

Highlights of Oil Distributors' Financial Results for Fiscal Year Ended March 2019

The following are Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning financial results for fiscal year ended March 2019 (FY2018) and earnings outlook for FY2019 of 4 oil distributors: SHOWA SHELL SEKIYU K.K. ("SHOWA SHELL SEKIYU") (security code: -), Idemitsu Kosan Co., Ltd. ("Idemitsu Kosan") (security code: 5019), JXTG Holdings, Inc., ("JXTG HD") (security code: 5020), and Cosmo Energy Holdings Co., Ltd. ("Cosmo Energy HD") (security code: 5021).

1. Industry Trend

Dubai crude oil price for FY2018 increased by US\$13.4 from FY2017 to US\$69.3 per barrel. The price, which has been on the rise since July 2017, continued to increase in the first half of FY2018. Against the backdrop of concerns about a drop of demand due to U.S.-China trade friction, the price began to fall in the middle of October and continued to decline till December 2018. Subsequently, the oil price began to rise due to concerns about a decline of supply as a result of reduction of oil production by OPEC and strengthened sanctions on Iran and Venezuela by the U.S. The price has been around US\$70 since April 2019. The crude oil price might be unstable in FY2019 due to the U.S.-China trade friction and various kinds of geopolitical risks.

Domestic demand for oil products has been declining. In FY2018, fuel oil as a whole declined 4.4% year-on-year to 169,141 thousand kl and gasoline declined 3.3% year-on-year to 50,769 thousand kl. According to "Demand Outlook for Oil Products from FY2019 to FY2023" by oil market trends survey working group in the Ministry of Economy, Trade and Industry, domestic demand for the whole fuel oil excluding C fuel oil used for power generation will decline 1.3% annually and gasoline will decline 2.2% annually for 5 years going forward. As shown by this outlook, it is forecasted that the domestic demand for oil products will continue to decline.

Domestic supply, on the other hand, increased its stability along with further development of industry reorganization. Following creation of JXTG HD through business integration between JX Holdings and TonenGeneral Sekiyu in April 2017, business integration between Idemitsu Kosan and SHOWA SHELL SEKIYU was realized in April 2019. As a result, JXTG Group has approximately 50% share for domestic fuel oil sales, while Idemitsu SHOWA SHELL Group has approximately 30% market share. Going forward, the 2 big groups will keep order in the industry, which can lead to reduction of excessive competition.

2. Financial Results

Total operating income of the 4 oil distributors (SHOWA SHELL SEKIYU's results are those from Jan. to Dec. 2018, Gross Profit - SG & A Expenses is used only for JXTG HD; the same applies hereafter) for FY2018 decreased 15.1% year-on-year to 759.5 billion yen (Chart 1). The primary reason for the decrease was a significant decrease of their inventory valuation gain in total from 191.4 billion yen for FY2017 to 21.4 billion yen for FY2018 along with slowdown of the rising pace of crude oil price. The total operating income of the 4 oil distributors excluding the inventory valuation effect for FY2018 increased 4.2% year-on-year to 732.2 billion yen, following the increase for FY2017.

By segment, margin of oil product business which is their earnings source remained solid, and the total operating income of the 4 oil distributors excluding the inventory valuation effect increased by 73.9 billion yen. Their operating income of oil exploration business also increased along with the increased crude oil price. JXTG HD's metals business incurred an operating loss for FY2017 due partly to the impairment loss on the copper mine, but it returned to profitability in FY2018 without recording of the impairment loss. Meanwhile, all 4 companies decreased their operating income of petrochemicals business against the backdrop of worsened markets for primary products.

For the financial aspect, all 4 companies increased their equity capital (equity attributable to owners of the parent for JXTG HD; the same applies hereafter). The increased amount of use in the investing cash flow and enhanced return to shareholders slightly increased their interest-bearing debt.

As a results, DER as of March 31, 2019 based on the 4 companies' equity capital and interest-bearing debt (SHOWA SHELL SEKIYU's amounts are as of December 31, 2018 and Cosmo Energy HD's amounts are after evaluation of equity content of subordinated loan; the same applies hereafter) was 1.0x, which was roughly the same level a year ago (Chart 2). The aggregate interest-bearing debt/ EBITDA ratio of the 4 companies in total for FY2018 based on their total EBITDA and interest-bearing debt worsened slightly to 3.5x from 3.0x for FY2017.

