Improving financial strength while responding well to the changing business environment

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Toward achieving the Sixth Consolidated Medium-Term Management Plan

The Sixth Consolidated Medium-Term Management Plan, which started in FY2018, aims to strengthen our financial position as one of its basic policies. It has the goal of increasing our earnings power and improving our financial position to achieve a net worth that can tide us over amid changes in the business environment, such as a decline in crude oil prices.
The financial target for the sixth management plan are cumulative free cash flow of over ¥150 billion, net worth of over ¥400 billion, net worth ratio of over 20%, and net D/E ratio of 1.0-1.5 times to be achieved by FY2022.
In FY2019, the second year of the plan, the COVID-19 pandemic, Saudi Arabia's oil policy to boost its production capacity, and other factors led to a decline in crude oil prices, which affected us mainly in the form of temporary deterioration in margins on petroleum products. Actual ordinary income, excluding the impact of inventory valuation, decreased by ¥38.9 billion to ¥68.5 billion, while we recorded net loss attributable to owners of the parent of ¥28.2 billion, affected by a decrease of ¥52.2 billion in inventory valuation.
Free cash flow was a positive ¥27.5 billion, supported by an improvement in working capital associated with the decline in crude oil prices. Net worth decreased by ¥41.3 billion to ¥239.8 billion, while the net worth ratio was down 1.9 percentage points to 14.6% and the net D/E ratio down 0.43 points to 2.41 times.
As major initiatives in FY2019, we refinanced the subordinated loan* of ¥60 billion and realized ESG financing with an objective to diversify funding source.
In particular, we made an early repayment of the ¥60 billion subordinated loan, procured in FY2015, and refinanced with a new ¥30 billion subordinated loan. Because the amount of the loan was reduced by half, the interest burden has been greatly curbed. At the same time, we have obtained more favorable conditions with the new loan, such as the provision of a profit redemption clause, no interest rate step-up, and the inclusion of 50% of the loan in equity.
As for ESG financing, we procured the first sustainability-linked loan in Japan's oil industry. This loan sets sustainability performance targets (SPTs) aligned with the borrowing company's CSR plans, and the achievement of these targets is incentivized by aligning interest rate terms with the borrower's performance. The SPTs stipulated under the agreement are: (1) The number of new onshore wind power stations that commence operations, and (2) the availability of existing wind power stations.
We believe that this financing will push us further into promoting the renewable energy business, which is one of our Group's major policies.
In FY2020, the COVID-19 pandemic is expected to make our business environment harsh. Nevertheless, we expect to maintain the sales volume, thanks to growth in supply to Kygnus Sekiyu, despite an expected decline in domestic demand. Japan's market environment is projected to remain robust. As a result, we forecast ordinary income, excluding the impact of inventory valuation of ¥30.0 billion, and profit attributable to owners of parent of ¥14.5 billion, marking a return to profitability.
In FY2020, free cash flow is expected to be negative, mainly due to the investment burden and a decline in earnings. Therefore. we intend to review the timing and composition of investment and reduce cash outflow from investing activities. Nonetheless, we will maintain important growth investment that will lead to the enhancement of corporate value.
Our balance sheet improvement may appear to have stalled somewhat, mainly due to the decline in crude oil prices, caused by the COVID-19 pandemic in FY2019. However, our petroleum business in Japan, which is a core source of profit, remains robust. Depending on the state of the recovery in crude oil prices, the temporary negative impact that occurred in prior years may be eliminated. We will continue to strive to achieve the sixth management plan.

* Subordinated loan: A form of hybrid finance that lies between equity and debt. It is also a capital financing method that has similar characteristics and features to equity.

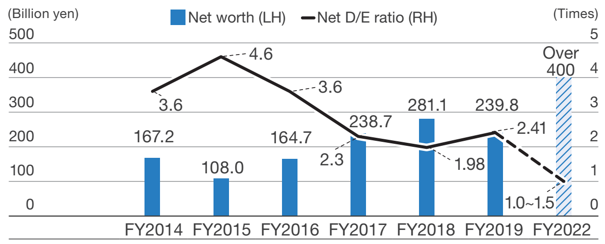
Responding to the COVID-19 pandemic

Due to the global economic slowdown and the deteriorating business environment caused by the COVID-19 pandemic, we have focused on securing liquidity in hand and financial stability.
Concerning liquidity in hand, we are maximizing use of Group financing and centrally managing the Group's cash and deposits to secure sufficient cash to withstand the changing business environment.
As for financial stability, we have secured sufficient procurement limits in yen and foreign currencies with multiple financial institutions. We also have a commitment line on a scale of ¥100 billion. We see this as more than sufficient for us to cope with unstable conditions going forward.
I believe we have to be prepared for the prolonged impacts of the COVID-19 pandemic. We will continue to strive for cost reduction across the group, will review the timing and composition of investment, and will take all possible measures to avoid hindering our business activities.

Message to investors

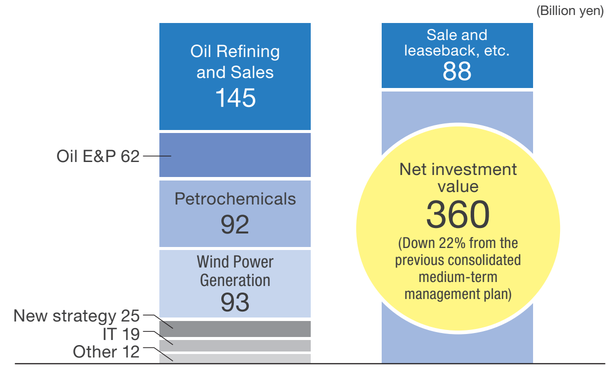
For FY2019, despite the deterioration in our financial position due to the net loss attributable to owners of the parent, we paid a per-share dividend of ¥80, as initially announced. This was because we recorded actual ordinary income excluding the impact of inventory valuation of ¥68.5 billion and we regarded the COVID-19 pandemic as a one-off factor.
In FY2020, the business environment is expected to be harsh, but we intend to maintain a per-share dividend of ¥80 under our basic policy of stable dividend payments. In the future, we will seek to raise the ratio of return to shareholders while considering the balance with the financial position.
Lastly, dialogues with investors is important to my role as CFO. I am determined to proactively engage with investors and apply their feedback in management. I would like to ask for your continued support.

Net Worth and Net D/E Ratio

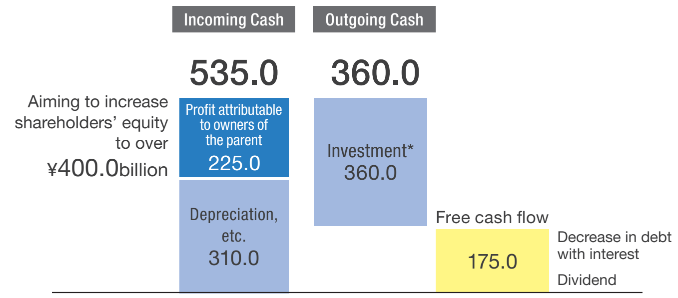


	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2022
Dubai crude oil price (USD/bbl, annual average)	84	46	47	56	69	60	70
Impact of inventory valuation (Billion yen)	-116.1	-68.7	39.4	21.0	-10.7	-52.2	—
Net interest-bearing debt (Billion yen)	597.7	666.2	727.3	635.8	644.7	628.3	—

Investment Plan (FY2018-FY2022)



Cash Balance and Use of Funds (FY2018-FY2022)



* Strategic investment is net amount reflecting sale and leaseback etc.

Dividends per share