

## Cosmo Oil (5007)

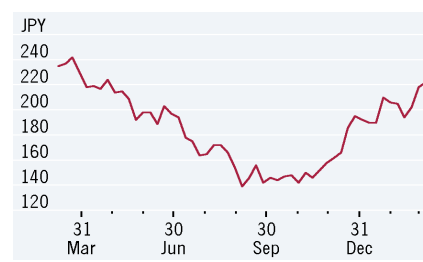
### Alert: New medium-term plan: FY3/18 RoE target of 10%+ high but nothing new

- **Conclusion** — On March 7 Cosmo Oil announced a new medium-term plan that will run through FY3/18. In a briefing held the same day the firm expressed its resolve to resume dividends from FY3/14, but given that 1) only FY3/18 profit targets were disclosed; 2) it did not disclose specific timing for the resumption of dividends; and 3) there was little in the way of new content, we do not think this will be positive for the shares.
- **Summary of medium-term plan** — For FY3/18 the plan targets adjusted RP (excluding inventory impacts) of ¥112bn (¥74bn above the company's FY3/13 target), breaking down to 1) ¥18bn for petroleum refining (+¥38bn versus the FY3/13 plan), 2) ¥10bn for petrochemicals (+¥9bn), 3) ¥77.5bn for upstream development (+¥20bn), and 4) ¥6.5bn for others/adjustments (+¥7bn). In our view, factors like the restart of the Chiba refinery (to boost profits ¥22bn over the FY3/14 target), the start-up of South Korean paraxylene facilities in South Korea (+¥12bn), and the start of production at the Hale oil field had been anticipated for some time. Also, with crude production volume set to nearly double the profit increase appears small.
- **Cash balance** — Cosmo also disclosed its five-year cash balance expectation. It expects to bring in ¥370bn in cash (profits of ¥190bn + ¥180bn in depreciation) while spending ¥280bn, resulting in free cash flow of ¥90bn. It intends to allocate free cash flow to paying down interest-bearing debt and to dividends. We did sense the company's resolve to resume dividends, but given current financial conditions it could be difficult to pay ¥8 in DPS in FY3/14 (we forecast ¥5) and raise the dividend further during the medium-term plan period.
- **Financial indicators** — In FY3/18 the firm aims for a shareholders' equity ratio of 21.5% and a net D/E ratio of 1.6x. Significant improvement over current levels (14.2%, 2.9x) is expected, but compared with peers and pre-March 11 disaster levels (the shareholders' equity ratio was 21.1% in FY3/11), we feel the targets are somewhat lacking
- **Our outlook for the shares** — In FY3/14 we anticipate a sharp profit increase on the re-start of the Chiba refinery and the re-posting of DTAs, and we also anticipate the resumption of dividends. However, in light of the profits and financial conditions we anticipate subsequently, the shares look overvalued on an FY3/14E PBR of around 0.8x.

#### Company Update

<b>Sell</b>	<b>3</b>
Price (07 Mar 13)	¥222
Target price	¥170
Expected share price return	-23.4%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>-23.4%</b>
Market Cap	¥188,048M
	US\$1,999M

#### Price Performance (RIC: 5007.T, BB: 5007.JP)



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#### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Cosmo Oil

### Valuation

We adopt PBR as our valuation metric for Cosmo Oil as we believe using net assets as a measure of shareholder value is appropriate given that 1) oil refining is a mature capital-intensive industry where domestic demand for petroleum is on a downtrend, 2) we anticipate demand growth overseas and in petrochemicals (we expect continued double-digit YoY growth in Chinese oil refining and assume that global paraxylene demand will rise 7%-8% annually), and 3) we think Cosmo Oil can ameliorate the impact of inventory.

Our ¥170 target price references historical PBRs, TOPIX-relative PBRs, and RoE. Taking particular account of RoE that lags peers and the lack of visibility on whether the initial plan for FY3/14 will call for the restoration of the dividend, with DTAs set to be rebooked in FY3/14, for Cosmo Oil we adopt a target PBR of just over 0.6x, a 45% discount to the TOPIX PBR. We calculate adjusted FY3/14 BPS by subtracting ¥39.9bn, or ¥47 per share, an amount equivalent to the overbooking of land revaluation differences in capital, from our nominal BPS forecast, with ¥39.9bn being calculated by subtracting the tax burden from the ¥101.5bn, the equivalent valuation loss difference in the notes of the Yuho securities filing). The land revaluation difference is a result of the company revaluing its landholdings in March 2002. Falling land prices thereafter led to disparities between properties' book and market values that will have to be booked as impairment charges when service stations or oil storage facilities are scrapped or halt operations. We thus conservatively leave them out of our BPS calculation.

Our target price equates to an EV/EBITDA of 8.3x on our FY3/14 forecasts. We think this looks reasonable given the EV/EBITDA range of 6x-9x for primary oil distributors.

### Risks

We see upside risks to our target price as: 1) demand for petroleum products like gasoline improving significantly if the economy shows increasing signs of recovery; 2) the difference in the price of heavy and light crude widening considerably moving forward; and 3) it looks increasingly as if margins will remain firm for gasoline and light oil. On the other hand, we see downside risks to our target price as: 1) a sharp deterioration in prices, especially overseas (particularly for diesel oil); and 2) cutting capacity as per the METI order prompting expectations that the firm will post large extraordinary losses.

## Appendix A-1

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Analyst: Takashi Miyazaki



	Date	Rating	Target Price	Closing Price
1	8-Jun-10	3H	*230	245
2	1-Sep-10	*2H	*220	209
3	30-Nov-10	*3H	*210	237
4	31-May-11	*2H	*240	244

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*2	-	193
7	12-Jul-12	*3	*150	178
8	23-Aug-12	3	*130	166

	Date	Rating	Target Price	Closing Price
9	5-Nov-12	*2	*150	148
10	18-Feb-13	*3	*170	199

Rating/target price changes above reflect Eastern Standard Time

### Cosmo Oil (5007) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Takashi Miyazaki



	Date	Rating	Target Price	Closing Price
1	27-Jan-11	*ADD LP	-	268
2	8-Jul-11	*REM LP	-	241
3	15-Jun-12	*ADD LP	-	189

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	17-Sep-12	*REM LP	-	153
5	18-Sep-12	*ADD LP	-	156
6	5-Nov-12	*REM LP	-	148

	Date	Rating	Target Price	Closing Price
7	30-Jan-13	*ADD LP	-	215

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12 Month Rating			Relative Rating		
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49%	38%	12%	7%	86%	7%
53%	49%	45%	60%	49%	55%

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