Can Idemitsu Kosan generate enough cash from oil to fund transition?





Valuation Master Class

This information is for learning purposes only.

This is not investment advice or a recommendation.



Can Idemitsu Kosan generate enough cash from oil to fund transition?





Sector: Energy



Second-largest Japanese petroleum refiner and operator of more than 6,300 gas stations across the country

My value estimate:

JPY3,595

(Upside 22%)

BUY



3 things to know about this company

- Slowing oil consumption could result in declining revenue
- Ramp-up of CAPEX necessary to ensure longevity
- Attractive dividend yield could rise to 2x Japanese average

Key statistics

Analyst consensus (9)

PE ratio

Dividend yield

JPY3,360

11.6x

4.1%

(Upside 14%)

BUY

Revenue breakdown 2020



Sales

Story

FVMR

Value

WCB

Risks

Petroleum 78%



Chemicals 7%



Materials 7%



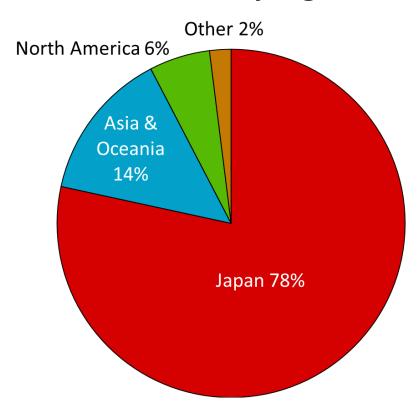
Power 4%



Resources 4%

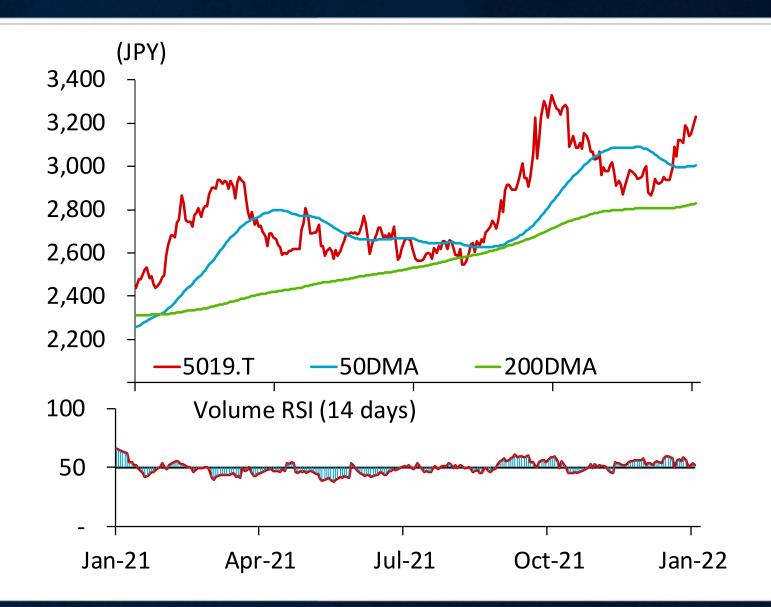


Breakdown by region



Price and volume remain bullish



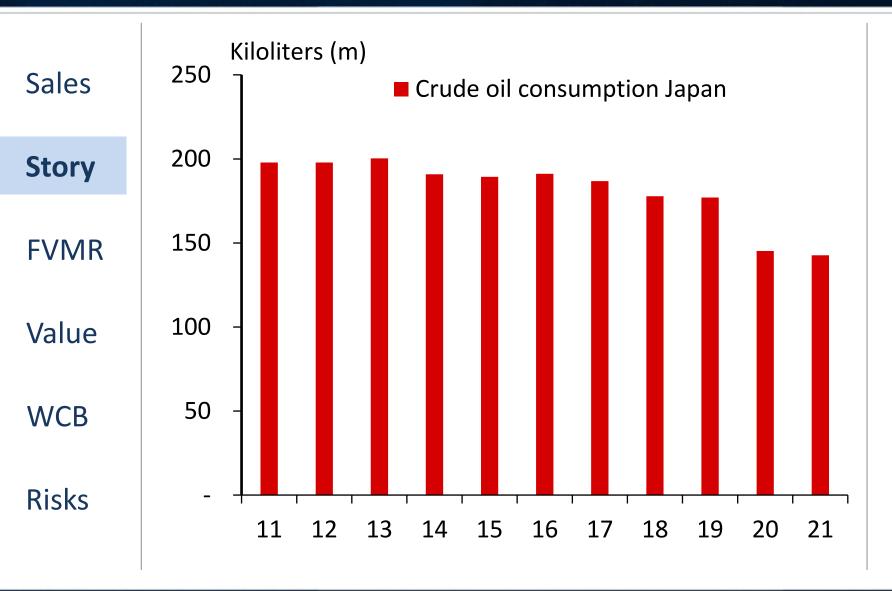


- Throughout the past year, the 50DMA has stayed above the 200 DMA, which is a strong bullish signal
 - The share price is up 33% YTD
- Volume RSI stayed above the 50%line, which is positive as well



