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Highlights of Major Tire Manufacturers' Financial Results for Fiscal Year Ended December 2018

The following are Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year ended December 2018 (FY2018) and earnings forecasts for FY2019 of Japan's major tire manufacturers: BRIDGESTONE CORPORATION ("BRIDGESTONE," security code: 5108); Sumitomo Rubber Industries, Ltd. ("Sumitomo Rubber," security code: 5110); The Yokohama Rubber Company, Limited ("Yokohama Rubber," security code: 5101); and Toyo Tire Corporation ("Toyo Tire," security code: 5105).

1. Industry Trend

Accounting for nearly 30% of the world tire production, 4 Japanese tire manufacturers have high presence in global market. While tire demand for new cars is susceptible to economic cycle, sales of replacement tires, for which demand is relatively stable, including exports, account for 70-80% of the tire sales. World tire demand is expected to gradually grow in the medium run, supported by demand for replacement tires. However, there are concerns about impact from political issues such as U.S.-China trade frictions and Brexit. According to BRIDGESTONE's FY2018 reference materials for financial results and forecasts, tough environment for sales of tires for new cars and replacement tires is expected in areas other than Asia in FY2019. The growth rates in major markets (FY2018 actual results and FY2019 forecasts) of tire demand for new cars (passenger cars) in major markets are the following: Japan: ±0% and ±0%; North America: ±0% and -6%; Europe: +1% and -2%; and Asia (Thailand, Indonesia, India and China): -4% and +1%. These figures for replacement tires (passenger cars) are the following: Japan: -1% and -1%; North America: +3% and -2%; Europe: +1% and -1%; and Asia: +2% and +6%.

As tires require higher transport cost, production in consuming areas is a basic principle. All 4 companies have expanded local production and BRIDGESTONE's overseas production ratio reaches approximately 73%. With proportion of raw materials costs to tire's entire cost being large, their business performance is susceptible to changes in markets for natural rubber and crude oil. In 2018, natural rubber price has been stable, and crude oil price continued rising from the beginning to fall of the year, but is currently declining.

In recent years, moves for alliance dissolution, new alliance and M&A have been active. While Sumitomo Rubber dissolved in October 2015 its alliance agreement with The Goodyear Tire & Rubber Company of the U.S., it acquired a major tire sales company in U.K., Micheldever Group Ltd., for acquisition price of approximately 31.2 billion yen and also acquired an overseas DUNLOP brand business for acquisition price of approximately 15.4 billion yen in 2017. While Yokohama Rubber dissolved in March 2016 its business alliance with Continental AG in Germany, it acquired India-based Alliance Tire Group for agricultural and industrial tires for acquisition price of 133.9 billion yen in July 2016. BRIDGESTONE has been aggressive engaging itself in expanding the overseas sales network, and been strengthening since 2016 its retail network in Europe through acquisitions of a major automotive maintenance service chain and a major tire retail chain in France. In January 2019, BRIDGESTONE announced that it would acquire TomTom Telematics BV in the Netherlands which provides vehicle management services using Internet for acquisition price of 113.8 billion yen. Toyo Tire announced in November 2018 its capital and business alliance with Mitsubishi Corporation ("MC"), and said that it would use proceeds from third-party allotment for new share issues from MC mainly for enhancement of production capacity of tire plants in U.S. and Malaysia and construction of new production bases.

JCR sees that dissolutions of these alliances by Sumitomo Rubber, etc. are a move toward flexibility of business development in significantly changing business environments including increasing demand in countries other than Japan, U.S. and Europe and their expanded overseas production bases. As for new alliances and M&A, JCR sees that they aim to expand their product lineups and overseas sales networks and also respond to shift to provisions of services from just tire sales through these measures.

