Operating Environment

In fiscal 2012, ended March 31, 2013, Japan's economy staged a gradual recovery on the strength of demand from reconstruction projects in the wake of the Great East Japan Earthquake and the introduction of the emergency stimulus package by the government. Nonetheless, the economy continued to deal with challenges that included weaker exports, reflecting the sluggish global economy.

In these circumstances, domestic demand for the petroleum products gasoline and kerosene remained level with the previous term, given an increase in the demand for the heavy fuel oil used to generate electricity at thermal power plants as a result of their increased capacity ratios. Accordingly, overall demand exceeded levels recorded in the previous period.

Looking at crude oil prices, the Dubai crude oil price stood at US$119/barrel at the beginning of fiscal 2012, but it temporarily dropped below US$90/barrel, mainly reflecting the European debt crisis. However, with rising tensions in the Middle East, the average price throughout the year was at the level of US$106/barrel.

As for exchange rates, the Japanese yen was at the level of ¥83 per U.S. dollar at the beginning of fiscal 2012. Coupled with the monetary easing policy adopted by the U.S. government and the reemergence of the debt crisis in Europe, the Japanese yen continued to appreciate to the ¥77 range in September 2012. However, it then began to depreciate, mainly reflecting rising anticipation that the Japanese government would adopt an extensive monetary relaxation policy. As a result, the yen stood at the level of ¥96 per U.S. dollar in March 2013.

Looking at the petroleum product market conditions in Japan, the retail prices of mass market products and industrial fuels, which are tied to crude oil prices, experienced a downturn from the beginning of the fiscal year under review but gradually rose after summer.

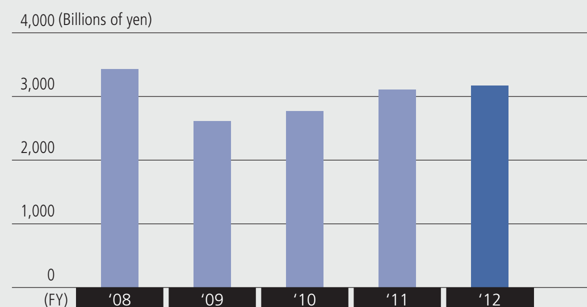
Results of Operations

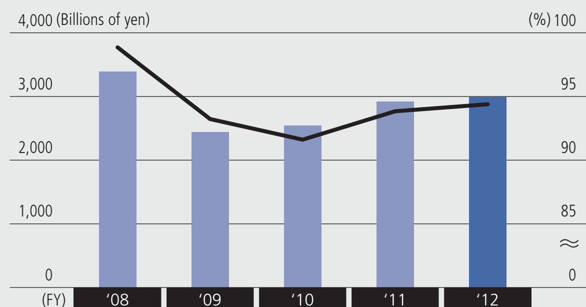
Overview

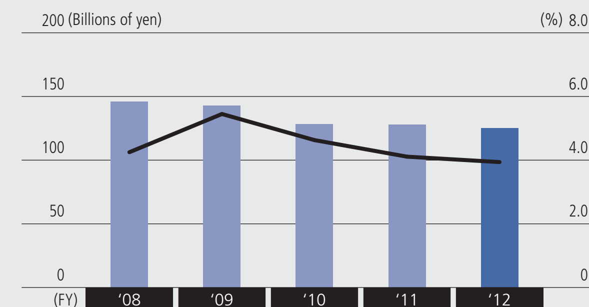
Against the backdrop of this operating environment, consolidated net sales for the fiscal year under review amounted to ¥3,166.7 billion, up ¥57.0 billion compared with the previous fiscal year. From a profit perspective, operating income declined ¥11.1 billion, to ¥52.4 billion. After accounting for extraordinary items and deducting income taxes, the Group posted a net loss of ¥85.9 billion, compared with the net loss of ¥9.1 billion in fiscal 2011. Due to the impact of the weak yen, the Group reported an inventory valuation gain of ¥15.3 billion. Excluding the impact of this inventory valuation, operating income was ¥37.1 billion.