Slowing oil consumption could result in declining revenue



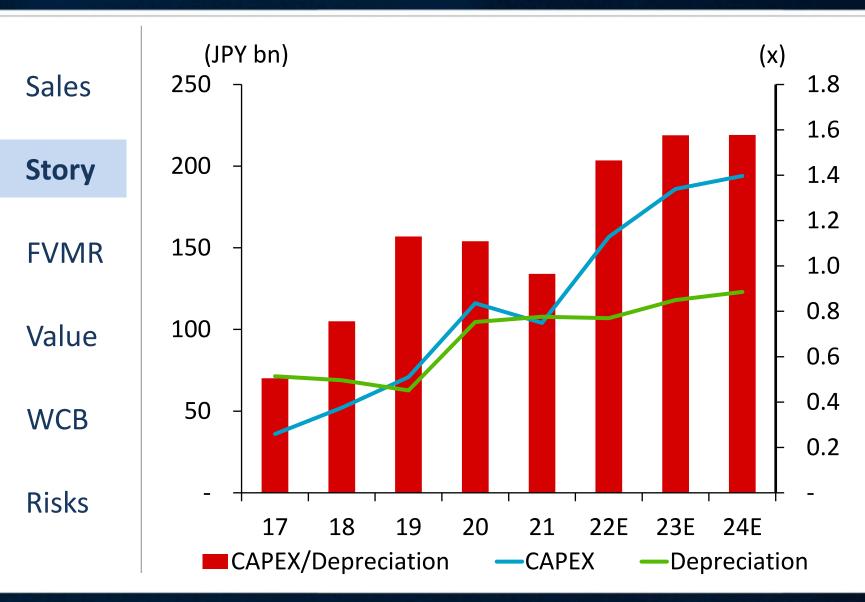


- With 80% of sales, Idemitsu is still heavily reliant on its petroleum segment
- Over the 10 past years, crude oil consumption in Japan declined by 3% annually
 - This trend might even accelerate, and the company should focus on generating cash from oil to fund other segments
 - I expect shrinking revenue after 22E



Ramp-up of CAPEX necessary to ensure longevity





- In the past, Idemitsu has been rather conservative in its expansion strategy
 - Capex/Depreciation even remained below 1x
- In its new alignment, the management must focus on expanding in other segments to compensate for a falling contribution from petroleum
 - CAPEX budget for the next 3
 years is JPY550bn+, which is
 much higher than the past

