◆ Cosmo Energy Holdings (5021)

Financial Results for FY2018

- Financial Results Explanatory Meeting for Analysts and Investors – Summary of Q&A

－This material contains descriptions regarding future prospects. Notes are provided at the end of this material －

1. Date and time : May 10, 2019 (Fri) 10:00 a.m. - 11:00 a.m.
2. Attendees : 86 persons
3. Main questions and answers :

<Petroleum business>

Q1: Please tell me about the factors behind the increase in sales volume in FY2018 compared to FY2017.

A1: In addition to retaining our customers, we focused on selling mainly diesel fuel through measures such as establishing a fleet SS.

Q2: Among the factors behind the increase in profit in the petroleum business in FY2019 is the impact of the supply to Kygnus Sekiyu. Please tell me why it has already had a significant impact on earnings, although the supply will not start until around 2020.

In addition, the sales volume is also increasing. If it becomes a short position, will profit increase due to the impact of the volume increase?

A2: With regard to Kygnus, we are implementing part of the supply in advance as a preliminary exercise. Given the current difference in domestic and overseas prices, we believe that we will be able to expect some profit even if we sell externally supplied oil.

Q3: Please provide me with the breakdown of “Expense, Other” of 6.8 billion yen in the FY2019 plan.

A3: It comprises in-house fuel costs of -0.3 billion yen, an increase in transfer costs of -1.8 billion yen (mainly an increase in fuel costs), an increase in sales variable expenses of -2.1 billion yen (mainly an increase in the payments to trucking companies), and depreciation and others of -2.6 billion yen.

Q4: Please tell me about Cosmo’s response to the IMO regulations.

A4: We have two issues regarding the IMO regulations: the treatment of high-sulfur C fuel oil and how to supply low-sulfur C fuel oil. We will address the former by establishing a system that does not produce high-sulfur C fuel oil by increasing the coker capacity of the Sakai Refinery. As for the latter, since there are two direct desulfurization units at the Chiba Refinery, there is room to produce low-sulfur C fuel oil, which allows for production based on market trends. We therefore believe that we have more options than other companies.

Q5: To what extent can you change the production of high-sulfur C fuel oil to low-sulfur C fuel oil after increasing the coker capacity of the Sakai Refinery to comply with the IMO regulations?

A5: The Chiba Refinery has two direct desulfurization units whose operating rate is approximately 70%, which provides room for operation. We have numerous options to choose from, such as changing the weight of processed crude oil depending on the market conditions of petroleum products.

Q6: Has the impact of the IMO regulations been reflected in the earnings forecast for FY2019?

A6: The margin assumptions for FY2019 do not include the impact of the IMO regulations. The margin was incorporated into the FY2019 plan, unchanged from the previous fiscal year. We expect an upswing of the margin as the start of compliance with the IMO regulations approaches, but we have not incorporated it into the plan.

Q7: Please tell us about the schedule for enhancing the coker capacity of the Sakai Refinery and its impact on income and losses in FY2019 and FY2020 as a result of the capacity enhancement.

A7: In the fall of FY2019, we will enhance the coker capacity during the regular maintenance conducted at the Sakai Refinery. Following the maintenance, high-sulfur C fuel oil will no longer be produced. Since there are various forecasts in terms of the impact on profit, it is difficult to calculate the specific impact, although improvements will be made.

Q8: What is your view on the impact of the consumption tax hike? In addition, what is your company's response to the Point Reward Project for Consumers using Cashless Payment?

A8: Demand for petroleum products will decrease due to the impact of the tax hike, but the impact of the 2% increase will be equivalent to a price fluctuation of around 3 yen/L. Compared to this fluctuation level, the movement of crude oil prices will have a greater impact. In addition, we are currently considering our response to the Point Reward Project.

<Oil E&P business>

Q9: You said that you would restrict the production volume of the Hail Oil Field. Please tell me about the timing and the amount of the restriction. Please also explain the outlook for the current recovery of the existing oil fields.

A9: The Hail Oil Field had been performing well, but the oil reservoir pressure fell more than expected, and the production volume fell to about 70% as a result. We will try water flooding and other secondary recovery methods in 2019, and through these the production volume will recover to its original volume by 2022. The ESP, which had problems last year, is now working well.

<Wind power generation>

Q10: Regarding offshore wind power generation, your company decided to participate in a project off the coast northwest of Aomori prefecture (Tsugaru). Please tell me your thinking behind this.

A10: We have now participated in four sites: off the coast northwest of Aomori (Tsugaru), the waters off Akita, Akita Port/Noshiro Port, and off the coast of Yuri Honjo. We believe that if we win all the bids, we could become a leading company. As for entering the offshore wind power business, we considered offshore wind power utilizing FIT in our medium-term management plan. Although there have been some changes in the environment since the plan was created, such as the development of legislation, we still believe that we have considerable advantages.

Q11: I would like to know more about your current technical efforts regarding offshore wind power generation and the company's future schedule.

A11: We do not consider that we have many technical issues. The government decides on the order of the sea area for offshore wind power generation, so if the order of the sea area that we are preparing for occurs more quickly, the operation will commence sooner.

Q12: Do you have an advantage regarding offshore wind power generation?

A12: Even though we do not have any experience in operating an offshore wind power business, the technology has already been established, so we do not have any problems with it. However, the buying power of major European companies can pose a threat to us. In Japan, there are complicated adjustments such as providing explanations to fisheries cooperatives, but we have an advantage because we have already been making adjustments for some time. In addition, bidding is not judged based on cost alone; whether we get along with the local community is also considered important.

<Cash flows and shareholder returns >

Q13: Please tell us about the forecasts for cash flows for FY2019 and the level of investment cash flows in the next fiscal year and beyond.

A13: In terms of investments from the next fiscal year onward, we plan to invest in preventive maintenance to maintain the high operation rate of the refinery in light of the investment for the second recovery at the Hail Oil Field, which was scheduled to be implemented under the next medium-term management plan, and in anticipation of petroleum products becoming short positions in the future. In addition, given the rising unit price of construction work, we expect our investment to increase.

The forecasts for cash flows in FY2019 are: 124.0 billion yen in cash flows from operating activities, 123.0 billion yen in cash flows from investing activities, an increase of 1.0 billion yen in free cash flow, and a decrease of 1.0 billion yen in cash flows from financial activities.

Q14: Will investments decrease much from the next fiscal year onward?

A14: Investments will increase, and earnings will also increase. If neither refinery failure nor a heavy fall in crude oil prices occurs, cash flows from operating activities will improve.

Q15: The dividend payout ratio is lower than those of other companies, even after the dividend increase. If you achieve the FY2019 plan, will you implement another increase?

A15: When developing the medium-term management plan, we expected the margin environment to deteriorate, but mainly due to the improved margin environment following the industry restructure, the net D/E ratio was less than two times at the end of FY2018, which was sooner than expected. Since Idemitsu Kosan Co. and Showa Shell Sekiyu K.K. will merge in FY2019, we expect that the margin environment will be stabilized further. Although the margin in the FY2019 plan remains unchanged from the previous fiscal year, the margin environment will improve once the IMO regulations take effect. Although they are not as high as other companies' returns, we would like to consider further returns to our shareholders while taking the balance with our financial position into consideration once our earnings have increased.

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