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Highlights of Oil Distributors' Financial Results for Fiscal Year Ended March 2021

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 2021 (FY2020) and earnings outlook for FY2021 of 3 companies: Idemitsu Kosan Co., Ltd. ("Idemitsu Kosan") (security code: 5019), ENEOS Holdings, Inc. ("ENEOS HD") (security code: 5020), and Cosmo Energy Holdings Co., Ltd. ("Cosmo Energy HD") (security code: 5021).

1. Industry Trend

Dubai crude oil price for FY2020 was USD 45 per barrel, a decrease of USD 15 per barrel compared to FY2019. In addition to the decline in demand due to the COVID-19 pandemic expansion, breakdown of oil production cut talks between OPEC members and non-OPEC oil-producing countries caused a sharp drop in the crude oil prices to USD 23 in April 2020, the lowest level since 2003, and the prices have been rising since May as oil-producing countries implemented coordinated production cuts and economic activity recovered around the world. From September to October, the price entered an adjustment phase, but in and after November, it began to rise again, and in March 2021, it reached USD 64, recovering to the level before the COVID-19 pandemic outbreak. Going forward, increased demand associated with spread of COVID-19 vaccines and other factors are expected to drive up the price of crude oil. However, the increase in demand may slow down depending on the COVID-19 pandemic situations, such as spread of variants. In addition, production trends in oil-producing countries and geopolitical risks in the Middle East are expected to have an impact on the crude oil prices.

Domestic demand for petroleum products has been on a long-term downward trend, with the decline widening in FY2020 due to the impact of COVID-19 pandemic expansion. According to Petroleum Statistics by the Ministry of Economy, Trade and Industry, the overall sales volume of domestic fuel oil in FY2020 was 151.53 million kl (down 6.2% year-on-year), with gasoline sales decreasing to 45.23 million kl (down 7.9% year-on-year). In addition, sales volume of jet fuel dropped sharply to 2.73 million kl (down 47.0% year-on-year) due to sluggish air passenger demand, especially for international flights. In FY2021, domestic demand for petroleum products is expected to increase slightly with a rebound from the decline in the previous fiscal year. However, the long-term downward trend will remain unchanged, and the pace of demand decline may accelerate for the purpose of realizing carbon neutrality.

The industry order has stabilized against the backdrop of industry restructuring. Even as demand declined due to the expansion of COVID-19 pandemic, there was little excessive competition, and operations were conducted with an emphasis on securing margins. Imports from overseas have been limited in volume, and JCR sees that oil distributors can continue to secure a certain level of margins in the future.

2. Financial Results

Total operating income of the 3 companies for FY2020 (Gross Profit - SG & A Expenses is used only for ENEOS HD) significantly improved to 522.3 billion yen (from a loss of 53.1 billion yen in FY2019) (Chart 1). Although the oil exploration business saw a decline in profit (excluding the improvement related to impairment losses at ENEOS HD) due to the decline in average crude oil price during the period, improvement in inventory valuation effect associated with rise in crude oil prices from the beginning to the end of the period and improvement in margins for petroleum products thanks to positive time lag effect boosted the performance. Excluding inventory valuation effect, the total operating income of the 3 companies (same as above) for FY2020 was 455.3 billion yen (up 52.7% year-on-year), the first increase in two years.

By segment, while petroleum products and ENEOS HD’s metal business, where business environment turned around, increased the profits, almost all other segments decreased their profits. In addition to oil exploration business, petrochemicals also posted lower profits or losses due to lower demand and lower selling prices. In the electricity retail business, higher procurement costs due to a sharp rise in wholesale prices were a factor for the deterioration of profits.

On the financial front, total equity capital of the 3 companies (equity attributable to owners of the parent for ENEOS HD) increased, mainly thanks to the return of net income to the black figure. In addition, interest-bearing debt decreased along with an increase in operating cash flow. As a result, at the end of FY2020, DER based on total equity capital of the 3 companies (same as above) and their interest-bearing debt (Cosmo Energy HD's amounts are after evaluation of equity content of subordinated loan for both figures) was 1.0x, a slight improvement from 1.1x at the end of FY2019 (Chart 2). The interest-bearing debt/ EBITDA ratio for FY2020 based on their total EBITDA excluding inventory valuation effect and interest-bearing debt (same as above) improved to 4.0x from 5.3x for FY2019.

3. Highlights for Rating

Each company expects an increase in operating income excluding inventory valuation effect for FY2021. In the petroleum products business, the positive time lag that contributed to the income increase in FY2020 will disappear, but sales volume is expected to increase through recovery in demand. In addition, higher crude oil prices and market prices for petrochemicals are expected to contribute to the income growth.

Crude oil prices will continue to be a fluctuating factor for forecasts of FY2021 business performance. All 3 companies assume that the Dubai crude oil price will be USD 60 per barrel for FY2021, an increase of USD 15 per barrel compared to FY 2020. The price has been stable around USD 65 per barrel since March 2021, but crude oil prices have been volatile and will continue to fluctuate due to a variety of factors. In addition to demand trend, JCR needs to pay attention to the impact on supply of coordinated production cuts by OPEC members and non-OPEC oil-producing countries, geopolitical risks in oil-producing countries, and other factors.

Among the petroleum products, there has been a marked decrease in the sales volume of jet fuel, and the product mix is less balanced than that before the COVID-19 pandemic outbreak. Although the sales volume of jet fuel will increase in FY2021, it is not expected to return to the level in FY2019. Furthermore, recovery of passenger demand has been slow at present, especially the number of international flights has been low, and there are concerns that recovery of jet fuel will be delayed. If companies use imports and exports to adjust the balance of their product mix, they will be affected by overseas product market conditions.