Transition takes long time, but should pay off in future



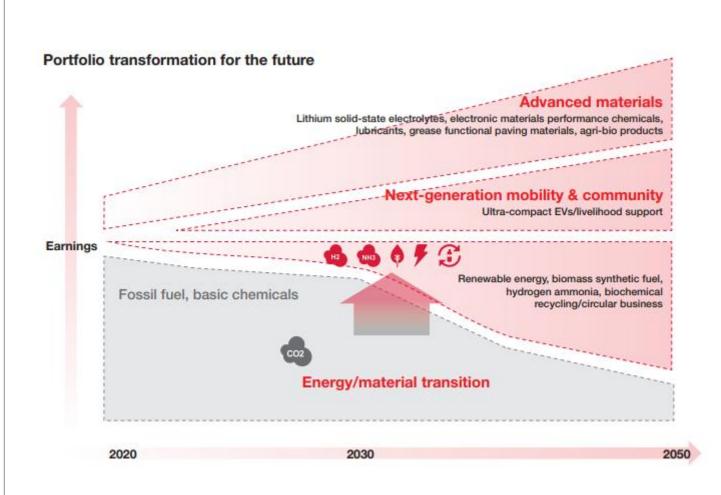
Sales

Story

FVMR

Value

WCB

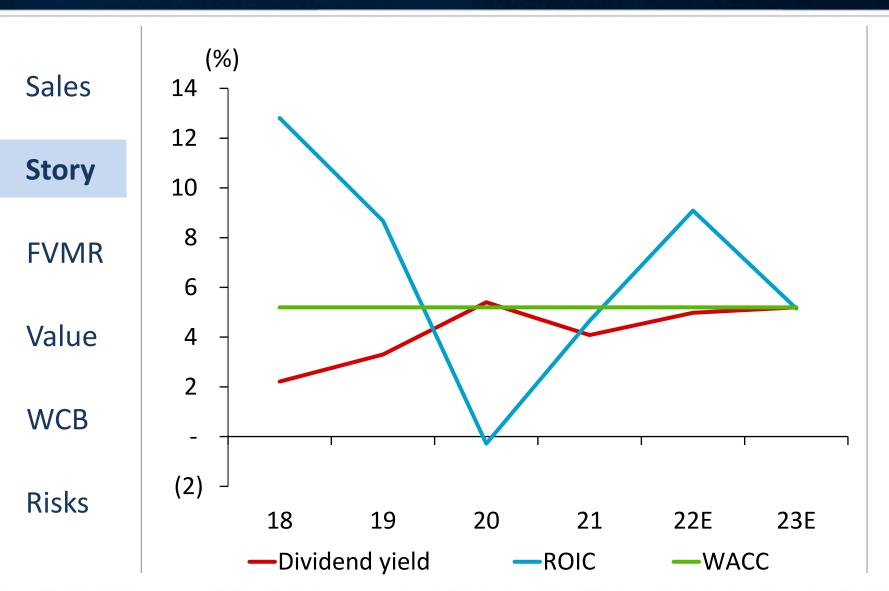


- By 2030, the company plans to increase its renewable capacity to 4 Gigawatt from currently 0.2 Gigawatt
 - In addition, it shifts from coal production to gas
- ★ Also, it allocated JPY100bn M&A budget to expand its chemicals and materials segment
 - I think that the market is too pessimistic about the long-term outlook



Attractive dividend yield could rise to 2x Japanese average





- Management aims to achieve a ROIC of 7% over time
 - This target might be a bit too optimistic in the short run, but it should at least cover WACC
- In the past share, the company has increased its dividend per share and is likely to maintain that level
- This could result in a massive dividend yield of 5%+ (Japanese average is 2.5%)



Home

Student login

FAQ

5

Resources

Testimonials



What Is Going to Happen with Inflation?

By Valuation Master Class Student

Many forces at work impact inflation.
There are current trends that cause both inflationary and deflationary measures.
Whether we'll see inflation or deflation in the future depends on which of these forces dominate.

Read More



How to Value a Startup

By Andrew Stotz

This story started when Dan, a podcast listener, replied to my recent weekly email with this question, "How do you value a startup, especially if there is no revenue?"

Read More



How to Fight Back When Your Dreams Are Crushed

By Andrew Stotz

The trouble you face is not your fault, and I'm gonna show you how you can fight back. I challenge you to recommit to your dreams today!

Read More

ValuationMasterClass.com



What Does It Mean to Be

Financially World Class?





Scan this QR code to go to the ValuationMasterClass.com blog to download all full Case Study reports for free.

*It's usually up within 24h.



FVMR Scorecard

- Measures a stock's
 attractiveness relative to all
 other companies
- * Attractiveness is based on four elements
 - Fundamentals, Valuation,
 Momentum, and Risk
- *Scale from 1 (Best) to 10 (Worst)



Favorable momentum at a cheap valuation

Momentum



Sales

Story

FVMR

Value

WCB

Risks



Wolfielitaili						MISK					
(%)	Mar-18	Mar-19	Mar-20	Mar-21	PTM**	<u>(x)</u>	Mar-18	Mar-19	Mar-20	Mar-21	PTM**
Revenue growth	16.9	18.6	36.6	(24.6)	6.8	Current ratio	1.0	1.0	0.9	1.0	1.1
Recurring EPS growth	48.4	(48.5)	(114.3)	458.2	432.8	Net debt-to-equity (%)	96.8	106.4	109.1	107.9	90.6
Operating profit margin chg. (bps)	108	(144)	(411)	321	699	Times-interest-earned	20.4	19.6	(1.3)	11.1	26.2
	6mth	3mth	1mth	3wk	1wk		5yr	3yr	1yr	6mth	3mth
Price change	8.2	7.9	(6.5)	(5.3)	(2.2)	Beta	1.0	0.9	0.6	0.5	0.6

Note: Benchmarking against 2,350 non-financial companies in Japan.

