◆ Cosmo Energy Holdings (5021)
Financial Results for Third Quarter of FY 2019
- 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 : February 14, 2020 (Fri) 09:30 a.m. - 10:30 a.m.
2. Attendees : 53 persons
3. Main questions and answers

Q1: What is the impact of the contribution of Kygnus Sekiyu on the nine-month and full-year results?

A1: We expect that the full-year results will be approximately 10 billion yen as initially announced. The impact of differences between domestic and overseas gasoline prices will be limited.

Q2: What is the effect of the IMO regulations?

A2: Although the spread between the LSC fuel oil and HSC fuel oil is decreasing slightly, we expect that the effect of the IMO regulations will be 5 billion yen primarily in the fourth quarter.
While the market outlook is somewhat uncertain, we think that one of Cosmo's strengths is our ability to flexibly make changes according to market trends, such as changing crude oil procurement and equipment operation, and we are confident that we can handle the changes.

Q3: How many temporary factors are included in the reasons for the current downward revision of your financial forecasts?

A3: While the precise distinction of temporary factors is difficult, the temporary factors that might influence on our forecasts include a time lag that impacts on the 8 billion yen downward caused by a sharp drop in crude oil prices in 4Q (January to March), firstly. Secondly, an increase in imports and purchases partly as well as a decrease in exports due to typhoons, regular maintenance at Sakai Refinery and power failure in Yokkaichi. We think that these have an impact of 5 billion yen to 6 billion yen.

Q4: Your initial forecasts and results for the nine month period show an underachievement of 10.3 billion yen in the petroleum business. What are the reasons for this?

A4: The underachievement of 10.3 billion yen in the petroleum business includes an increase of 0.3 billion yen in the margin of four products and a decrease of 4.3 billion yen in other products. This was caused primarily by a decrease of 4.3 billion, including a significant fall in jet fuel and naphtha and a decline of 1.3 billion yen in other types of oil, which more than offset an increase of 3.2 billion yen in C heavy fuel. Sales volume rose by 0.8 billion yen. Export decreased by 2.5 billion yen due to the typhoons. Import and purchase dropped 3.3 billion yen. Other expenses declined 1.3 billion yen.

Q5: Comparison with the previous full-year plan shows an increase of 8.4 billion yen in expenses and others. What were the causes of the increase in expenses from the initial plan (May)?

A5: Repair expenses amounted to 1.7 billion yen. reward points for cashless payments cost 1.7 billion yen. We also incurred expenses resulting from the typhoons of approximately 1.5 billion yen. These added up to expenses of approximately 5 billion yen.

Moreover, a loss in barter and other deals of 1 billion yen was caused by the timing of the barter deals.

Although we initially planned to reduce cost through structural reform of the operational section of our refineries, refinery operation decreased due to issues largely related to the typhoons and we were unable to complete the reform. However, we plan to pay all these expenses by March and conservatively estimate the amounts.

Q6: What is your outlook for free cash flow and net DER after applying the revised plan?

A6: While the profit will decrease, we expect certain improvement in the operating balance thanks to the current decrease in oil prices. Free cash flow will decrease from our initial forecast, which is expected to be mostly offset.

While there is an issue of how to handle the refinancing of subordinated loans, we assume that in the most conservative scenario that does not consider subordinated loans, net DER will fall approximately 0.1 point.

Q7: How much deterioration in the business environment, such as margins and sales volumes, is assumed in this downward revision?

A7: First, the revision basically reflects the actual condition until January.

While the impact of COVID-19 may cause a further fall in oil prices or a decrease in product spreads depending on economic activities, the revision does not include an assumption to that extent. It includes up to the current fall in oil and product market prices.

We think jet fuel will be our focus in the sales volume for fiscal 2019, but do not assume a decrease in volume. Since Cosmo has many channels in the U.S. and European airline markets, we expect that the impact on sales volume will be limited.

Q8: How does the point reward program for cashless-payment increase your cost?

A8: We provide customers buying gasoline using a credit card issued by Cosmo with shopping points worth 2% of consumption tax as part of the sales promotion. The impact of this program is included in our financial forecasts for fiscal 2019.

Q9: Your reference material states that the forecasts assume an impairment risk of Qatar Petroleum Development. What is the background for this?