Operating Income

Operating income in fiscal 2012 declined ¥11.1 billion compared with the previous







fiscal year, to ¥52.4 billion.

Excluding the impact of inventory valuation, operating income declined ¥1.3 billion compared with the previous fiscal year, to ¥37.1 billion. While the partial resumption of operations at the Chiba Refinery helped drive up earnings thanks to the year-on-year drop in costs incurred to find alternative supplies, profit in the Petroleum Business decreased owing largely to the slump in market conditions for the segment's four mainstay products and the downturn in sales volume. On a positive note, earnings increased in the Oil Exploration and Production Business due primarily to the increase in crude oil prices. Earnings also improved in other businesses following the introduction of the Feed-in-Tariff (FIT) scheme, which entails the purchase of renewable energy sources at a fixed price.

Ordinary Income

After adding/deducting non-operating items incurred in regular business activities, ordinary income declined ¥13.0 billion, to ¥48.4 billion. During the fiscal year under review, an extraordinary loss totaling ¥11.6 billion was recorded for fixed costs associated with the suspension of operations at the Chiba Refinery to December 2012. Despite the year-on-year improvement of ¥4.6 billion in these expenses, the impact on ordinary income remained negative. Excluding the impact of the inventory valuation, ordinary income declined ¥3.1 billion, to ¥33.1 billion.

Ordinary income by segment (including the impact of inventory valuation) is presented as follows.

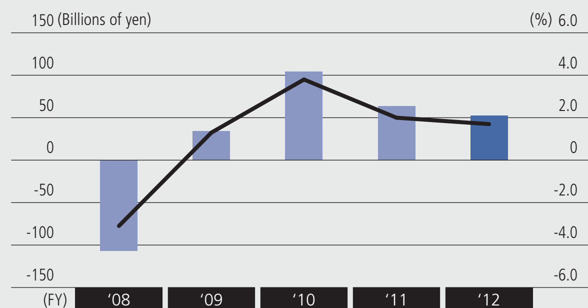
(Billions of yen)

	FY2012	FY2011	Change
Petroleum	**-23.7**	8.0	-31.7
Petrochemical	**3.3**	2.1	+1.2
Oil Exploration and Production	**60.7**	52.0	+8.7
Other	**4.9**	2.9	+2.0
Adjustments	**3.2**	-3.6	+6.8
Consolidated ordinary income	**48.4**	61.4	-13.0
Purchase price of crude oil	**US109.90$/bbl**	US110.87$/bbl	-US$0.97/bbl
JPY/USD Exchange rate	**¥82.70/US$**	¥79.02/US$	+¥3.68/US$

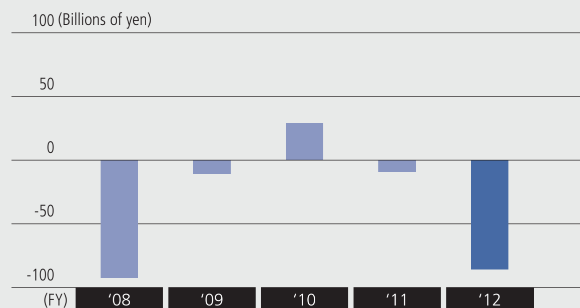
Net Income

In the fiscal year under review, the Group reported an extraordinary loss of ¥52.2 billion. This extraordinary loss was mainly comprised of business structure improvement expenses, which came to ¥20.3 billion and represented provisions made for removal expenses in connection with the closure of the Sakaide Refinery and maintenance and repair expenses incurred at the Chiba Refinery, and extraordinary loss totaling ¥11.6 billion representing fixed costs at the Chiba Refinery. In addition, steps were taken to reverse deferred tax assets following a review of realizability. This contributed to an increase in income taxes-deferred to ¥44.7 billion, up ¥43.8 billion. As a result, total income taxes surged ¥37.3 billion year on year to ¥76.2 billion. On

