

1. Consolidated Operating Results

## (1) Analysis of Consolidated Operating Results

## 1) Consolidated Operating Results during Fiscal Year 2008

During the consolidated full year of Fiscal Year 2008 that ended on March 31, 2009, the economy of Japan in the first half of the year suffered from doldrums mainly due to soaring energy and raw material prices and flat growth of exports and was then adversely affected by a global economic recession triggered by a financial capital market crisis in September to rapidly aggravate domestic corporate profits and employment climate, so that the harsh state of economy continued. Under these circumstances, the overall demand for oil products in Japan was significantly lower than in FY2007 reflecting a reduction in the gasoline demand due to sluggish consumption caused by wild fluctuations in gasoline prices and by improved fuel efficiency in passenger cars, a reduction in the diesel fuel demand due to a decrease in the cargo shipment volume caused by economic aggravation, and a reduction in the demand for kerosene and heavy fuel oil A due to a drop in the industrial demand and conversion to other energy resources.

As for crude oil prices, the Dubai crude oil price was at the level of US\$94 per barrel on April 2008, the beginning of the fiscal year, and subsequently rose to set new records due to speculative investment fund inflows into the oil commodity market against a background of financial uncertainty triggered by sub-prime loan issues in the U.S., hitting the level of US\$140 a barrel in July, the highest record marked during the fiscal year. Subsequently, adversely affected by the rapidly aggravated global economy, the crude oil price sharply dropped to the level of US\$36 a barrel in December 2008 but somewhat bounced back, partly due to an uplift effect brought by the OPEC's aiming at cutting crude oil production in January onwards, to the level of US\$46 a barrel at the end of the fiscal year. The average amount throughout FY2008 was at the level of US\$82, up about US\$5 from FY2007.

The Japanese yen was at the level of ¥99 per US\$ on April 2008 and then depreciated against the dollar, due to expectations of the subsidence of financial uncertainty in the U.S. and a sharp increase in crude oil prices, down to ¥110 per US\$ in August. In September, the bankruptcy of a leading U.S. investment bank worsened the financial crisis and aggravated the real sides of the economy, appreciating the yen up to the level of ¥98 per US\$ at the end of the fiscal year. As for oil product market conditions in Japan, provisional oil-related tax issues (consisting of the expiration of the terms of the provisional measures for the gasoline tax and the diesel fuel transaction tax in April and the restoration of the provisional measures in May) caused a temporary disruption in the market at the beginning of the fiscal year, as retail prices then showed the upward trend up until August against the background of fluctuations in crude oil prices but turned downward in September, making FY2008 represent a year of erratic fluctuations.

Under these circumstances, the Cosmo Oil Group developed the "Third Consolidated Medium-Term Management Plan (FY2008-10)," a new three-year plan starting from FY2008 designed to restructure the earnings base and to make strategic moves for further growth, to bring all forces into one across the Group to work on the plan.

As a result, consolidated net sales in FY2008 were ¥3,428.2 billion (down ¥94.9 billion from FY2007), consolidated operating loss, ¥107.0 billion (down ¥190.8 billion) and consolidated ordinary loss, ¥125.0 billion (down ¥219.3 billion).

After extraordinary gain and loss adjustments and corporation taxes and other adjustments, consolidated net loss for FY2008 was ¥92.4 billion (down ¥127.6 billion).

Segment-specific results were as follows:

## [Business Segment Information]

(Unit: ¥ billion)

	Petroleum business	Oil exploration and production business	Other businesses	Deletion or other adjustments	Consolidated
Net sales	3,352.9	89.1	91.8	-105.6	3,428.2
Operating income	-162.6	50.8	2.2	2.6	107.0

## [Petroleum Business Segment]

1) In the oil product business, oil product market conditions oscillated against the background of wild fluctuations in crude oil prices but efforts were made to shift increased costs to consumer costs at an appropriate level. On the other hand, the selling volume reduced reflecting the lower domestic demand mainly caused by sluggish consumption due to the downturn in the economy and by progress in fuel conversion. Furthermore, an inventory valuation impact significantly increased cost of sales. As a result, the segment recorded lower profit from FY2007.

2) The petrochemical business recorded lower profit from FY2007 mainly reflecting the reduced selling volume due to a drop in the product demand and a squeeze on margins.

As a result, the segment reported net sales in FY2008 of ¥3,352.9 billion (down ¥89.3 billion from FY2007), operating loss of ¥162.6 billion (down ¥202.0 billion) and ordinary loss of ¥175.1 billion (down ¥221.5 billion).