2. Financial Results

Aggregate operating income of the 4 companies (business profit (IFRS) for Sumitomo Rubber from FY2016 and Yokohama Rubber from FY2017), increased for 6 years in a row till FY2015 after it bottomed out in FY2009, but it decreased in FY2016 due to appreciation of yen and again in FY2017 due to increased raw materials price (Chart 1). In FY2018, revenue decreased 0.3% year-on-year and operating income decreased 4.2% year-on-year. In the profit increase/ decrease analysis (total of 4 companies), major factors for profit increase were “Price, Mix, Volume, etc.” of 13.7 billion yen and “Raw Materials Price” of 3.8 billion yen (Chart 2). Effects from gradual price hike of tires and increased sales of high-value added large-diameter tires such as tires for SUVs contributed to “Price, Mix, Volume, etc.” “Raw Materials Price” (total of 3 companies excluding BRIDGESTONE) consisted of natural rubber of +22.6 billion yen (factor for profit increase) and petroleum raw materials of -15.2 billion yen (factor for profit decrease). Price of carbon black, which is a petrochemical product derived from naphtha, increased. Major factors for profit decrease, on the other hand, were “Impact of Foreign Exchange Fluctuation” of 5.6 billion yen and increased fixed and other expenses due to development of new overseas bases.

As for financial aspect, Toyo Tire, which recorded an extraordinary loss due to a seismic isolation rubber problem (non-conformity to the certification standards), and Yokohama Rubber, which implemented a large acquisition, both deteriorated their equity ratio for FY2016. In FY2017, BRIDGESTONE and Sumitomo Rubber slightly worsened this ratio. This is because Sumitomo Rubber increased its interest-bearing debt due to the 2 large acquisitions in 2017 and BRIDGESTONE promoted repurchase of its own shares up to 150 billion yen as a ceiling after shifting into a net cash position of 128.9 billion yen as of December 31, 2016. In FY2017, while 3 companies excluding Toyo Tire improved their equity ratio, Toyo Tire slightly worsened its equity ratio due to the increased interest-bearing debt caused by cash outs for investments for enhancement of production capacity at the overseas plants and repair works for the seismic isolation rubber.

3. Highlights for Rating

Aggregate revenue of the 4 companies is expected to increase 1.5% year-on-year and the operating income is expected to decline 0.3% year-on-year for FY2018. In the profit increase/ decrease analysis, while major factor for profit increase is “Price, Mix, Volume, etc.” of 97.1 billion yen, major factors for profit decrease are “Impact of Foreign Exchange Fluctuation” of 31.8 billion yen and “Raw Materials Price” of 2.3 billion yen. For the “Price, Mix, Volume, etc.,” JCR pays attention to how much they can recover the increased petroleum raw materials price in 2018 by price hike mainly for replacement tires and how much the decreased natural rubber price can have an impact as a factor for profit decrease through a price system where prices are linked with raw materials costs for tires for new cars. There are differences among countries and areas in allowance of price hike for replacement tires and the 4 companies need to increase the price in consideration of the competitive conditions. Thus, the price hike will be different from company to company. For impact from the “Raw Materials Price,” most companies assume it as a factor for a slight profit increase, but there are also companies, which assume it as a factor for profit decrease, and there are differences in price outlook of raw materials.

There will remain concerns for the time being about impact from political issues as external factors such as U.S.-China trade frictions and Brexit on slowdown of economies. For additional duties between Japan and U.S., which is being studied by the U.S. government, there is a risk that it will decrease domestic automobile production, although tire exports to the U.S. from Japan are not large, if realized.