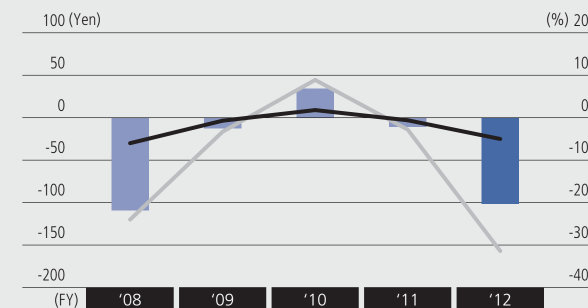
Operating income (loss), Operating margin



Net income (loss)



Earnings (loss) per share, ROA, ROE



this basis, the Group recorded a net loss for the period of ¥85.9 billion, an increase of ¥76.8 billion compared with the previous fiscal year.

Outlook

The Cosmo Oil Group has positioned its Fifth Consolidated Medium-Term Management Plan, which covers the period from fiscal 2013 to fiscal 2017, as a five-year roadmap by which it will establish a solid business foothold for further expansion. During this period, the Group will work to regain profitability in the Petroleum Business and steadily recoup strategic investments made mainly in the Petrochemical and Oil Exploration and Production businesses under the Fourth Consolidated Medium-Term Management Plan. As of July 31, 2013, operations at the Chiba Refinery had fully resumed. At the same time, the Group has completed steps aimed at developing a robust supply structure. As a result, considerable energy will be channeled toward strengthening sales. In addition to the forecast boost to marketing capabilities following the acquisition of Sojitz Energy Corporation in January 2013, the Group will target a substantial increase in earnings on the back of a full-fledged resumption of export activities.

For fiscal 2013, the Group anticipates a crude oil price of US$100/barrel and an exchange rate of ¥100 per U.S. dollar. On this basis, consolidated net sales are forecast to reach ¥3,550.0 billion, up ¥383.3 billion compared with fiscal 2012, consolidated operating income to come in at ¥64.0 billion, an increase of ¥11.6 billion year on year, consolidated ordinary income to total ¥61.0 billion, up ¥12.6 billion, and consolidated net income to amount to ¥16.0 billion, compared with the consolidated net loss for fiscal 2012 of ¥85.9 billion.

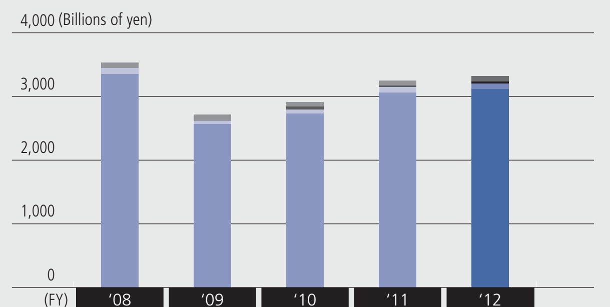
Segment Information

Petroleum

In the Petroleum Business, sales increased ¥60.6 billion compared with the previous fiscal year, to ¥3,116.2 billion mainly reflecting higher sales prices on the back of the weak yen and increased sales of heavy fuel oil C for electric power generation. On the earnings front, however, the Petroleum Business reported a segment loss of ¥23.7 billion compared with segment income of ¥8.0 billion in fiscal 2011. This was largely attributable to the downturn in product market conditions and the drop in sales volume.

Turning to fiscal 2013, the Petroleum Business is expected to benefit from a lower year-on-year burden with respect to alternative supply costs. This reflects efforts to ramp up measures aimed at securing safe operations at refineries and stable supply. The forecast substantial increase in product exports is also projected to ensure a positive operating environment. As a result, the Petroleum Business is anticipated to report higher earnings for fiscal 2013 compared with fiscal 2012. Looking at improvements in the margin environment, the Group is adopting a conservative