Recently, I created a short online course explaining my FVMR investing approach

I usually sell it for \$97 but for a limited time I am offering it for FREE





Analysts see small upside, but remain cautious



Sales

Story

FVMR

Value

WCB

Risks

Analyst consensus valuation						
Recommendation	Oct-21	Nov-21	Dec-21	Current		
Strong buy	2	2	2	2		
Buy	1	1	1	1		
Hold	7	7	7	6		
Sell	-	-	-	-		
Strong sell	-	-	-	-		
Average score	2.5	2.5	2.5	2.4		
Price target	Oct-21	Nov-21	Dec-21	Current		
Median	2,900	3,200	3,360	3,360		
Mean	3,095	3,156	3,252	3,297		

1.8

9 analysts



Upside: 14%

Analyst consensus 3-year forecast (%) 21 20 **22E 23E 24E** (2.6)Revenue growth 2.5 36.6 37.5 (2.7)(24.6)Gross margin 11.0 6.8 12.3 11.2 11.4 11.4 **EBIT** margin 4.1 (0.1)3.1 na na na

(0.4)

8.0

3.1

- Currently, there is no catalyst in place, that would lead to excessive optimism
 - Most analysts are still on HOLD
- Consensus expects a record revenue in 21E
 - However, as oil price tends to normalize, the company is likely to face shrinking revenue in 22E and 23E

2.0

2.1

Net margin

Profit & loss statement



Sales

Story

FVMR

Value

WCB

(YE Mar, Yen bn)	2020A	2021A	2022E	2023E
Revenue	6,046	4,557	6,197	5,949
Cost of goods & services	(5,633)	(3,998)	(5,503)	(5,354)
Gross profit	413	559	694	595
SG&A	(417)	(419)	(403)	(416)
Other operating (exp)/inc	(0)	(0)	(0)	(0)
EBIT	(4)	140	291	178
Interest expense (net)	(2)	(2)	(2)	(5)
Other non-operating inc/(exp)	14	22	23	22
Earnings before taxes (EBT)	8	160	312	196
Income tax	(4)	(29)	(91)	(54)
Earnings after taxes (EAT)	4	131	221	142
Equity income/Minority interest	(25)	(40)	0	3
Earnings from cont. operations	(20)	91	221	145
Forex/Exceptionals before tax	(3)	(56)	(28)	(27)
Net profit	(23)	35	193	117

- Strong bottom-line mainly driven by inflated oil prices worldwide
 - The Japanese gov't announced to release some of its oil reserve to prevent a further spike in price

Balance sheet - assets



Sales

Story

FVMR

Value

WCB

(YE Mar, Yen bn)	2020A	2021A	2022E	2023E
Cash & short-term investments	132	131	93	89
Accounts receivable	592	601	671	694
Inventories	623	695	841	833
Other current assets	203	239	279	268
Total current assets	1,550	1,666	1,884	1,884
Long-term investments	239	214	209	204
Net fixed assets	1,478	1,522	1,534	1,547
Intangible assets	165	160	160	157
Goodwill	167	159	159	159
Other long-term assets	287	234	245	250
Total assets	3,887	3,954	4,191	4,201

- ★ As of 2021, Idemitsu has a cash-to-assets ratio of 3%
 - Low cash generation ability might result in conservative expansion plans

Balance sheet - liabilities



Sales

Story

FVMR

Value

WCB

(YE Mar, Yen bn)	2020A	2021A	2022E	2023E
Overdrafts & short-term loans	664	552	494	418
Accounts payable	486	542	611	595
Other current liabilities	499	527	545	524
Total current liabilities	1,648	1,621	1,650	1,536
Long-term debt	672	757	793	825
Other long-term liabilities	366	361	375	390
Total liabilities	2,686	2,739	2,819	2,752
Minority interest	51	64	70	74
Paid-up capital - Common shares	630	630	630	630
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	408	401	552	626
Revaluation/Forex/Others	112	120	120	120
Total equity	1,150	1,151	1,302	1,376
Total liab & shareholders' equity	3,887	3,954	4,191	4,201

- ★ Idemitsu has moderate high leverage
 - Its net-debt to equity ratio stood at 0.9x in 2021