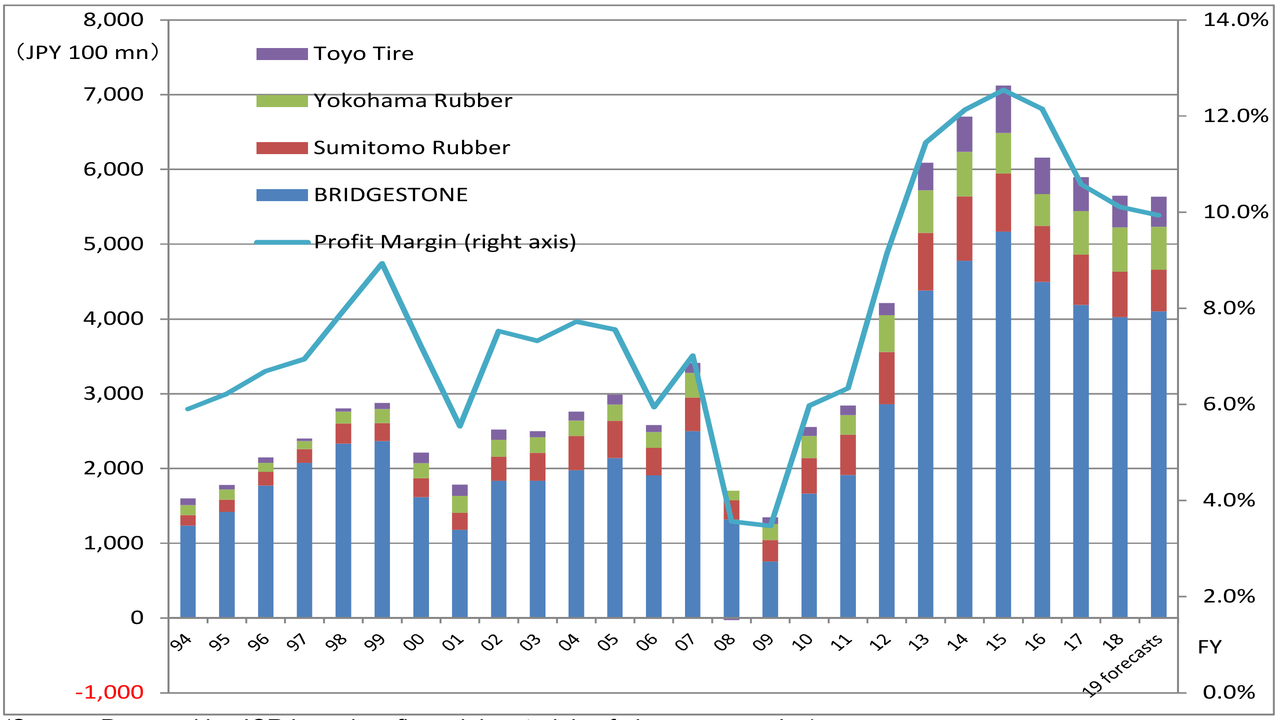
JCR expects that all 4 companies will improve financial structure over a medium term thanks to tire business’ stable cash flow generating abilities. For capital investments, overseas capital expenditures have been staying at a high level against the background of their enhancement of supply system for large-diameter tires such as tires for SUVs. JCR therefore sees that it is unlikely that their interest-bearing debt will be significantly reduced and that it is likely that an improvement of financial structure will be slow for the time being.

Automakers are now fully engaging in developments and services of next generation technologies that are represented by CASE (Connected, Autonomous, Shared and Electric). While impact from electric vehicles on tire industry will not be large, requirements for durability and fuel efficiency will become stronger, because vehicle is expected to be heavier. Concerning progress of autonomous driving technology, it is assumed that demand for run-flat and airless tires will increase and that needs for understanding road conditions and information management technologies will increase, because a puncture is not allowed.

JCR will in general pay attention to impact of trend of world economy on tire sales. It is important to expand effects from "Price, Mix, Volume, etc." for profit increase in the midst of focusing on strategic products and high value-added products. For individual companies, JCR will pay attention to realization of synergistic effects with acquired companies and progress of financial improvement for Sumitomo Rubber and Yokohama Rubber, and synergistic effects from capital and business alliance with MC, contents of construction plan for new production bases, and repair works for seismic isolation rubber for Toyo Tire.