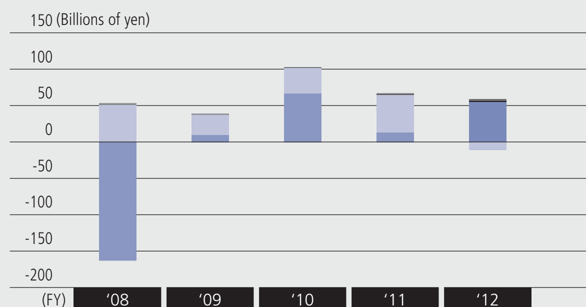
Segment sales



Petroleum Business Segment | Oil Exploration and Production Business Segment | Petrochemical Business Segment | Other Business Segment

Note: The Petrochemical Business, which had previously been included in the Petroleum Business segment, was made a separate segment from FY2010.

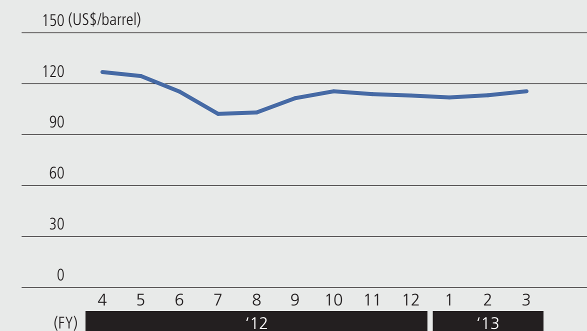
Segment operating income (loss)



Petroleum Business Segment | Oil Exploration and Production Business Segment | Petrochemical Business Segment | Other Business Segment

Note: The Petrochemical Business, which had previously been included in the Petroleum Business segment, was made a separate segment from FY2010.

Crude oil price (CIF)



approach. Every effort will, however, be made to boost earnings by promoting the shift to more economical heavier forms of crude oil, and building an agile production and sales structure. Taking into consideration each of these measures and factors, sales in this segment are forecast to reach ¥3,460.0 billion, an increase of ¥343.8 billion. Segment income is estimated to total ¥3.0 billion, a positive turnaround of ¥26.7 billion.

Petrochemicals

In the Petrochemicals Business, sales climbed ¥1.1 billion, to ¥30.5 billion. This largely reflected the recovery in market conditions for aromatic petrochemical products including benzene and mixed xylene. Segment income in fiscal 2012 came to ¥3.3 billion, an increase of ¥1.2 billion compared with the previous fiscal year.

Buoyed by such factors as the start of new unit operations at Hyundai Cosmo Petrochemical Co., Ltd. (HCP), segment earnings are projected to increase in fiscal 2013. Sales in the Petrochemicals Business are expected to reach ¥80.0 billion, up ¥49.5 billion year on year while segment income is forecast to total ¥3.5 billion, an improvement of ¥0.2 billion against the backdrop of projected conservative petrochemical product market conditions.

Oil Exploration and Production

Sales in the Oil Exploration and Production Business came to ¥85.9 billion, down ¥1.7 billion, and income totaled ¥60.7 billion, up ¥8.7 billion.

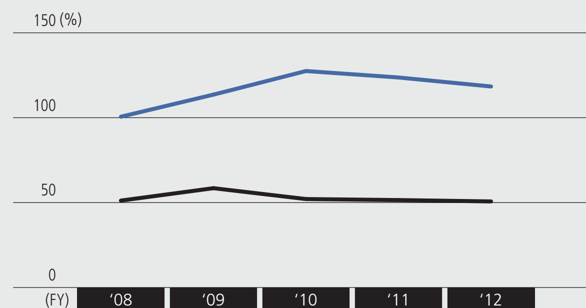
Looking at forecasts for the next fiscal year in this segment, earnings are projected to fall owing mainly to the upswing in operating expenses commensurate with efforts to ensure the ongoing steady production of crude oil. As a result, sales in the Oil Exploration and Production Business are forecast to reach ¥98.0 billion, an increase of ¥12.1 billion, while income is projected to fall ¥5.2 billion, to ¥55.5 billion.

