◆ Cosmo Energy Holdings (5021)

Third Quarter of Fiscal 2020 - 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 10, 2021 (Wed) 18:00 p.m. – 19:00 p.m.
2. Attendees : 83 persons
3. Main questions and answers :

Q1: Could you give details of actual cash flows from operating activities and cash flows from investing activities for the first nine months of the fiscal year as well as your forecasts for free cash flow and the net debt-to-equity ratio following revision of the consolidated business forecast for the full year of FY2020?

A1: Cash provided by operating activities during the first nine months was 86.7 billion yen, while cash used in investing activities was 62.4 billion yen, resulting in positive free cash flow of just over 20 billion yen. On a full-year basis, we forecast positive free cash flow of just over 20 billion yen, though there is some uncertainty regarding capital expenditures. We expect the net debt-to-equity ratio to be below 2.0 on a full-year basis.

Q2: With respect to the Offshore Exploration Block 4 bid, could you give an idea of the schedule between now and the start of production and details of the timing of investment?

A2: Exploration generally takes 4-5 years. After that, a decision on investment will be made based on an assessment and from exploration to the start of production can take as long as 10 years. However, this block is adjacent to the exploration zone of Abu Dhabi Oil that is now in operation and we have a considerable degree of knowledge about it. We aim to start production as soon as possible before 2030. We expect that expenses for investment will be incurred from the mid to late 2020s onwards.

Q3: When you consider your ordinary profit forecast for next fiscal year compared with your FY2020 forecast for ordinary profit (inventory effects excluded) of 65 billion yen, what positive and negative factors do you foresee?

A3: Looking at qualitative factors, there is no scheduled major maintenance work next fiscal year, which is likely to help reduce per-unit operating cost due to lower fixed costs. Further, provided the effects of COVID-19 ease next fiscal year, reasonable market conditions and recovery in volumes are anticipated, which is important for us given that there is no scheduled major maintenance work. However, if the overall market improvement is driven by overseas market prices, this means that, due to our short position, our import purchasing costs will increase, which will offset any benefits we enjoy. The Dubai crude oil price has risen more than anticipated recently, reaching 60$/B. However, provided the market normalizes, for example, the light-heavy crude price spread widens, our strength in terms of cracking capacity will come to the fore. Demand for petrochemicals has recovered considerably recently and the issue will be paraxylene market prices but we believe that reasonable recovery in market prices is likely.

Q4: Am I correct in understanding with respect to Cosmo's oil refining margin approach, that it is better if domestic market prices are high and overseas market prices are low?

A4: That is generally our approach. We adopt a short position and basically produce our own products fully and we believe that our adoption of a short position generally works to our advantage although our margins are slightly eroded by importing and purchasing costs.

Q5: Could you give details of factors which will push profits up in the wind power generation business next fiscal year?

A5: The onshore Chuki site is scheduled to start operation in FY2021 and will contribute to earnings.

Q6: I would like to know whether you conduct a review of the value of oil exploration assets, including recognition of impairment taking into consideration oil price levels in the long term given the trend towards decarbonization?

A6: We believe that the general trend towards decarbonization will continue in the future. However, whilst the energy mix changes, shifting towards renewable energy, there will still also be a certain degree of demand for fossil fuels. We believe it is our responsibility to maintain a stable supply of energy to support people's lives. We intend to make an assessment on the long-term outlook for crude oil prices once a certain amount of data such as the outlooks of various thinktanks is available.

Q7: Regarding the Block 4 bid, could you give details of your assumption regarding crude oil prices and the business environment?

A7: We expect to break even on producing oil assuming that we do. We made the decision based on the judgment that in the long run crude oil prices will probably rise above the breakeven point in the period during which Block 4 is producing oil.

Q8: In connection with your aim of becoming a leading company in offshore wind power, what are your current strengths and how will you become even stronger in the future?

A8: Whilst we have knowledge, a proven track record and expertise in onshore wind power generation, offshore wind power is in many respects a blue ocean and is poised to play an important role in future energy systems. In the project offshore Yurihonjo, we are working day and night on preparations for completion of the project whilst communicating with the local authority aiming for the completion of the project through collaboration with the local authority. Contractors who make such steady efforts are few and far between and we are proud that Cosmo Eco Power is very rare in its field. The latest bid was half qualitative assessment and we believe that our ability to complete projects and our teamwork with the local authorities are strengths unique to us.

