

Highlights of Oil Distributors' Financial Results for Fiscal Year 2017

The following are Japan Credit Rating Agency, Ltd. (JCR)'s view of the current status and highlights for rating concerning financial results for FY2017 and earnings outlook for FY2018 of 4 oil distributors: JXTG Holdings, Inc., ("JXTG HD") with fiscal year-end in March, SHOWA SHELL SEKIYU K.K. ("SHOWA SHELL SEKIYU") with fiscal year-end in December, Idemitsu Kosan Co., Ltd. ("Idemitsu Kosan") with fiscal year-end in March, and Cosmo Energy Holdings Co., Ltd. ("Cosmo Energy HD") with fiscal year-end in March.

1. Industry Trend

Dubai crude oil price for FY2017 increased by US\$9 from FY2016 to US\$55.9 per barrel. Thanks to cooperative reduction of oil by OPEC and non-OPEC oil-producing countries started in January 2017, supply-demand balance improved and excess inventory was reduced. The crude oil price on a monthly basis began to rise in July and has been staying at over US\$60 in and after November 2017. Due to the U.S.'s restart of economic sanctions against Iran following its breakaway from the Nuclear Deal with Iran and concerns about possible tightening of supply-demand balance as a result of reduction of production by Venezuela, the price has been over US\$70 since April 2018. The price is expected to stay high for the time being. Given the shale oil production in the U.S. is starting to increase as the crude oil price increases, however, it is unlikely that the crude oil price will constantly increase.

Domestic demand for oil products has been declining. In FY2017, fuel oil as a whole declined 1.2% year-on-year to 174,740 thousand kl and gasoline declined 1.3% year-on-year to 51,830 thousand kl. According to "Demand Outlook for Oil Products from FY2018 to FY2022" 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 1.7% annually and gasoline will decline 2.3% annually for the 5 years. As shown by this outlook, it is forecasted that the domestic demand for oil products will continue to decline.

For the supply, on the other hand, there was a significant improvement in FY2017. With completion of measures for meeting the guidelines under the 2nd public notice of Energy Supply Structure Sophistication Act, the whole domestic refining capacity in the industry was reduced by about 10% from a year earlier to 3,519 thousand barrels per day as of March 31, 2017. Business integration of JX Group and TonenGeneral Group in April 2017 created JXTG Group, which has 50% share for domestic fuel oil sales. Business integration between Idemitsu Kosan and SHOWA SHELL SEKIYU has taken slightly longer time, but the 2 companies are strengthening and promoting their collaborative businesses through creating a corporate group ahead of their business integration. As a result of development of the industry reorganization into the 2 big groups, the order in the industry is maintained, which led to reduction of excessive competition.

2. Financial Results

The total operating income of the 4 oil distributors (Gross Profit - SG & A Expenses is used only for JXTG HD) for FY2017 improved for 3 years in a row to 894.4 billion yen (37.1% year-on-year increase). The total amount in FY2016 was the total of 5 companies with TonenGeneral Sekiyu before business integration included in addition to the 4 companies (Chart 1). The 4 companies continued to record a high level of inventory valuation gain amounting 191.4 billion yen in total for FY2017 (231.7 billion yen in total for the 5 companies for FY2016). The total operating income of the 4 oil distributors excluding the inventory valuation effect for FY2017 significantly increased to 703 billion yen (67.2% year-on-year increase). The primary reason for the increase of the income was the improved margin of oil products against the background of tightening of domestic supply-demand balance and the consequent significant increase of oil business income of these 4 companies.

All 4 companies do not expect inventory valuation effect and expect their operating income to remain unchanged or drop for FY2018. For the operating income excluding inventory valuation effect, 3 companies excluding Idemitsu Kosan expect their operating income to increase for FY2018, and

JCR sees that their business performance will remain solid. The domestic supply-demand balance of oil products will remain tight, and the level of margin which improved in FY2017 will be roughly maintained. An improvement of businesses other than oil business is expected for JXTG HD in which the impairment loss of the Caserones Copper Mine recorded in FY2016 is expected to be eliminated, SHOWA SHELL SEKIYU in which the energy solutions business will turn into the black, and Cosmo Energy HD in which the production at the Hail Oil Field will increase.