A9: Renewal of our interest in Qatar Petroleum Development will occur in 2022 and the remaining contract term is limited. We are reaching the stage where we need to examine the asset potential of the right to collect production sharing expenses posted in the current balance sheet. We assumed the maximum risk while consulting with an accountant, taking into account the oil price, production volume, and other factors. Conversely, the risk may decrease somewhat. We have estimated the impairment loss on Qatar Petroleum Development to be approximately 7 billion yen as the maximum risk currently shown.

Q10: Break down the net profit in this downward revision of the full-year forecasts by segment.

A10: We do not disclose net profit by segment. Of the decrease of 58.5 billion yen in ordinary profit, 51.5 billion yen is attributable to the petroleum business. The remainder includes the petrochemical business, the oil exploration and production business, and other businesses. The petroleum business has the largest impact on net profit. The effective tax rate in the petroleum business is low due to losses carried forward and its contribution to net profit is high. The decrease of 51.5 billion yen in ordinary profit in the petroleum business is equivalent to the impact of approximately 44 billion to 45 billion yen in terms of net profit.

This means that 44 billion to 45 billion yen in the decrease of 57.5 billion yen in net profit is an impact of the petroleum business and the remainder is slightly more than 10 billion yen. Of this, slightly less than 10 billion yen is attributable to extraordinary losses, such as the impairment loss on Qatar Petroleum Development. While profit in the oil exploration and production business is shown as an increase from the previous announcement, its contribution to net profit is low and its impact on net profit is small, even if it increases 4 billion to 5 billion yen.

Q11: Did you review your deferred tax assets in this revision of financial results?

A11: No, we did not.

Q12: You stated that you had assumed conservative expenses in the petroleum business in these financial forecasts. Do you expect the expenses to increase or decrease in the next fiscal year?

A12: The expenses for the entire Cosmo Group increased due to workstyle reform, the tightening of legal compliance, and other activities. In addition, we have a retail company called Cosmo Oil Sales Corporation, and expenses are rising in the industry as a whole largely due to labor shortages.

While it remains difficult to discuss the next fiscal year since we have not yet started budgeting, reasons for a decrease in expenses cannot be easily found.

In our effort to reduce expenses, we will ensure full operation and achieve the benefits of the operation while working to reduce the cost in operation activities.

Q13: You stated that you were adjusting the operation at Maruzen Petrochemical. Please provide details.

A13: Because the profitability of the segment that primarily sells products overseas is very low, we are adjusting operation and reducing export. The remaining 70% to 80% mostly sells products to industrial complexes, in which prices are based on cost and will not seriously affect profit even if the market significantly falls. Meanwhile, there is concern that demand on the other side of the supply chains of industrial complexes may substantially fall largely due to the current novel coronavirus outbreak and we must carefully observe the developments.

Q14: The current financial forecasts suggest that you expect the results for the petrochemical business in the fourth quarter to be a deficit. What are the reasons?

A14: Most products are sold based on cost and a decline in the market conditions of ethylene and benzene generally does not cause a chronic deficit. If we look at the fourth quarter alone, however, the petrochemical business is expected to incur a loss due to the current fall. The market for the paraxylene business of HCP is also deteriorating considerably and this fall will also impact the fourth quarter results.

Q15: What kind of risks will arise if the impact of COVID-19 is prolonged?

A15: The situation is still changing and we have yet to be able to analyze the extent of the impact. Factors such as the impact of the slowdown in the Chinese economy on the supply-demand balance is difficult to determine. The current market condition, however, is considered in the current financial forecasts.

We are using components made in China in part of our businesses, such as refineries, oil exploration and production. We must determine the impact, if any. The largest negative factor for us may be the prospects for the economic condition in China and its impact on the oil price and product spreads.

Q16: What are the reasons for the decrease in the impact of inventory of 5.7 billion yen for the nine month period and the relatively large fall despite a difference of only 1 dollar in the oil price from the initial forecast (from 65 U.S. dollars announced in May to the actual price of 64 U.S. dollars in the nine month period)?

A16: The inventory has been changing significantly due to the impact of the typhoons affecting the supply-demand balance, the abnormally warm winter, the regular maintenance, and other factors. For instance, Sakai Refinery carried out maintenance for the fall season. If inventory is increased in the first half of the fiscal year and reduced at the time of regular maintenance, the impact of inventory valuation expands. Products that were priced high in the first half and existed in the inventory were reduced in the season of low prices, which affected the inventory value.