3. Highlights for Rating

All 4 companies expect their operating income excluding the inventory valuation effect for FY2019 to be roughly equal to the income for FY2018. The margin of oil products, which will be kept at a level from FY2017 to FY2018, will support their performance. While they have different outlooks for their oil exploration business, depending on their assumptions for crude oil price and production volume, a solid income is expected.

Stability of margin of oil products has increased. While demand is on the decline, domestic supply-demand balance for oil products remains favorable for oil distributors against the background of structural reforms in supply. There were changes in the margins between the rising phase and declining phase of crude oil prices in FY2018, but they secured a higher margin level in FY2018 as compared with that prior to FY2016. JCR sees that they will continue to be able to keep the current level of margin for oil products, and will pay attention to a possibility of worsening of supply-demand balance and their measure to keep the balance.

Changes in crude oil prices have an impact on business results of each company in the form of inventory valuation gains (losses) of oil business or changes in the profit of oil exploration business. Having high volatility, crude oil price significantly fluctuated in the short run in FY2018. In the aspect of demand, there remain concerns about the decline due to slowdown of Chinese economy in addition to seasonal factors. In the aspect of supply, on the other hand, it is likely that manifestation of geopolitical risks in Iran and Venezuela as well as trend of production in OPEC member countries will have an impact. There are many other various kinds of elements that can change the crude oil price.

The industry reorganization promoted stability of industry order and had a plus effect on their business performance through synergistic effects. JXTG HD realized synergistic effects of 78.7billion yen from FY2017 to FY2018 and expects its synergistic effects for 3 years from FY2017 to FY2019 to reach 114 billion yen, exceeding the initially planned 100 billion yen. SHOWA SHELL SEKIYU and Idemitsu Kosan realized synergistic effects of 13 billion yen in FY2018 prior to the business integration, and they aim to get the synergistic effects of 30 billion yen from FY2018 to FY2019, and to achieve 60 billion in total till FY2021.

Although all companies improved their financial structure along with improved earnings capacity, the improvement pace slowed down in FY2018. Going forward, their financial improvement will be slow due to expansion of return their profits to shareholders as well as various investments for business expansion in growth areas. In light of the facts that there are differences among the companies in terms of level of financial indicators and that their earnings volatility is large, JCR sees that it is important to secure a sound financial structure. JCR will pay attention to whether they can further improve their financial structure, while making necessary investments.

Hiroyuki Chikusa, Masayoshi Mizukawa

(Chart 1) Financial Results of Oil Distributors

(JPY 100 mn, %)

FY Ended		Net Sales	Operating Income	Ordinary Income	Net Income Attributable to Owners of the Parent	Inventory Valuation Effects	Operating Income less Inv. Valuation Effects	Net Income/ Net Sales
SHOWA SHELL SEKIYU (-)	Dec. 2017	20,459	784	929	427	244	540	2.1
	Jan.-Dec. 2018	24,946	818	848	440	106	712	1.8
Idemitsu Kosan (5019)	Mar. 2018	37,306	2,013	2,263	1,623	311	1,702	4.4
	Mar. 2019	44,251	1,793	1,691	814	60	1,733	1.8
	Mar. 2020F	67,900	2,200	2,285	1,600	0	2,200	2.4
Cosmo Energy HD (5021)	Mar. 2018	25,231	1,118	1,168	728	210	908	2.9
	Mar. 2019	27,703	946	966	531	-107	1,053	1.9
	Mar. 2020F	29,130	1,090	1,110	600	50	1,040	2.1
FY Ended		Net Sales	Gross Profit - SG & A Expenses	Operating Income	Profit Attributable to Owners of the Parent	Inventory Valuation Effects	Operating Income less Inv. Valuation Effects	Net Income/ Net Sales
JXTG HD (5020)	Mar. 2018	103,010	5,027	4,875	3,619	1,149	3,726	3.5
	Mar. 2019	111,296	4,036	5,370	3,223	214	5,156	2.9
	Mar. 2020F	115,000	N.A.	5,500	3,200	500	5,000	2.8
		Net Sales	Operating Income	-	Net Income Attributable to Owners of the Parent	Inventory Valuation Effects	Operating Income less Inv. Valuation Effects	Net Income/ Net Sales
Total of 4 Companies	Mar. 2018	186,008	8,944	N.A.	6,397	1,914	7,030	3.4
	Mar. 2019	208,197	7,595	N.A.	5,009	273	7,321	2.4
	Mar. 2020F	212,030	N.A.	N.A.	5,400	550	N.A.	2.5

