23-D-0224
June 2, 2023

Highlights of Major Cement Companies' Financial Results for Fiscal Year Ended March 2023

The following are Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning two major specialized cement companies: Sumitomo Osaka Cement Co., Ltd. ("Sumitomo Osaka Cement") and TAIHEIYO CEMENT CORPORATION ("TAIHEIYO CEMENT"), which are based on the financial results for the fiscal year ended March 2023 (FY2022) and earnings forecasts for FY2023 of Japan's four major cement companies* (collectively, the "Companies").

* Consolidated financial figures of Mitsubishi UBE Cement Corporation ("MUCC"; created through the integration of the cement and related businesses of Mitsubishi Materials Corporation, UBE Corporation and UBE-MITSUBISHI CEMENT CORPORATION in April 2022) and the cement business' figures of Tokuyama Corporation ("Tokuyama") are used for cement-related businesses' net sales and operating income in "2. Financial Results."

1. Industry Trend

Japan's domestic cement demand fell 1.6% over the year to 37.28 million tons in FY2022, down for the fourth consecutive year. Private-sector demand was firm, but public-sector demand including public works plunged. With the reversal of the public-private ratio in domestic demand since FY2017, the decline in public-sector demand has been remarkable. Cement exports dropped sharply by 29.1% over the year to 8.14 million tons in FY2022, falling below 10 million tons for the first time since FY2014. Cement manufacturers have to date enhanced exports to offset the decline in domestic demand, but, because profitability fell due to the soaring coal prices and the rise in freight rates, they restrained one-time transactions in particular.

According to the FY2023 forecast announced by the Japan Cement Association in February 2023, domestic demand is projected to grow 1.9% over the year to 38.00 million tons. Public-sector demand is expected to remain almost flat from the previous year as the same level of the public construction budget as the previous year will be secured thanks in part to supplementary budgets related to the initiatives for building national resilience. Private-sector demand on the other hand is expected to exceed the FY2022 level as growth in construction demand is anticipated in the non-residential areas, including large-scale urban redevelopment projects, warehouses and factories. However, the postponement of construction works due to labor shortage has become a structural problem in recent years, on top of which skyrocketing construction costs are causing a decline in demand for the reconstruction of residences and small- and medium-sized buildings. JCR views that this downward trend in domestic demand could continue going forward, too.

2. Financial Results

Net sales of the Companies combined for the cement-related businesses for FY2022 came to1,592.3 billion yen, while operating income turned negative to 48.9 billion yen in loss. All four companies reported loss despite growth in net sales. Net sales improved thanks to price increases, albeit a year-on-year drop in domestic sales volume. Operating loss was reported because of delays in the price pass-through to respond to a surge in energy prices, especially for coals.

In terms of FY2022 results of the two major specialized cement companies, Sumitomo Osaka Cement saw net sales improve 11.1% over the year to 204.7 billion yen while operating income fell from positive 6.8 billion yen to negative 8.5 billion yen. Domestic sales volume was 8.14 million tons, and export volume 1.15 million tons, falling 2.4% and 25.1% from the previous year, respectively. Net sales for the Cement-related business grew thanks in part to price increases, but such increases were insufficient to absorb soaring coal prices, resulting in large operating loss. The High-Performance Product business achieved growth in net sales and operating income, helped by the robust sales of electronic materials for semiconductor manufacturing equipment, but not to the extent of offsetting the loss in the Cement-related business. As regards TAIHEIYO CEMENT, while net sales rose 14.3% to 809.5 billion yen, operating income plunged 90.5% to 4.4 billion yen. Domestic sales volume was 13.13 million tons, and export volume 2.44 million tons, falling 1.8% and 41.2% from the previous year, respectively. Net sales grew in all segments thanks in part to price increases; for operating income, although it was solid for some segments, it was drastically impacted by the large loss in the domestic cement businesses as price increases were insufficient, as with other companies, to absorb the soaring coal prices. Financial structure weakened for both companies. Interest-bearing debt climbed sharply due in part to an increase in working capital caused by a sharp rise in coal prices and growth in capital investments. Shareholders' equity also declined due to the deficit. Equity ratio as of the year-end fell sharply year on year: 9.5 points to 51.2% for Sumitomo Osaka Cement and 7.3 points to 39.0% for TAIHEIYO CEMENT.

3. Highlights for Rating

For FY2023, the forecast of the Companies combined for the cement-related businesses is 1,832.1 billion yen in net sales, up 15.1% from the previous year, and 84.7 billion yen in operating income, turning positive. Growth in net sales will likely be helped by an increase in sales volume to some extent but mostly by price revisions. For operating income, the surge in coal prices is expected to tail off, and price revisions will have positive impact. Some companies anticipate profit contribution also from structural reforms, including a cut in production capacity.