Q9: With respect to your oil refining margin, what is your sense of the level of margin in the fourth quarter, taking October-December results and forecasts into consideration?

A9: In the third quarter, the margin improved ¥0.5/L year on year. Our margin may be slightly low compared with other companies due to increased supply to KYGNUS SEKIYU. During the third quarter, the negative time lag was almost eliminated. Our fourth quarter estimate is slightly conservative compared to the margin environment in the third quarter.

Q10: Your forecast for the profit level in the petroleum business, inventory effects excluded, is around 15~16 billion yen each quarter including the fourth quarter. While there is a time lag in some areas, is it fair to assume that this is real profit?

A10: Though account differences do actually occur, we believe that generally around 15 billion yen is the profit baseline Regarding account differences, expenses of more than 10 billion yen arose in the third quarter compared to the second quarter, mainly reflecting scheduled maintenance at the Yokkaichi refinery. However, these expenses were cancelled out because the third quarter is the demand period and the margin improved due to a positive time lag. In the fourth quarter, oil refining fixed expenses due to scheduled maintenance will decrease, pushing up profit. However, we are estimating the margin conservatively compared with the third quarter and account differences which will push profits down have arisen.

Q11: I would like to know whether rising spot prices have any impact on electric power retail sales.

A11: The impact is extremely small. The impact on our earnings is insignificant because our sense of scale is vastly different compared with other companies and our spot ratio is also not very high.

Q12: Regarding the relationship between financial position and shareholder returns, you recognized that you will see improvement earlier than expected at the time of the second quarter results, due to rising crude oil prices and other factors. I would like to know whether you recognize that you have surplus cash for shareholder returns or will you use this surplus cash to improve your financial position as in the past?

A12: We intend to maintain the current dividend level. Whilst our net debt-to-equity ratio looks set to dip below 2.0, last year crude oil prices fell sharply and we are now only back to the situation before our financial position deteriorated. We recognize that we are still currently lagging behind compared with the medium-term management plan. We made the management decision that enhancing shareholder returns without improving our financial position would ultimately be detrimental to our corporate value.

Q13: You recognized that capital expenditure next fiscal year will be on a par with depreciation. Is this still the case?

A13: Yes, this is basically still the case. We have to curb capital expenditure as must as possible and promote rationalization. We will sell assets in the onshore wind power generation business. We are also considering steps in other areas and plan to reduce our interest-bearing debt by using fund generated through such approach.

Q14: Regarding the revision of the consolidated business forecast for the full year of FY2020, net profit (profit attributable to owners of parent) relative to ordinary profit looks set to be much better than previously forecast. Could you give more details?

A14: The contribution of the petroleum business to net profit will be much higher. Inventory effects included, this contribution will result in an increase in profit of more than 40 billion yen. The effective tax rate in the petroleum business also has a bearing on loss carried forward and roughly 80% of petroleum business profit will contribute to net profit.

Q15: Even though investment in Block 4 makes economic sense, do you not think you should invest in the "New" of "Oil & New" given the direction of travel towards carbon neutral?

A15: We are currently producing our long-term outlook for carbon neutral given that we have also expressed our support the TCFD recommendations. The Block 4 project is not an expansion of the Oil E&P Business, rather from the viewpoint of energy security we aim to maintain oil production at a certain level from 2030 onwards. Moreover, given that the block is adjacent to the facilities of Abu Dhabi Oil, we think it is more energy efficient for us to do this than for another player to build new processing facilities.

Q16: Surely, for carbon neutrality, the challenge facing you is not to maintain oil development but to fade it out?

A16: We believe that the trend towards the downscaling of oil development will continue in the future and there is also no change in our policy of contributing to a sustainable society through our wind power business and other sustainable activities.

Q17: Could you give details of the strengths of Cosmo Eco Power and each company in the project offshore Yurihonjo and the division of roles?

A17: The consortium for the project offshore Yurihonjo is led by Renova and also includes us, JR-EAST Energy Development and Tohoku Electric Power Company. As for the roles of each company, Tohoku Electric Power Company has experience of operating the electric power business with the local community for many years. JR-EAST Energy Development has the JR East Group's logistics and tourism industry networks. Cosmo Eco Power provides end-to-end services starting from the operation of the wind power generation projects to the maintenance and the management of power generation facilities. Renova has started up renewable energy power generation projects across Japan and is expected to bring its engineering capabilities to the project.

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