For the financial aspect, all companies increased their equity capital (equity attributable to owners of the parent company for JXTG HD). Thanks to the increased free cash flow, reduction of interest-bearing debt has progressed. As a result, DER based on the 4 companies' equity capital (same as above) and interest-bearing debt after evaluation of subordinated loan's equity content for both numerator and denominator for Cosmo Energy HD improved to 1.0x as of the end of FY2017 from 1.6x which was a result by 5 companies including TonenGeneral Sekiyu before business integration as of the end of FY2016 (Chart 2). The aggregate interest-bearing debt/ EBITDA ratio of the 4 companies in total for FY2017 based on their total EBITDA and interest-bearing debt (same as above) improved to 3.0x from 4.4x a year earlier.

3. Highlights for Rating

An improvement of margin of oil products led the increase of profit for each oil distributor for FY2017. Although every company expects margin of oil products to remain unchanged or slightly drop in FY2018, the margin will continue to support business performance. It is expected that domestic supply-demand balance for oil products will remain favorable for oil distributors against the background of structural reforms in supply. JCR will closely watch whether the supply-demand condition can worsen and sustainability of the good condition. Given that tightening of domestic supply-demand conditions was partly caused by improved export profitability associated with rise of overseas market, JCR will closely watch the overseas markets for oil products.

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. Inventory valuation losses were primary reasons for the worsening of business results for oil distributors in FY2014 and FY2015, but inventory valuation gains pushed up their business results in FY2016 and FY2017. They do not incorporate effects from inventory valuation into their earnings forecasts for FY2018. They expect, on the other hand, an increase of profit for the oil exploration business thanks to the rising of crude oil price. The current crude oil price is above their assuming prices, and JCR considers at the moment it is less likely that the price will sharply fall in the short run. In light of the high volatility of crude oil price, however, JCR considers that future trend should be carefully watched.

The industry reorganization will promote stability of industry order and have a plus effect on their business performance through realization of synergistic effects. Synergistic effects for JXTG HD in FY2017 reached as much as 44.1 billion yen, far exceeding the initially estimated amount of 23 billion yen. JXTG HD estimates the effects in FY2018 will reach 65 billion yen, and the effects are expected to steady progress towards the goal of 100 billion yen for FY2019. Despite the stagnated progress towards business integration between SHOWA SHELL SEKIYU and Idemitsu Kosan, the 2 companies aim to achieve a synergistic effect of 30 billion yen in FY2019 through strengthening and promoting collaborative businesses ahead of their business integration.

In the face of the declining domestic demand for oil products, oil distributors are making efforts to expand businesses in the fields other than oil. Idemitsu Kosan's electronic materials and Cosmo Energy HD's renewable energy businesses will grow in the future, but it will take time for these businesses to contribute to their profits. SHOWA SHELL SEKIYU's energy solutions business and JXTG HD's metals business both recorded an operating loss for FY2017. Given that each company is securing a decent level of profit from oil business, impact of such losses on business results and financial structure is limited. JCR will confirm a progress of profit improvement for businesses other than oil.

Although there remain differences in financial structure among companies, their financial structures in general are improving. Given the highly volatile earnings structure, however, JCR considers that further improvement of financial structure is necessary. It is assumed that various investments for business stability and business expansion in the growth area will be required over a medium and long term. In the midst of increasing expectations for expansion of return of profits to shareholders, JCR will pay attention to the future developments as to whether oil distributors can further improve their financial structure, while implementing required investments.

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(Chart 1) Financial Results of Oil Distributors

(JPY 100 mn, %)

FY		Net Sales	Operating Income	Ordinary Income	Net Income Attributable to Owners of the Parent Company	Inventory Valuation Effects	Operating Income Excluding Inventory Valuation Effects	Net Income/Sales
SHOWA SHELL SEKIYU (5002)	Dec. 2016	17,260	464	478	169	112	352	1.0
	Dec. 2017	20,459	784	929	427	244	540	2.1
	Jan.-Dec. 2018 F	21,000	770	770	510	90	680	2.4
Idemitsu Kosan (5019)	Mar. 2017	31,903	1,352	1,399	881	331	1,021	2.8
	Mar. 2018	37,306	2,013	2,263	1,623	311	1,702	4.4
	Mar. 2019 F	39,000	1,540	1,700	1,030	0	1,540	2.6
Cosmo Energy HD (5021)	Mar. 2017	22,922	921	814	532	394	527	2.3
	Mar. 2018	25,231	1,118	1,168	728	210	908	2.9
	Mar. 2019 F	27,200	1,180	1,210	570	0	1,180	2.1
TonenGeneral Sekiyu (before business integration)	Dec. 2016	20,893	810	766	644	80	730	3.1

