838)
Special depreciation	(168)	(1,590)
Other	(4,978)	(47,099)
Total non-current deferred tax liabilities	(24,377)	(230,646)
Account offset against deferred tax assets	10,651	100,776
Net non-current deferred tax liabilities	¥ (13,726)	\$ (129,870)

In addition, deferred tax liability related to land revaluation of ¥10,272 million and ¥10,592 million (\$100,218 thousand) were included in the consolidated balance sheets for the years ended March 31, 2003 and 2004, respectively, other than the above mentioned items.

**13 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.

For the years ended March 31, 2002, 2003 and 2004, product groups summarize business operations of the Company and its consolidated subsidiaries as follows:

Year ended March 31, 2002						Millions of yen	
	Petroleum	Oil Resource Development	Other	Total	Elimination or corporate	Consolidated	
<b>NET SALES:</b>							
Outside customers	¥ 1,746,659	¥ 10,856	¥ 56,323	¥ 1,813,838	¥ —	¥ 1,813,838	
Inter-segment	3,223	19,676	20,899	43,798	(43,798)	—	
Total	1,749,882	30,532	77,222	1,857,636	(43,798)	1,813,838	
Operating expenses	1,736,059	22,390	78,040	1,836,489	(44,708)	1,791,781	
Operating income (loss)	¥ 13,823	¥ 8,142	¥ (818)	¥ 21,147	¥ 910	¥ 22,057	

**IDENTIFIABLE ASSETS, DEPRECIATION AND****AMORTIZATION AND CAPITAL EXPENDITURES:**

Assets	¥ 1,091,592	¥ 63,539	¥ 37,122	¥ 1,192,253	¥ 49,918	¥ 1,242,171
Depreciation and amortization	¥ 21,792	¥ 2,353	¥ 148	¥ 24,293	¥ (801)	¥ 23,492
Capital expenditures	¥ 22,532	¥ 2,959	¥ 198	¥ 25,689	¥ (260)	¥ 25,429

Year ended March 31, 2003						Millions of yen	
	Petroleum	Oil Resource Development	Other	Total	Elimination or corporate	Consolidated	
<b>NET SALES:</b>							
Outside customers	¥ 1,830,940	¥ 9,773	¥ 62,055	¥ 1,902,768	¥ —	¥ 1,902,768	
Inter-segment	1,658	23,625	11,874	37,157	(37,157)	—	
Total	1,832,598	33,398	73,929	1,939,925	(37,157)	1,902,768	
Operating expenses	1,816,403	25,452	73,392	1,915,247	(36,646)	1,878,601	
Operating income	¥ 16,195	¥ 7,946	¥ 537	¥ 24,678	¥ (511)	¥ 24,167	

**IDENTIFIABLE ASSETS, DEPRECIATION AND****AMORTIZATION AND CAPITAL EXPENDITURES:**

Assets	¥ 1,151,639	¥ 60,466	¥ 38,430	¥ 1,250,535	¥ (3,805)	¥ 1,246,730
Depreciation and amortization	¥ 20,628	¥ 2,711	¥ 115	¥ 23,454	¥ (612)	¥ 22,842
Capital expenditures	¥ 21,240	¥ 3,305	¥ 151	¥ 24,696	¥ (564)	¥ 24,132

							Millions of yen
Year ended March 31, 2004	Petroleum	Oil Resource Development	Other	Total	Elimination or corporate	Consolidated	
<b>NET SALES:</b>							
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	
<b>IDENTIFIABLE ASSETS, DEPRECIATION AND AMORTIZATION AND CAPITAL EXPENDITURES:</b>							
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	

							Thousands of U.S. dollars (Note 1)
Year ended March 31, 2004	Petroleum	Oil Resource Development	Other	Total	Elimination or corporate	Consolidated	
<b>NET SALES:</b>							
Outside customers	\$ 17,622,802	\$ 122,528	\$ 385,789	\$ 18,131,119	\$ —	\$ 18,131,119	
Inter-segment	5,081	176,904	245,624	427,609	(427,609)	—	
Total	17,627,883	299,432	631,413	18,558,728	(427,609)	18,131,119	
Operating expenses	17,458,047	228,224	625,045	18,311,316	(419,065)	17,892,251	
Operating income	\$ 169,836	\$ 71,208	\$ 6,368	\$ 247,412	\$ (8,544)	\$ 238,868	
<b>IDENTIFIABLE ASSETS, DEPRECIATION AND AMORTIZATION AND CAPITAL EXPENDITURES:</b>							
Assets	\$ 10,217,428	\$ 604,598	\$ 293,926	\$ 11,115,952	\$ 806,576	\$ 11,922,528	
Depreciation and amortization	\$ 197,228	\$ 30,911	\$ 1,116	\$ 229,255	\$ (5,658)	\$ 223,597	
Capital expenditures	\$ 268,966	\$ 82,042	\$ 1,362	\$ 352,370	\$ (6,330)	\$ 346,040	

As described in Note 2, effective January 1, 2002, Cosmo Engineering changed its revenue recognition from the completed contract method to the percentage of completion method for long-term and large engineering contracts which are more than 1 year and of which the contract amount is more than ¥100 million (\$946 thousand).