## [Oil Exploration and Production Business Segment]

The oil exploration and production business reported net sales of ¥89.1 billion (up ¥5.0 billion from FY2007), operating income of ¥50.8 billion (up ¥7.3 billion) and ordinary income of ¥45.9 billion (down ¥1.0 billion), mainly reflecting the lower selling volume and the impact of foreign exchange translation, though crude oil price hovering high in general.

## [Other Business Segment]

Reflecting continued efforts made to improve rationalization and efficiency, the segment reported net sales of ¥91.8 billion (down ¥7.2 billion from FY2007), operating income of ¥2.2 billion (down ¥300 million) and ordinary income of ¥2.4 billion (down ¥500 million).

## 2) Outlook for FY2009

The Group will steadily execute a variety of programs, as defined by the “Third Consolidated Medium-Term Management Plan” starting from FY2008, for further strengthening the earnings base of the crude oil refining and marketing businesses and for accelerating the pace of implementing the growth strategies for the oil exploration and production and petrochemical businesses.

Assumptions for FY2009 include an average crude oil price at US\$50.0 per barrel and the Japanese yen at ¥100 per US\$ on the average. Consolidated net sales are forecast to be ¥2,300 billion (down ¥1,128.2 billion from FY2008), consolidated operating income, ¥85.0 billion (up ¥192.0 billion), consolidated ordinary income, ¥82.0 billion (up ¥207.0 billion) and consolidated net income for FY2009, ¥33.0 billion (up ¥125.4 billion).

## [Segment-Specific Business Outlook]

(Unit: ¥ billion)

	Petroleum business	Oil exploration and production business	Other businesses	Deletion or other adjustments	Consolidated
Net sales	2,232.0	57.0	86.0	-75.0	2,300.0
Operating income	60.0	23.0	2.0	0.0	85.0

## [Petroleum Business Segment]

The segment is expected to improve profit by enhancing the competitive advantage of the refineries and by building the stronger sales network among other things, as defined by the “Third Consolidated Medium-Term Management Plan” and the profit for FY2009 is likely to be higher than that of FY2008 mainly due to cost of sales expected to be significantly brought down by the impact of inventory valuation that arose in FY2008.

## [Oil Exploration and Production Business Segment]

The segment will continue stable crude oil production but is expected to reduce profit as compared with FY2008 since crude oil prices are not likely to be as high as in FY2008.

## (2) Analysis of Financial Position

## 1) Assets, Liabilities and Net Assets

As for consolidated financial conditions as of March 31, 2009, total assets amounted to ¥1,440.4 billion, down ¥187.5 billion from March 31, 2008, mainly reflecting a decrease in inventories due to crude oil price drops.

Net assets amounted to ¥347.4 billion, down ¥122.3 billion from March 31, 2008, mainly reflecting net loss recorded due to negative inventory valuation impact, resulting in a net worth ratio of 22.8%.

## 2) Cash Flows

As for consolidated cash flows as of March 31, 2009, net cash provided by operating activities amounted to ¥82.1 billion, mainly reflecting a decrease in inventories due to a drop in crude oil prices. Net cash used in investing activities amounted to ¥56.0 billion, mainly reflecting payments for fixed asset acquisitions. Net cash provided by financing activities amounted to ¥57.9 billion, mainly reflecting an increase in borrowings.

As a result, cash and cash equivalents as of March 31, 2009 amounted to ¥159.9 billion, up ¥77.2 billion from March 31, 2008.

The trends of the indicators for cash flows of the Group for the past four years are as follows:

	Year ended March 31, 2005	Year ended March 31, 2006	Year ended March 31, 2007	Year ended March 31, 2008	Year ended March 31, 2009
Net worth ratio	17.2%	21.4%	21.5%	27.2%	22.8%
Net worth ratio on a fair value basis	16.6%	28.3%	21.0%	16.3%	17.5%
Ratio of cash flows to interest-bearing debt	12.3 years	-	24.4years	—	7.3years
Interest coverage ratio	3.6times	-	2.4times	—	7.6times

## Notes:

Net worth ratio: Net worth divided by total assets (shareholders' equity divided by total assets up to FY2005)

Net worth ratio on a fair value basis: Market capitalization divided by total assets

Ratio of cash flows to interest-bearing debt: Interest-bearing debt divided by operating cash flow

Interest coverage ratio: Operating cash flow divided by interest payable

- Each indicator is calculated by using consolidated financial data.
- Market capitalization is calculated by multiplying the share price as of the end of the term above by the number of outstanding shares (excluding treasury stock) as of the end of the term.
- Operating cash flow refers to cash flow from operating activities in the consolidated statement of cash flows. Interest-bearing debt refers to all debts with interest payments among debts stated in the consolidated balance sheet. Interest payable refers to interest expenses stated in the consolidated statement of cash flows.