Sources of Liquidity and Funds

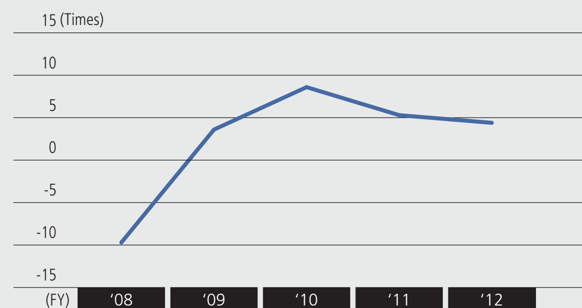
The Cosmo Oil Group's core petroleum business is its principal source of income. While rising crude oil prices benefit sales and operating income in the Company's Oil Exploration and Production Business segment, high tax rates in oil producing countries mean that the negative impact in terms of cash inflow is limited.

In the Petroleum Business segment, there is a noticeable lag between the import of crude oil and the receipt of funds from the sale of petroleum products. This is because the transportation of crude oil requires a significant amount of time. Also, the Company is obligated to maintain reserves equivalent to 70 days of domestic sales volume. Because it is entirely dependent on imports of raw materials, the Cosmo Oil Group is also affected significantly by fluctuations in exchange rates, which influence

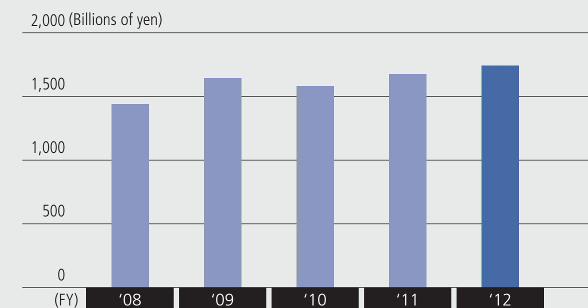
Current ratio, Quick ratio



Interest coverage ratio



Total assets



import costs, and in domestic sales prices. The Company engages in forward foreign exchange contracts to hedge this risk.

The Company must undertake short-term borrowings from time to time to provide additional working capital to facilitate crude oil imports. Long-term debt as of the fiscal year-end totaled ¥489.3 billion, up ¥32.5 billion, or 7.1%, year on year. Total interest-bearing debt increased ¥121.7 billion, or 16.9%, to ¥842.9 billion.

In November 2012, Japan Credit Rating Agency, Ltd. (JCR) downgraded the Company's long-term issuer rating from BBB+ to BBB. This decision largely reflects JCR's assessment that it will take some time before the Company can improve its financial structure that has deteriorated more than previously thought due in part to delays in the resumption of operations at the Chiba Refinery, the full reversal of deferred tax assets, and the temporary increase in oil exploration and development-related investment.

In December 2012, Moody's Japan K.K. (Moody's) decided to downgrade the Company's long-term issuer rating to Ba1 from Baa3. This rating action is a measure of Moody's concern that any improvement in the Company's balance sheet structure will take much longer than expected, given the persistent erosion in profitability attributable to the suspension of operations at the Chiba Refinery.

The Cosmo Oil Group plans strategic capital investments under its Fifth Consolidated Medium-Term Management Plan. Moving forward, the Company will seek to flexibly raise funds while monitoring market trends, and at the same time endeavor to optimize its balance sheet, thereby reinforcing its financial condition and ensuring its ability to support strategic investments.

Financial Position

Assets

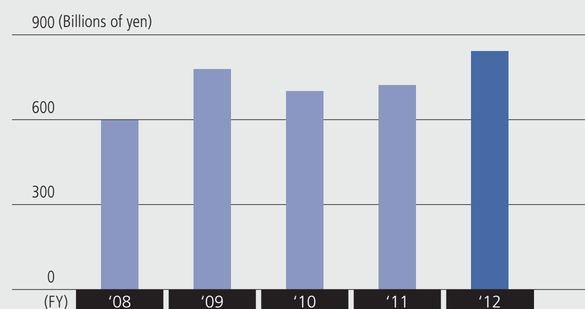
As of March 31, 2013, total assets amounted to ¥1,743.5 billion, up ¥68.4 billion from a year earlier. This was mainly due to a ¥46.7 billion rise in current assets, to ¥967.1 billion. Major factors boosting current assets were increases in accounts receivable and inventory assets, stemming from the upswing in crude oil prices due mainly to the weak yen.

