

**Mr. Takayuki Koishi**

**Hong Kong, the 22<sup>th</sup> of April**

**Cc: BP Castrol KK Board Members**

BP Castrol K.K.  
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Dear Koishi-san:

Thank you for your having taken the time to address most of our questions in your presentation at the AGM.

Now that we have had time to translate and process your answers, we would like to address once more the excess cash on BP Castrol K.K.'s balance sheet, which is not needed for the continued operation of an asset-light, cash generative business model.

#### **Return of Excess Cash to Shareholders**

We applaud management's decision to increase the dividend payout in FY2013; however, if management does not take further action, ROE is still destined to fall into the single digits.

The company's cash balances are earning very low rates of interest and hurting overall returns, and as the company's cash balances grow larger, shareholders will suffer from steadily declining returns on equity:

¥ Millions	2010	2011	2012	2013	2014E	2015E	2016E
Net Income	1,631	1,600	1,574	1,460	1,400	1,400	1,400
Dividend	367	367	367	527	527	527	527
Payout %	22.5%	22.9%	23.3%	36.1%	37.6%	37.6%	37.6%
Equity	7,100	8,334	9,542	10,643	11,516	12,389	13,262
Cash	6,194	7,527	8,392	8,500	9,373	10,246	11,119
ROE	25.2%	20.7%	17.6%	14.5%	12.6%	11.7%	10.9%

We propose that the simplest and fairest solution to this problem is to pay a special dividend of ¥7B and revise the recurring dividend pay-out ratio to 100% of net income.

This action will vastly improve ROE and total returns to shareholders, while still providing the business with a comfortable cash position, as shown below:

¥ Millions	2014E	2015E	2016E
Net Income	1,400	1,400	1,400
Dividend	1,400	1,400	1,400
Payout %	100%	100%	100%
Equity	3,643	3,643	3,643
Cash	1,500	1,500	1,500
ROE	38.4%	38.4%	38.4%

### Other Potential Uses of Excess Cash

As you noted at the AGM, the current business only requires approximately ¥1.5 billion of working capital and ¥100 million of cash to operate at its current level. This means that over ¥8 billion of the cash on the balance sheet is free to be used apart from the operating business to benefit shareholders.

The potential uses for this cash include term deposits, investments and acquisitions, share repurchases or a tender offer, and dividends. It appears to us that the Company's current actions and stated intentions for its excess cash are unfair to minority shareholders and inappropriate considering BP Castrol K.K.'s role within the larger BP organization.

The bulk of BP Castrol's excess cash is currently deposited in BP Group's corporate bank, where it earns an exceedingly low interest rate of 0.325% (before tax). This is unquestionably a poor return on shareholders' capital, regardless of what the comparable market interest rate on bank deposits is at the moment. This arrangement unfairly benefits the BP Group, which gets access to cheap financing at the expense of minority shareholders, who could otherwise reinvest the dividends at much higher rates of return.

For minority investors, on the other hand, there is a major opportunity cost in the current environment: many Japanese equities are attractively priced, especially BP Castrol's stock, which offers a 4.2% dividend yield, much higher than the 0.325% interest on term deposits!

BP Castrol K.K. essentially operates as BP Group's marketing and distribution arm for BP and Castrol branded automotive lubricants in Japan. It would appear to be inappropriate or at least very difficult for the Company to make an acquisition or investment in another business in Japan. However, in the event that an investment opportunity does arise, it would make a more sense to raise debt financing and take advantage of low Japanese interest rates rather than suffer from lousy returns on cash!



### Dialogue with Board and Management

Thank you for your attention to this letter. We look forward to meeting with you to discuss the best way forward for all shareholders.

We are tentatively planning a trip to Japan during the week of June 2<sup>nd</sup>. Please inform us of your availability around this time. In the meantime, we look forward to hear back with your comments on our simple and straightforward proposal.

Best regards,

Two handwritten signatures are shown side-by-side. The first signature, on the left, is 'Edouard Mercier' written in a cursive style. The second signature, on the right, is 'Andrin Bachmann' written in a cursive style.

Edouard Mercier and Andrin Bachmann

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