

Highlights of Oil Distributors' Financial Results for Fiscal Year Ended March 2020

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 2020 (FY2019) and earnings outlook for FY2020 of 3 companies: 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 and Impact of COVID-19 Pandemic

The COVID-19 pandemic impact on business performance of oil distributors is significant. Economic activities became stagnant in countries all over the world. Demands for petroleum products and petrochemicals are decreasing. In particular, declines of demands for jet fuel and gasoline are significant due to restrictions on people's movements both in Japan and abroad. Sales volumes of oil distributors are declining, and the lowered overseas product markets are deteriorating their profits from petroleum products exports and petrochemicals. Crude oil price has fallen due to the decreased demand, which is placing downward pressure on business performance of oil distributors through effects on their inventory valuation in oil business and reduction of profit from their oil exploration business.

Prior to the COVID-19 pandemic, domestic demand for petroleum products has been declining in the long run. According to Petroleum Statistics by the Ministry of Economy, Trade and Industry, domestic sales of fuel oil and gasoline for the fiscal year ended March 2020 (FY2019) decline 3.7% year-on-year and 3.0% year-on-year to 161.6 million kl and 49.1 million kl, respectively. It is highly likely that the decrease will become larger in FY2020 than before due to the COVID-19 pandemic impact. Along with recovery of domestic economic activities, the impact is expected to be reduced, but it is necessary to confirm the degree of the effects and demand trend over the medium and long term.

Dubai crude oil price for FY2019 decreased by USD 9 from FY2018 to USD 60.3 per barrel. The price, which was above USD 70 in April 2019, began to decline and stayed at around USD 60 from June to November 2019. The price subsequently recovered once thanks to factors such as expanded reduction of oil production by OPEC members and non-OPEC members and progress of U.S.-China trade talks, but rapidly declined in and after February 2020 due to breakdown of negotiations among OPEC members and non-OPEC members for reduction of oil production in addition to the decreased demand following the COVID-19 pandemic. Although the price is beginning to gradually rise in and after May 2020 along with restart of economic activities in countries all over the world, the price remains at around USD 35. The crude oil price will remain unstable due to the conditions of the COVID-19 pandemic, U.S.-China trade frictions, production by oil-production countries, geopolitical risks, etc.

2. Financial Results

Total operating income of the 3 companies (Gross Profit - SG & A Expenses is used only for JXTG HD) for FY2019 significantly worsened to 53.1 billion yen in the red from 759.5 billion in the black for FY2018 based on total of 4 companies including SHOWA SHELL SEKIYU's results from January to December 2018 (Chart 1). The worsened inventory valuation effect due to rapid fall of crude oil price and also deteriorated margins of petroleum products due to the time lag in the fourth quarter became factors for placing downward pressure on the business performance. The decreased profits from the oil exploration business due to fall of crude oil price and reduced margins due to fall of market for petrochemicals had negative effects on the business performance. As a result, total operating income of the 3 companies (same as above) for FY2019 excluding inventory valuation effect decreased a significant 59.3% year-on-year to 298.2 billion yen.

By segment, operating income of almost all segment decreased for all 3 companies. In addition to businesses related to petroleum products, petrochemicals, and oil exploration of the 3 companies, JXTG HD's metals business and Idemitsu Kosan's coal business all decreased their operating income

due partly to fall of resources prices. For businesses in growth areas on which they focus their attentions, the impacts on business performance were small because of the small business sizes.

For the financial aspect, total equity capital of the 3 companies (equity attributable to owners of the parent for JXTG HD) decreased due mainly to the net losses. The increased amount of use in the investing cash flow and enhanced return of their profits to shareholders slightly increased their interest-bearing debt. As a results, DER based on the 3 companies' total equity capital (same as above) and interest-bearing debt (Cosmo Energy HD's amounts are after evaluation of equity content of subordinated loan for both figures) as of March 31, 2020 slightly worsened to 1.1x from 1.0x as of March 31, 2019 based on total of 4 companies including SHOWA SHELL SEKIYU's results as of December 31, 2018 (Chart 2). The interest-bearing debt/ EBITDA ratio of the 3 companies in total based on their total EBITDA excluding inventory valuation effect for FY2019 and interest-bearing debt as of the end of FY2019 (same as above) worsened to 5.3x from 3.5x for FY2018.

3. Highlights for Rating

All 3 companies expect their operating income excluding the inventory valuation effect for FY2020 to slightly decrease. JXTG HD expects the income (IFRS) to increase, but it is considered that the income is expected to be effectively a slight decline excluding one-time factor in the oil and natural gas business. It is assumed that severe business environments including the declining demand and stagnant overseas markets for petroleum products and petrochemicals will continue.

Variation factor in the earnings forecasts for FY2020 is crude oil price. JXTG HD set USD 30 as crude oil price for FY2020, Idemitsu Kosan set it at USD 25, and Cosmo Energy HD set it at USD 29, assuming that the price will be less than half of the price in FY2019. Crude oil price is highly volatile by nature, and is significantly declining at the moment due to the worsening supply-demand balance. Although OPEC members and non-OPEC members agreed to cut oil production, oil is considered to remain in an oversupply condition with large drop of demand due to the COVID-19 pandemic. There are also signs of rekindling of the U.S.-China trade frictions, which may slow down recovery of demand. For supply side, geopolitical risks such as Iran need to be closely watched.

There are concerns that the decreasing demand may have an impact on production cost through the declining production volume as well as revenue drop through decrease of sales volume. As the mainstay oil refining business is facility-intensive industry, drop of capacity utilization rate can lead to the rise of production cost per unit. Additionally, as petroleum products are joint products, it is difficult to adjust production volume for each petroleum product. Demands for jet fuel and gasoline are significantly declining, collapsing the balance of product mix. If this condition continues, it may lead to restrictions on production.