Sales

Story

FVMR

Value

WCB

Risks

(YE Mar)	2020A	2021A	2022E	2023E
General growth (YoY, %)				
Revenue	36.6	(24.6)	36.0	(4.0)
Assets	34.5	1.7	6.0	0.2
Gross profit	(15.3)	35.3	24.2	(14.3)
Operating profit	(102.2)	nm	107.9	(38.7)
Attributable profit	(128.2)	252.3	454.0	(39.4)
EPS	(123.1)	226.7	454.0	(39.4)
Recurring EPS	(114.3)	458.2	183.1	(36.1)
Du Pont analysis (%)				
Net profit margin	(0.4)	0.8	3.1	2.0
Revenue per Yen100 of assets	178.4	116.2	152.2	141.8
Assets/equity (x)	3.4	3.4	3.3	3.1
Return on equity	(2.3)	3.0	15.8	8.8
Others (%)				
Effective tax rate	69.4	28.1	32.0	32.0
Dividend payout ratio	(227.0)	47.6	19.9	31.9

★ Unlike other petroleum companies, Idemitsu has a very high efficiency

Ratios (cont.)



Sales

Story

FVMR

Value

WCB

Risks

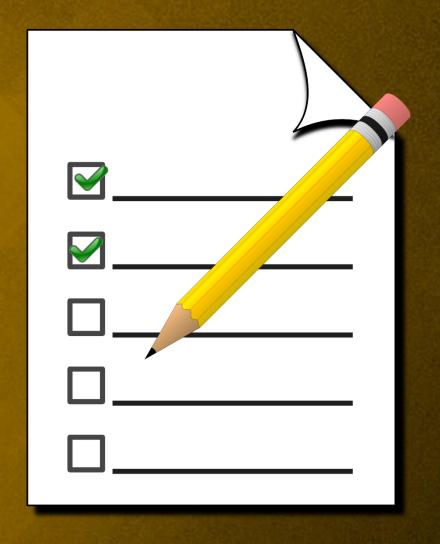
(YE Mar)	2020A	2021A	2022E	2023E
Internal liquidity (x)				
Current ratio	0.9	1.0	1.1	1.2
Quick, or acid test ratio	0.6	0.6	0.6	0.7
Working cap. mgmt (Days)				
Inventory conversion period	39	59	50	56
Receivables collection period	31	47	37	41
Days from raw mat to coll	70	106	87	98
Payables deferral period	29	46	38	41
Cash conversion cycle	41	60	49	57
Profitability ratios (%)				
Gross profit margin	6.8	12.3	11.2	10.0
EBIT margin	(0.1)	3.1	4.7	3.0
EBIT return on avg assets	(0.1)	3.6	7.2	4.3
Return on average assets	(0.7)	0.9	4.8	2.8
Financial risk (x)				
Liabilities-to-assets (%)	69.1	69.3	67.3	65.5
Debt-to-equity	1.2	1.1	1.0	0.9
Net debt-to-equity	1.0	1.0	0.9	0.8
Times-interest-earned	7.7	20.7	33.3	25.1
Effective interest rate (%)	1.1	0.9	0.9	0.9

★ Gross margin in 21E and 22E continues to stay on a high level, attributable to high oil price rather than efficiency gains

A. Stotz Investment Research
Stock Picking Checklist

*Inspired by Peter Lynch's ten baggers (A stock that has gone up 10x)

- * Based on our extensive research
- * 9 factors that drive long-term share price performance



Long-term share price performance potential



Sales

Story

FVMR

WCB

Ratios

Value

A. Stotz Investment Research			Good
Stock Picking Checklist	Potential	Comment	
 Management – Management has a proven commitment to growth 	Weak	Currently, there is a lack of strategy how to compensate declining oil revenue over time	
2. Growth – Product and industry can support a decade of 10%+ annual growth	Weak	Oil consumption in Japan continues to shrink	
3. Sustainable – Competitive strategy creates sustainably high gross margin	Moderate	Its gross margin is similar to its closest compe Eneos, the largest petroleum player in Japan	titor
4. Quality – Good earnings quality, non-core items are small or non-existent	Weak	Earnings fluctuate quite a lot given the indust volatile nature	ry's
5. Efficiency – In the long run sales grow faster than assets	Good	The company is characterized by a remarkable efficiency; asset turnover is 150%+	е
6. Tight – Relatively low cash conversion cycle, negative is best	Moderate	Cash conversion is moderately high and stood days in 2021	l at 60
7. Cash flow – Operating cash flow is consistently positive	Moderate	Operating cash flow has been consistent over but was not always able to cover investing ou	•
8. Capacity – Company has access to capital to fund growth	Moderate	Leverage is moderately high	
9. Inexpensive – Valuation is reasonable, avoid very expensive stocks	Good	Cheap on both 21E PE and PB compared to Ja Energy companies, in line with ROE	panese