(Source: Prepared by JCR based on financial materials of above companies)

- Notes:
1. Forecasts are those publicized by companies.
 2. Figures for JXTG HD are based on IFRS.
 3. SHOWA SHELL SEKIYU's fiscal year ended March 2019 was an irregular accounting period of 15 months, but the above figures are 12-month results from January to December 2018 for adjustment with other companies.
 4. Total of 4 companies for fiscal year ended March 2020 is total of 3 companies excluding SHOWA SHELL SEKIYU, which was integrated with Idemitsu Kosan.
 5. Gross Profit - SG & A Expenses is used only for JXTG HD in total of 4 companies' operating income.
 6. Total of 4 companies' Net Income is a sum of Net Income Attributable to Owners of the Parent under Japanese GAAP and Profit Attributable to Owners of the Parent under IFRS.

(Chart 2) Financial Conditions of Oil Distributors

(JPY 100 mn, times, %)

FY Ended		Equity Capital	Interest-bearing Debt	DER	EBITDA	Interest-bearing Debt/EBITDA	Operating Cash Flow	Investing Cash Flow
SHOWA SHELL SEKIYU (-)	Dec. 2016	2,212	1,276	0.6	833	1.5	809	-165
	Dec. 2017	2,533	1,174	0.5	1,064	1.1	473	-96
	Jan.-Dec. 2018	2,707	1,262	0.5	1,068	1.2	901	-459
Idemitsu Kosan (5019)	Mar. 2017	5,838	10,406	1.8	2,054	5.1	535	-2,148
	Mar. 2018	8,687	8,670	1.0	2,692	3.2	1,367	-898
	Mar. 2019	8,421	9,398	1.1	2,409	3.9	1,510	-1,222
Cosmo Energy HD (5021)	Mar. 2017	1,947	7,425	3.8	1,266	5.9	476	-1,120
	Mar. 2018	2,686	6,704	2.5	1,502	4.5	1,926	-964
	Mar. 2019	3,110	6,641	2.1	1,414	4.7	904	-845
TonenGeneral Sekiyu (before business integration)	Mar. 2017	2,409	2,636	1.1	1,067	2.5	1,086	-290
		Equity Attributable to Owners of the Parent	Interest-bearing Debt	DER	EBITDA	Interest-bearing Debt/EBITDA	Operating Cash Flow	Investing Cash Flow
JXTG HD (5020)	Mar. 2017	17,071	24,326	1.4	5,171	4.7	2,257	-2,519
	Mar. 2018	25,395	22,599	0.9	7,706	2.9	7,071	-951
	Mar. 2019	27,178	22,179	0.8	6,519	3.4	3,441	-2,069
		Equity Capital	Interest-bearing Debt	DER	EBITDA	Interest-bearing Debt/EBITDA	Operating Cash Flow	Investing Cash Flow
Total of 4 Companies	Mar. 2017	29,479	46,072	1.6	10,393	4.4	5,165	-6,243
	Mar. 2018	39,302	39,148	1.0	12,965	3.0	10,838	-2,910
	Mar. 2019	41,417	39,482	1.0	11,411	3.5	6,757	-4,596

(Source: Prepared by JCR based on financial materials of above companies)

- Notes:
7. Interest-bearing debt is a sum of borrowings, corporate bonds and CP.
 8. Cosmo Energy HD's equity capital and interest-bearing debt are amounts after evaluation of subordinated loan's equity content.
 9. TonenGeneral Sekiyu's EBITDA, Operating Cash Flow and Investing Cash flow for fiscal year ended March 2017 are the results for the fiscal year ended December 2016.
 10. JXTG HD's fiscal year ended March 2016 figures are results of JX Holdings under Japanese GAAP.
 11. Total of 4 companies' figures for fiscal year ended March 2017 are total of 5 companies including TonenGeneral Sekiyu before business integration.
 12. Total of 4 companies' Equity Capital is a sum of Shareholders' Equity under Japanese GAAP and Equity Attributable to Owners of the Parent under IFRS.

<Reference>

Issuer: SHOWA SHELL SEKIYU K.K.

Long-term Issuer Rating: A Outlook: Positive

Issuer: Idemitsu Kosan Co., Ltd.

Long-term Issuer Rating: A Outlook: Positive

Issuer: JXTG Holdings, Inc.

Long-term Issuer Rating: A+ Outlook: Positive

Issuer: Cosmo Energy Holdings Co., Ltd.

Long-term Issuer Rating: BBB Outlook: Stable

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