Margins of petroleum products in Japan are stable. Thanks to advance of industry reorganization, there has been no excess competition for sales in the phase of demand decline, and it seems that imported products have not largely increased. The margins dropped in the fourth quarter of FY2019 due to time lag caused by rapid decline of crude oil price, but companies will be able to keep stable margins in and FY2020 excluding these one-time factors.

Although all companies had been improving their financial structure along with improved earnings capacity, their financial indicators worsened in FY2019 due to the deteriorated business performance. Going forward, their financial improvement will be slow due to expansion of return of their profits to shareholders as well as various investments including those for business expansion in growth areas. In light of the facts that there are differences among companies in terms of level of financial indicators and that their earnings volatility is large, JCR sees that it is important to continue securing a sound financial structure. JCR will pay attention to whether they can 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 Effect	Operating Income less Inventory Valuation	Net Income/ Net Sales
SHOWA SHELL SEKIYU*	Jan. – Dec. 2018	24,946	818	848	440	106	712	1.8
Idemitsu Kosan (5019)	Mar. 2019	44,251	1,793	1,691	814	60	1,733	1.8
	Mar. 2020	60,458	-38	-139	-229	-893	854	-0.4
	Mar. 2021F	39,000	600	300	50	0	600	0.1
Cosmo Energy HD (5021)	Mar. 2019	27,703	946	966	531	-107	1,053	1.9
	Mar. 2020	27,380	138	162	-281	-522	660	-1.0
	Mar. 2021F	20,400	345	300	145	0	345	0.7

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
JXTG HD (5020)	Mar. 2019	111,296	4,036	5,370	3,223	214	5,156	2.9
	Mar. 2020	100,117	-631	-1,130	-1,879	-2,098	967	-1.9
	Mar. 2021F	73,400	N.A.	1,100	400	-550	1,650	0.5

		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 3 Companies	Mar. 2019	208,197	7,595	N.A.	5,009	273	7,321	2.4
	Mar. 2020	187,956	-531	N.A.	-2,390	-3,513	2,981	-1.3
	Mar. 2021F	132,800	N.A.	N.A.	595	-550	N.A.	0.4

(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 3 companies for fiscal year ended March 2019 is total of 4 companies adding SHOWA SHELL SEKIYU before business integration with Idemitsu Kosan.
 5. Gross Profit - SG & A Expenses is used only for JXTG HD in total of 3 companies' operating income.
 6. 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*	Dec. 2017	2,533	1,174	0.5	819	1.4	473	-96
	Jan. - Dec. 2018	2,707	1,262	0.5	962	1.3	901	-459
Idemitsu Kosan (5019)	Mar. 2018	8,687	8,670	1.0	2,381	3.6	1,367	-898
	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
Cosmo Energy HD (5021)	Mar. 2018	2,686	6,704	2.5	1,292	5.2	1,926	-964
	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

		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
JXTG HD (5020)	Mar. 2018	25,395	22,599	0.9	6,557	3.4	7,071	-951
	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

		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. 2018	39,302	39,148	1.0	11,050	3.5	10,838	-2,910
	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

(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. Total of 3 companies' figures for fiscal years ended March 2018 and March 2019 are total of 4 companies including SHOWA SHELL SEKIYU before business integration.
 10. 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: JXTG Holdings, Inc.

Long-term Issuer Rating: AA- Outlook: Stable

Issuer: Cosmo Energy Holdings Co., Ltd.

Long-term Issuer Rating: BBB Outlook: Positive

Japan Credit Rating Agency, Ltd.

Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026

Information herein has been obtained by JCR from the issuers and other sources believed to be accurate and reliable. However, because of the possibility of human or mechanical error as well as other factors, JCR makes no representation or warranty, express or implied, as to accuracy, results, adequacy, timeliness, completeness or merchantability, or fitness for any particular purpose, with respect to any such information, and is not responsible for any errors or omissions, or for results obtained from the use of such information. Under no circumstances will JCR be liable for any special, indirect, incidental or consequential damages of any kind caused by the use of any such information, including but not limited to, lost opportunity or lost money, whether in contract, tort, strict liability or otherwise, and whether such damages are foreseeable or unforeseeable. JCR's ratings and credit assessments are statements of JCR's current and comprehensive opinion regarding redemption possibility, etc. of financial obligations assumed by the issuers or financial products, and not statements of opinion regarding any risk other than credit risk, such as market liquidity risk or price fluctuation risk. JCR's ratings and credit assessments are statements of opinion, and not statements of fact as to credit risk decisions or recommendations regarding decisions to purchase, sell or hold any securities such as individual bonds or commercial paper. The ratings and credit assessments may be changed, suspended or withdrawn as a result of changes in or unavailability of information as well as other factors. JCR receives a rating fee paid by issuers for conducting rating services in principle. JCR retains all rights pertaining to this document, including JCR's rating data. Any reproduction, adaptation, alteration, etc. of this document, including such rating data, is prohibited, whether or not wholly or partly, without prior consent of JCR.

JCR is registered as a "Nationally Recognized Statistical Rating Organization" with the U.S. Securities and Exchange Commission with respect to the following four classes. (1) Financial institutions, brokers and dealers, (2) Insurance Companies, (3) Corporate Issuers, (4) Issuers of government securities, municipal securities and foreign government securities.

JCR publishes its press releases regarding the rating actions both in Japanese and in English on the same day. In case that it takes time to translate rating rationale, JCR may publicize the summary version, which will be replaced by the full translated version within three business days. (Regarding Structured Finance products, JCR only publicize the summary version in English.)

Copyright © Japan Credit Rating Agency, Ltd. All rights reserved.