(3) Basic Policy regarding Earnings Appropriation and Dividend for FY 2008, 2009

The Company places particular emphasis on shareholder return. Its basic policy is to maintain stable dividend payments by taking financial structural enhancement, future business development, business results and balanced fund positions into due consideration. In accordance with the policy, the Company projects payments of ¥5 per share as a term-end dividend. Including an interim dividend, dividends for this fiscal year will be ¥3 per share.

Full-year dividends for FY2009 are expected to be ¥8 per share.

(4) Business and Other Risks

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

1) Supply and Demand Trends

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

2) Crude Oil Price Fluctuations

Crude oil prices are significantly affected by demand and production trends. In terms of demand trends, the impact of large consuming nations, such as the U.S., and of Asian nations showing rapid economic growth (particularly China) is highly significant. Increases and decreases in the crude oil production by Middle East oil-producing nations primarily have a large impact on production trends. In addition to political instability, such as the outbreak of war around oil-producing nations, and terrorism and other uncertainties that could significantly affect crude oil prices and crude oil procurement by the Group, production stoppages at the Group's production bases could also have a material impact on the Group's business performance and financial condition.

The Group uses the weighted average method to value crude oil inventories. Therefore, lower crude oil prices can have a material impact on the Group's operating performance and financial condition, such as a heavier cost burden the Group might have to bear for actual market conditions.

3) Foreign Exchange Rate Fluctuations

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

Foreign exchange rate fluctuations can also have a material impact when the financial statements of consolidated subsidiaries outside Japan and associated companies accounted for in the equity method are restated in the Japanese yen currency.

4) Market Impact

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

5) Interest Rate Fluctuations

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

6) Asset Valuation Fluctuations

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

7) Competition Risk

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

8) Impact by Natural Disasters and Accidents

As its refineries handle large volumes of flammable materials, the Group takes particular care in implementing various safety measures to prevent accidents caused by human errors, and to avoid workplace injuries. Notwithstanding these precautions, the occurrence of an earthquake, other natural disasters or unforeseen accidents can result in unavoidable stoppages of operations. For example, an explosion and fire accident at the Chiba Refinery in April 2006 forced the Group to suspend operations of the refinery for a while and to report losses caused by such suspended operations and restoration costs accordingly. In addition, accidents in non-refinery operations, such as oil storage depots, service stations, marine tankers and tanker trucks, could

noticeably affect the Group's operations and have material impact on its business performance and financial condition.

9) Impact by Regulations Applicable to the Oil Industry

Various regulations regarding pollution and environmental issues that affect the oil industry have been implemented, and the Group bears the cost of complying with these regulations. As more stringent environmental countermeasures are expected, the Group recognizes the possibility that it could be subject to new laws, regulations and taxes. Going forward, there is a risk that new laws or amendments to existing laws will result in an additional cost burden for the Group. In promoting its CSR management efforts, the Group positions legal compliance as an integral part of such efforts, establishing the necessary systems and striving to enhance the morale of all employees. However, if the risk of legal infraction materializes because of human error or other factors, the Group may become subject to government penalties that would obstruct business operations, reduce the level of trust among customers and damage the Group's brand image, which could, in turn, affect the Group's operating performance. For example, it was discovered that one of the Company's refineries was not in compliance with the High Pressure Gas Law and other regulations and that some construction was unauthorized, which resulted in the imposition of administrative penalties by the Nuclear and Industrial Safety Agency of the Ministry of Economy, Trade and Industry, which had an impact on the Group's business performance and financial condition.

10) Information Management

In terms of information management, malicious software countermeasures and personal information protection measures have been implemented to strengthen the Group's internal IT system security. In addition, the Group has established internal monitoring procedures and regulations on how to handle confidential information, including customer information, and it has contracted external third parties to have them implement supervision and audits over the management and handling of confidential information within the Group. However, the materialization of risks, such as any loss, leakage or alteration of confidential information, including personal information, for any reason, could result in a loss of customer trust and tarnish the Group's brand image, which, in turn, could have material impact on the Group's business performance.