Free cash flow



Sales

Story

FVMR

Value

WCB

Risks

(YE Mar, Yen bn)	2020A	2021A	2022E	2023E
EBIT	(4)	140	291	178
Est tax rate (%)	69	28	32	32
NOPAT	(4)	101	198	121
Add: Depre & amort	105	108	107	116
Less: CAPEX	(116)	(92)	(114)	(117)
Chg in A/R	(140)	(9)	(70)	(23)
Chg in inventory	(36)	(72)	(146)	8
Chg in oth curr assets	(108)	(35)	(40)	11
Chg in A/P	78	57	69	(17)
Chg in oth curr liabs	79	29	18	(22)
Less: Chg in working cap	(127)	(31)	(169)	(42)
Less: Chg in invest cap				
Free cash flow to firm	(143)	86	22	78

★ FCFF likely to remain volatile given abrupt changes in working capital

Value estimate



Sales

Story

FVMR

Value

WCB

Forecast assumptions			
3-year average	Consensus	My assur	mptions
Revenue growth (CAGR)	9.2		7.4
Gross margin	11.3		10.4
EBIT margin	na		3.6
Net margin	2.4		2.4

My valuation method		
Market: Japan		
Market risk-free rate	0.5	
Market equity risk premium	9.5	
Market return	10.0	Valuation Method:
Company beta (x)	1.0	
COE	10.0	FCFF
WACC	5.4	
Terminal growth rate	2.0	

- I expect a higher revenue drop in 23E and 24E than the consensus
 - However, my long-term outlook is a bit more optimistic
 - focus on its other segments to diversify away from oil
- Historically, Japan has a very low risk-free rate

Value estimate



Sales

Story

FVMR

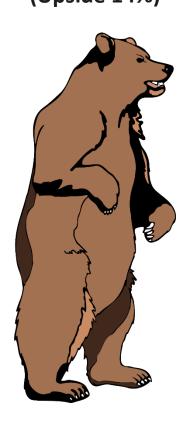
WCB

Ratios

Value

Risks

Bear JPY3,348 (Upside 14%)



Base JPY3,595 (Upside 22%)



Bull JPY3,895

(Upside 31%)



World Class Benchmarking Scorecard

- We identify a company's competitive position relative to global peers
- * We use a composite rank of profitability and growth, called "Profitable Growth"
- Scale from 1 (Best) to 10 (Worst)



Strong profitability and good growth



Sales

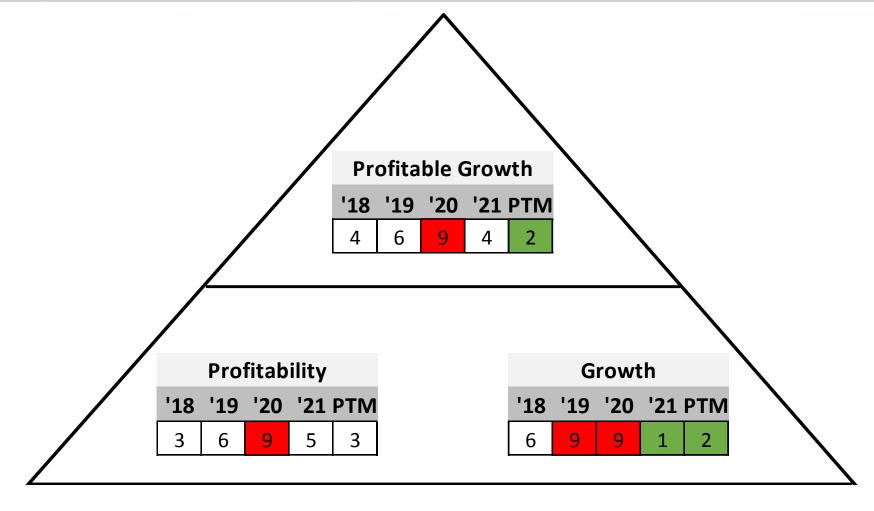
Story

FVMR

Value

WCB

Risks



Benchmarked against 310 large Energy companies worldwide.

Key risk is high dependency on oil



Sales

Story

FVMR

Value

WCB

- ★ Adverse regulatory changes could accelerate phase-out of fossil fuels
- ★ Failure to identify suitable expansion opportunities for non-oil business segments
- ★ Lower than expected operating cash flows could hamper expansion plans as the company has not much cash reserves

CONCLUSION

 Petroleum segment strong in short run but does not ensure longevity

- Management's plans to expand other segments should drive revenue growth in the long run
- A 5% dividend yield at cheap valuation might be already attractive enough