Liabilities and Net Assets

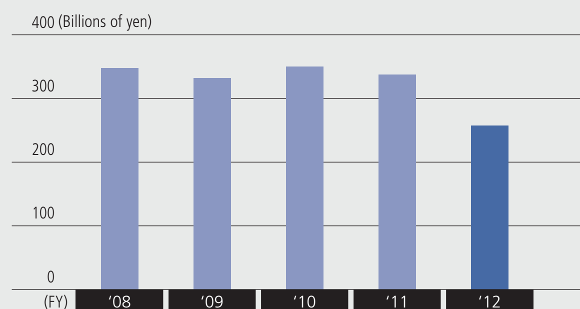
Total liabilities as of the fiscal year-end stood at ¥1,486.6 billion, up ¥148.9 billion from a year earlier. This was mainly due to a ¥72.3 billion rise in current liabilities, to ¥816.6 billion, stemming primarily from the increase in short-term loans payable, and a ¥76.6 billion upswing in noncurrent liabilities, to ¥669.9 billion, largely reflecting the higher balance of long-term loans payable.

Net assets declined ¥80.5 billion, to ¥256.9 billion, owing mainly to the drop in retained earnings. The equity ratio was 13.2% as of the fiscal year-end.

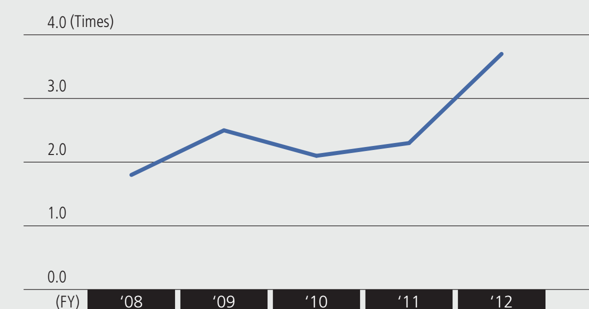
Interest-bearing debt



Net assets



Debt-to-equity ratio



Cash Flows

Net cash used in operating activities amounted to ¥21.0 billion. The main cash outflows were the increase in notes and accounts receivable-trade and the increase in inventories reflecting such factors as the upswing in crude oil prices as well as the decrease in notes and accounts payable owing mainly to cutbacks in the cost of finding alternative supplies stemming from the suspension of operations at the Chiba Refinery.

Net cash used in investing activities totaled ¥80.5 billion owing primarily to the purchase of fixed assets.

Net cash provided by financing activities was ¥104.7 billion. This was due mainly to increases in borrowings.

As a result, cash and cash equivalents as of the fiscal year-end totaled ¥129.7 billion, up ¥7.3 billion from a year earlier.

(Billions of yen)

	FY2012	FY2011	Change
Cash flows from operating activities	**-21.0**	43.6	-64.6
Cash flows from investing activities	**-80.5**	-25.8	-54.7
Cash flows from financing activities	**104.7**	11.6	+93.1
Cash and cash equivalents at fiscal year-end	**129.7**	122.4	+7.3
Ratio of cash flows to interest-bearing debt (years)	—	16.5	—

Note: The ratio of cash flows to interest-bearing debt = Interest-bearing debt divided by operating cash flows

Capital Expenditures

In the fiscal year under review, the Company made total capital expenditures of ¥83.4 billion, up ¥55.5 billion from the previous year. In the Petroleum Business, expenditure was directed toward production facilities at the refineries, marketing facilities including the new construction and refurbishment of self-service stations, and consolidated subsidiaries. In the Petrochemical Business, the principal investment was related to production facilities of Cosmo Matsuyama Oil Co., Ltd., a consolidated subsidiary. Major capital expenditures in the Oil Exploration and Production Business included outlays for production facilities by Abu Dhabi Oil Co., Ltd., a consolidated subsidiary. Other substantial expenditures comprised investments in wind power generation facilities by consolidated subsidiary EcoPower Co., Ltd. During fiscal 2012, the Company did not dispose of or sell any important facilities in each of its mainstay businesses.