In FY2019, financial indicators deteriorated due to deteriorating business performance, but in FY2020, their financial structures have improved again. However, pace of financial improvement is expected to be slow in the future due to various investments for business expansion in growth areas and enhancement of return of their profits to shareholders. The level of financial indicators itself varies from company to company, and degree of improvement at each company in the future may differ. JCR believes that it is highly important for oil distributors to maintain a sound financial structure, as they have an earnings structure with highly volatile business performance. JCR will pay attention to whether they can further improve their financial structures, while making necessary investments.

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(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 Effect	Operating Income less Inventory Valuation	Net Income/ Net Sales
Idemitsu Kosan (5019)	Mar. 2020	60,458	▲38	▲139	▲229	▲893	854	▲0.4
	Mar. 2021	45,566	1,400	1,083	349	75	1,325	0.8
	Mar. 2022F	56,800	1,350	1,400	850	0	1,350	1.5
Cosmo Energy HD (5021)	Mar. 2020	27,380	138	162	▲281	▲522	660	▲1.0
	Mar. 2021	22,332	1,012	973	859	208	804	3.8
	Mar. 2022F	21,500	930	880	400	80	850	1.9

	FY Ended	Net Sales	Gross Profit – SG & A Expenses	Operating Income	Profit Attributable to Owners of the Parent	Inventory Valuation Effect	Operating Income less Inventory Valuation	Net Income/ Net Sales
ENEOS HD (5020)	Mar. 2020	100,117	▲631	▲1,130	▲1,879	▲2,098	967	▲1.9
	Mar. 2021	76,580	2,809	2,541	1,139	387	2,154	1.5
	Mar. 2022F	95,000	N.A.	2,600	1,400	300	2,300	1.5

		Net Sales	Operating Income	–	Net Income	Inventory Valuation Effects	Operating Income less Inv. Valuation Effects	Net Income/ Net Sales
Total of 3 Companies	Mar. 2020	187,956	▲531	—	▲2,390	▲3,513	2,981	▲1.3
	Mar. 2021	144,478	5,223	—	2,348	670	4,553	1.6
	Mar. 2022F	173,300	N.A.	—	2,650	380	N.A.	1.5

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

Notes:
1. Figures for fiscal year ending March 2022 are the forecasts announced by each company.
2. Figures for ENEOS HD are based on IFRS.
3. Gross Profit - SG & A Expenses is used only for ENEOS HD in Total of 3 Companies' operating income.
4. Total of 3 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 less Inventory Valuation	Interest-bearing Debt/ EBITDA less Inventory Valuation	Operating Cash Flow	Investing Cash Flow
SHOWA SHELL SEKIYU*	Jan. - Dec. 2018	2,707	1,262	0.5	962	1.3	901	▲ 459
Idemitsu Kosan (5019)	Mar. 2019	8,421	9,398	1.1	2,349	4.0	1,510	▲ 1,222
	Mar. 2020	11,500	13,036	1.1	2,043	6.4	▲327	▲ 1,344
	Mar. 2021	11,509	12,797	1.1	2,545	5.0	1,704	▲ 1,098
Cosmo Energy HD (5021)	Mar. 2019	3,110	6,641	2.1	1,521	4.4	904	▲ 845
	Mar. 2020	2,547	6,663	2.6	1,173	5.7	1,117	▲ 842
	Mar. 2021	3,399	5,943	1.7	1,479	4.0	1,674	▲ 845

		Equity Attributable to Owners of the Parent	Interest-bearing Debt	DER	EBITDA less Inventory Valuation	Interest-bearing Debt/ EBITDA less Inventory Valuation	Operating Cash Flow	Investing Cash Flow
ENEOS HD (5020)	Mar. 2019	27,178	22,179	0.8	6,305	3.5	3,441	▲ 2,069
	Mar. 2020	23,110	23,008	1.0	4,853	4.7	5,107	▲ 3,713
	Mar. 2021	23,251	20,369	0.9	5,756	3.5	6,790	▲ 3,067

		Equity Capital	Interest-bearing Debt	DER	EBITDA less Inventory Valuation	Interest-bearing Debt/ EBITDA less Inventory Valuation	Operating Cash Flow	Investing Cash Flow
Total of 3 Companies	Mar. 2019	41,417	39,482	1.0	11,138	3.5	6,757	▲ 4,596
	Mar. 2020	37,158	42,708	1.1	8,070	5.3	5,897	▲ 5,900
	Mar. 2021	38,159	39,110	1.0	9,780	4.0	10,170	▲ 5,012

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

Notes:
5. Interest-bearing debt is a sum of corporate bonds and borrowings for ENEOS HD and a sum of borrowings, corporate bonds, and CP for Idemitsu Kosan and Cosmo Energy HD.
6. 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.
7. Cosmo Energy HD's equity capital and interest-bearing debt are amounts after evaluation of subordinated loan's equity content.
8. Total of 3 Companies' figures for fiscal year ended March 2019 are total of 4 companies including SHOWA SHELL SEKIYU before business integration.
9. Total of 3 Companies' Equity Capital is a sum of Shareholders' Equity under Japanese GAAP and Equity Attributable to Owners of the Parent under IFRS.

*before business integration

<Reference>

Issuer: Idemitsu Kosan Co., Ltd.

Long-term Issuer Rating: A+ Outlook: Stable

Issuer: ENEOS Holdings, Inc.

Long-term Issuer Rating: AA- Outlook: Stable

Issuer: Cosmo Energy Holdings Co., Ltd.

Long-term Issuer Rating: BBB Outlook: Positive

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