As a result of the change, the sales regarding "Other" for the year ended March 31, 2003 increased by ¥312 million (\$2,952 thousand) and operating income increased by ¥9 million (\$85 thousand).

The Company modified business sectionalization, and business segment information for "Oil Resource Development" is disclosed independently for the year ended March 31, 2003 because sales, operating income, and assets for "Oil Resource Development" are more important from year to year.

Also, along with these changes, the Company and its consolidated subsidiaries reviewed the content of administrative expenses that were treated as unallocated operating expenses for the previous years and those expenses were allocated to each segment for the year ended March 31, 2003 to match each segment's revenue against its expenses more accurately.

As a result, operating expenses for "Petroleum", "Oil Resource Development" and "Other" increased by ¥670 million (\$6,339 thousand), ¥16 million (\$151 thousand) and ¥34 million (\$322 thousand), respectively, and operating income for each of these three segments decreased by the same amount for the year ended March 31, 2003, respectively.

As described in Note 2, effective April 1, 2001, Cosmo Matsuyama Oil changed the method of costing inventories

and the scope of calculation for the allowance of special repair work. As a result, operating expenses for "Petroleum" increased by ¥295 million (\$2,791 thousand) for the year ended March 31, 2002.

## (2) Geographic segment information

Geographic segment information of the Company and its consolidated subsidiaries for the year ended March 31, 2004 is disclosed as follows:

Year ended March 31, 2004	Millions of yen				
	Japan	Other	Total	Elimination or corporate	Consolidated
<b>NET SALES:</b>					
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, 2004	Thousands of U.S. dollars (Note 1)				
	Japan	Other	Total	Elimination or corporate	Consolidated
<b>NET SALES:</b>					
Outside customers	\$17,707,001	\$ 424,118	\$18,131,119	\$ —	\$18,131,119
Inter-segment	91,523	1,656,306	1,747,829	(1,747,829)	—
Total	17,798,524	2,080,424	19,878,948	(1,747,829)	18,131,119
Operating expenses	17,628,101	2,008,847	19,636,948	(1,744,697)	17,892,251
Operating income	\$ 170,423	\$ 71,577	\$ 242,000	\$ (3,132)	\$ 238,868
Assets	\$10,471,663	\$ 850,818	\$11,322,481	\$ 600,047	\$11,922,528

Geographic segment information for the years ended March 31, 2002 and 2003 is not disclosed as the net sales and assets of the Company and its consolidated subsidiaries in Japan were more than 90% of the consolidated net sales and assets.

## (3) Exports 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, 2002, 2003 and 2004

## 14 PLEDGED ASSETS

Assets pledged as collateral at March 31, 2003 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Land	¥ 262,996	¥ 265,156	\$ 2,508,809
Buildings and structures at net book value	36,475	35,225	333,286
Machinery and equipment at net book value	40,174	35,245	333,475
Investments in securities	2,744	5,513	52,162
Cash and deposits	—	100	946
Total	¥ 342,389	¥ 341,239	\$ 3,228,678

Secured liabilities at March 31, 2003 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
Notes and accounts payable, trade	¥ 32	¥ —	\$ —
Short-term loans	25,678	24,085	227,883
Long-term debts	195,181	202,611	1,917,031
Other long-term liabilities	470	470	4,447
<b>Total</b>	<b>¥ 221,361</b>	<b>¥ 227,166</b>	<b>\$ 2,149,361</b>

Other pledged assets at March 31, 2003 and 2004 were as follows:

	Millions of yen		Thousands of U.S. dollars (Note 1)
	2003	2004	2004
<b>CONTINGENCIES FOR LOANS PAYABLE:</b>			
Investment in securities	¥ 665	¥ —	\$ —
<b>DEPOSITS AS SECURITY FOR DEALING:</b>			
Marketable securities	¥ 10	¥ 13	\$ 123
Investments in securities	53	50	473
<b>Total</b>	<b>¥ 63</b>	<b>¥ 63</b>	<b>\$ 596</b>

## 15 SUBSEQUENT EVENTS

On June 29, 2004, the Company's annual shareholders' meeting approved the year-end cash dividend payment of ¥3.00 (US\$0.03) per share, or a total of ¥1,895 million (\$17,931 thousand) to shareholders of record at March 31, 2004.

# 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, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 31, 2004, 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, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2004, 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 expenses.
- (2) As discussed in Note 13 to the consolidated financial statements, effective April 1, 2002, COSMO OIL COMPANY, LIMITED and its consolidated subsidiaries changed its business segment and allocating method of operating expenses.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2004 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, 2004