Mikiya Kubota, Akio Kamimura

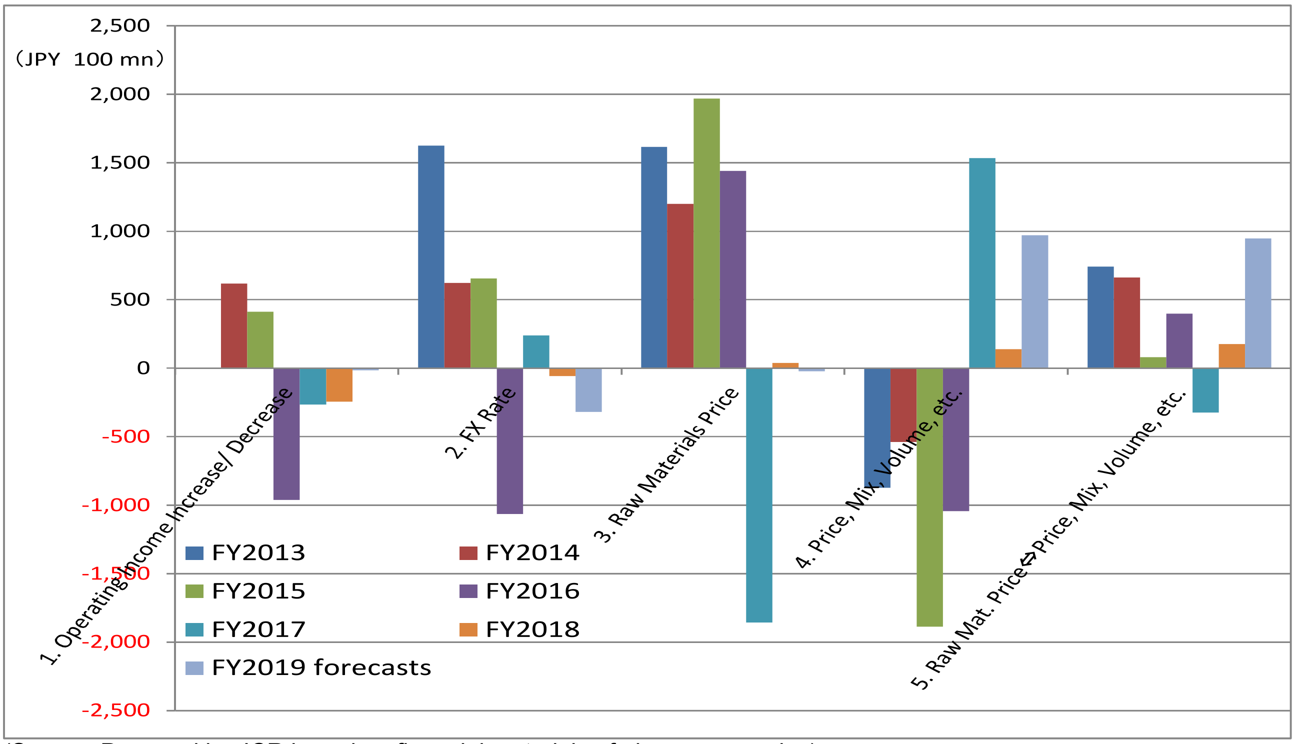
(Chart 1) Operating Income and Operating Margin (Total of 4 Companies)



(Source: Prepared by JCR based on financial materials of above companies)

Note: Business profit (IFRS) for Sumitomo Rubber from FY2016 and Yokohama Rubber from FY2017

(Chart 2) Profit Increase/ Decrease Analysis (Total of 4 Companies)



(Source: Prepared by JCR based on financial materials of above companies)

<Reference>

Issuer: BRIDGESTONE CORPORATION

Long-term Issuer Rating: AA+ Outlook: Stable

Issuer: Sumitomo Rubber Industries, Ltd.

Long-term Issuer Rating: AA- Outlook: Stable

Issuer: The Yokohama Rubber Company, Limited

Long-term Issuer Rating: A+ Outlook: Stable

Issuer: Toyo Tire Corporation

Long-term Issuer Rating: BBB+ Outlook: Stable

Japan Credit Rating Agency, Ltd.
Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026