		Net Sales	Gross Profit - SG & A Expenses	Operating Income	Profit Attributable to Owners of Parent	Inventory Valuation Effects	Operating Income Excluding Inventory Valuation Effects	Net Income/Sales
JXTG HD (5020)	Mar. 2017	70,250	2,973	2,711	1,500	1,400	1,311	2.1
	Mar. 2018	103,010	5,027	4,875	3,619	1,149	3,726	3.5
	Mar. 2019 F	107,000	N.A.	4,900	3,100	0	4,900	2.9

		Net Sales	Operating Income	—	Net Income	Inventory Valuation Effects	Operating Income Excluding Inventory Valuation Effects	Net Income/Sales Ratio
Total of 4 Companies	FY2016	163,228	6,520	N.A.	3,726	2,317	4,203	2.3
	FY2017	186,006	8,942	N.A.	6,397	1,914	7,028	3.4
	FY2018 F	194,200	N.A.	N.A.	5,210	90	N.A.	2.7

(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, and its figures for FY2016 are results of JX Holdings, Inc.
 3. SHOWA SHELL SEKIYU's fiscal year ending March 2019 was an irregular accounting period of 15 months, but the above figures are 12-month forecasts by SHOWA SHELL SEKIYU.
 4. Total of 4 companies for FY2016 is total of 5 companies including TonenGeneral Sekiyu before business integration.
 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 Company under Japanese GAAP and Profit Attributable to Owners of Parent under IFRS.

(Chart 2) Financial Conditions of Oil Distributors

(JPY 100 mn, times, %)

FY		Shareholders' Equity	Interest-bearing Debt	DER	EBITDA	Interest-bearing Debt/ EBITDA	Operating Cash Flow	Investing Cash Flow
SHOWA SHELL SEKIYU (5002)	Dec. 2015	2,226	1,554	0.7	266	5.8	748	▲ 436
	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
Idemitsu Kosan (5019)	Mar. 2016	5,006	9,095	1.8	606	15.0	2,163	▲ 980
	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
Cosmo Energy HD (5021)	Mar. 2016	1,380	7,271	5.3	▲ 22	-	184	▲ 328
	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
TonenGeneral Sekiyu (before business integration)	Dec. 2015	2,329	3,342	1.4	262	12.7	1,709	▲ 441
	Mar. 2017	2,409	2,636	1.1	1,067	2.5	1,086	▲ 290

		Equity Attributable to Owners of the Parent Company	Interest-bearing Debt	DER	EBITDA	Interest-bearing Debt/ EBITDA	Operating Cash Flow	Investing Cash Flow
JXTG HD (5020)	Mar. 2016	14,989	25,613	1.7	1,654	15.5	5,549	▲ 3,077
	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

		Equity Capital	Interest-bearing Debt	DER	EBITDA	Interest-bearing Debt/EBITDA	Operating Cash Flow	Investing Cash Flow
Total of 4 Companies	FY2015	25,932	46,877	1.8	2,767	16.9	10,355	▲ 5,264
	FY2016	29,479	46,072	1.6	10,393	4.4	5,165	▲ 6,243
	FY2017	39,302	39,148	1.0	12,965	3.0	10,838	▲ 2,910

(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 Mar. 2017 are the results for the fiscal year ended December 2016.
 10. JXTG HD's FY ended Mar. 2016 figures are results of JX Holdings under Japanese GAAP.
 11. Total of 4 companies for FY2016 and FY2017 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 Company under IFRS.

<Reference>

Issuer: JXTG Holdings, Inc.

Long-term Issuer Rating: A+ Outlook: Stable

Issuer: SHOWA SHELL SEKIYU K.K.

Long-term Issuer Rating: A Outlook: Stable

Issuer: Idemitsu Kosan Co., Ltd.

Long-term Issuer Rating: A- Outlook: Positive

Issuer: Cosmo Energy Holdings Co., Ltd.

Long-term Issuer Rating: BBB Outlook: Negative

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