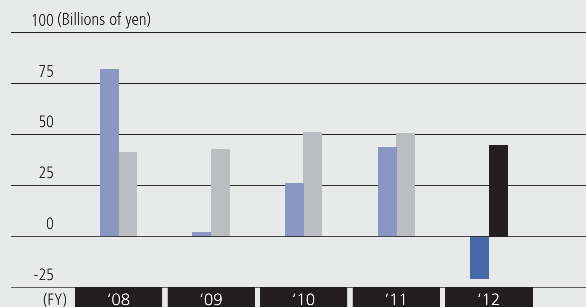
Capital expenditures by segment are summarized as follows.

(Billions of yen)

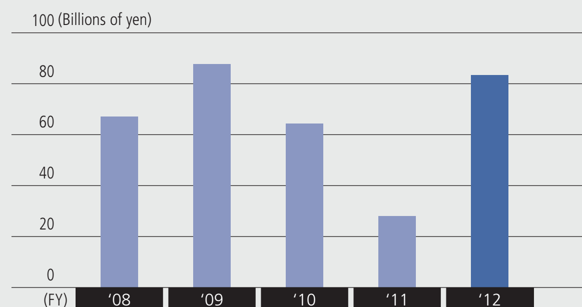
	FY2012	FY2011	Change
Petroleum	**24.1**	17.5	+6.6
Petrochemical	**0.6**	0.5	+0.1
Oil Exploration and Production	**57.3**	9.6	+47.7
Depreciation and Amortization	**45.0**	50.6	-5.6

Notes: 1. Capital expenditure is recorded on an inspection basis.
2. Depreciation and amortization included recovery of recoverable accounts under production sharing as well as depreciation applicable to such items as intangible fixed assets and long-term prepaid expenses.

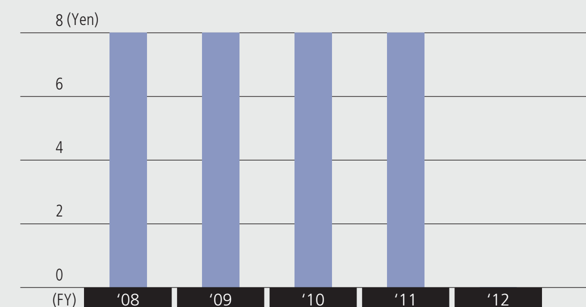
Cash flows from operating activities, Depreciation and amortization



Capital expenditures



Cash dividends per share



Basic Policy Regarding Earnings Appropriation

The Company places particular emphasis on shareholder returns. 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. However, considering the financial situation, among other factors, the Company has regrettably decided not to pay dividends for the term under review.

Turning to the payment of dividends for fiscal 2013, Cosmo Oil's policy concerns take into consideration the need to improve its earnings foundation. This in turn draws on the Company's ability to secure safe operations at its refineries when ensuring stable supply. With this as its base, the payment of future dividends will then depend on operating results and the Company's financial condition.

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 a 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 Prices and Procurement

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 United States, 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 Japanese yen.

(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. As a result of the Great East Japan Earthquake of March 11, 2011, for example, the Group was forced to suspend operations of the Chiba Refinery for a certain period and consequently incur losses and restoration costs. 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 a 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, one of the Company's refineries was subject to administrative penalties by the Nuclear and Industrial Safety Agency of the Ministry of Economy, Trade and Industry. This incurred additional maintenance costs, which had an impact on the Group's business performance.

(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 a material impact on the Group's business performance.