As regards the FY2023 forecast of the two major specialized cement companies, Sumitomo Osaka Cement forecasts 230.0 billion yen in net sales with a 12.4% year-on-year growth and 6.1 billion yen in operating income turning around from operating loss. The Cement-related business is expected to turn profitable with the penetration of price increases, while the High-Performance Product business will likely remain firm. TAIHEIYO CEMENT forecasts 920.0 billion yen in net sales and 58.0 billion yen in operating income, both improving from the previous year by 13.6% and 1,201.5%, respectively. The domestic cement business will likely turn profitable with the penetration of price increases, and the overseas cement and cement-related businesses are also expected to continue faring well.

For the purpose of the rating in FY2023, JCR continues monitoring progress in cement price increases. The approximately 2,000-yen hike announced by the Companies in the fall of 2021 has been largely implemented by the end of FY2022. As regards the additional 3,000-yen increase announced in the summer of 2022, it seems to be gradually gaining acceptance in 2023. The problem is the time span of negotiations and the actual timing of the price increases. If negotiations take time, the risk of fluctuations in coal prices will increase, which may affect the negotiations. The earnings forecasts of the Companies also suggest that the timing of contribution from the price increases varies. If sufficient price increases cannot be realized, the cash flow generation capacity of the domestic cement business will decline, which will affect investments in the measures to address aging and environmental issues. As the above factors will put downward pressure on the rating, JCR will keep monitoring the degree of penetration of the price hikes.

JCR is also watching the restructuring of production systems in the industry. As operating rates of factories are declining, there are moves among the companies other than the two major specialized cement companies to reduce production capacity or withdraw from the cement business. MUCC has announced, among others, the decommission of Aomori Plant, while Denka Company Limited has announced that it will transfer its cement sales business to TAIHEIYO CEMENT and stop cement production in the future, stating that it is difficult to maintain, and pursue growth of, the business on its own. Tokuyama, too, has begun considering the partial shutdown of its cement kilns. Domestic demand has not been declining sharply but is certainly shrinking. It appears that this has been impacted also by a drop in operating rates due to the decline in exports, an increase in expenditures for achieving carbon neutrality, etc. JCR considers that the restructuring of production systems will affect the earnings structure of the industry over the medium to long term.

JCR will also monitor the impact of the initiatives aimed at carbon neutrality and growth investments on the financial structure. The development of new technologies and capital investments to curb CO_2 emissions will become even more essential in the future. The Companies' management plans include plans for capital investments to address environmental issues. However, there are many uncertainties about capital expenditures arising from new technologies, and such spending may grow larger than expected. Moreover, the Companies are striving to strengthen non-cement businesses in Japan, resulting in an increase in investments every year. Their investment policies and financial discipline are important factors for the rating.

Naoki Kato, Hajime Inoue

(Chart 1) Net Sales and Operating Income of the Companies' Cement-related Businesses

(JPY 100 mn, %)

		FY2018	FY2019	FY2020	FY2021	FY2022	FY2023F
Sumitomo Osaka Cement (5232)	Net Sales	2,249	2,205	2,170	1,597	1,758	1,991
	Operating Income	112	125	132	17	-156	-0
TAIHEIYO CEMENT (5233)	Net Sales	9,056	8,743	8,479	6,778	7,817	8,940
	Operating Income	616	559	574	404	-12	537
MITSUBISHI MATERIALS (5711)	Net Sales	2,536	2,475	2,158	2,098		
	Operating Income	197	122	66	32		
UBE (4208)	Net Sales	3,210	3,030	2,828	2,215		
	Operating Income	144	145	147	34		
MUCC (Unlisted)	Net Sales					5,736	6,700
	Operating Income					-284	250
Tokuyama (4043)	Net Sales	923	872	908	503	585	690
	Operating Income	32	38	45	-19	-37	605
Total	Net Sales	17,975	17,325	16,543	13,191	15,923	18,321
	Operating Income	1,101	989	964	468	-489	847
	Operating Income Margin	6.1%	5.7%	5.8%	3.5%	-3.1%	4.6%
Percent change in Total from the previous year	Net Sales	12.4%	-3.6%	-4.5%	-20.3%	-	15.1%
	Operating Income	-2.7%	-10.2%	-2.6%	-51.5%	-	-

Notes:
1. Sumitomo Osaka Cement: Cement, mineral resources and cement-related products businesses
   Net Sales refer to sales to outside customers.
2. TAIHEIYO CEMENT: Cement, mineral resources, environmental and construction materials businesses
3. MITSUBISHI MATERIALS: Cement business
   There were inter-segment transfers in FY2018 and FY2020.
4. UBE: Construction materials business
   FY2018 figures are affected by the integration with other segments.
5. Tokuyama: Cement business
   FY2021 figures are affected by inter-segment transfers.
6. MUCC: Construction materials business
   Figures are taken out from the financial materials of MITSUBISHI MATERIALS and UBE.

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

(Chart 2) Business Performance of Specialized Cement Companies

(JPY 100 mn, %)

		FY2018	FY2019	FY2020	FY2021	FY2022	FY2023F
Sumitomo Osaka Cement	Net Sales	2,510	2,451	2,392	1,842	2,047	2,300
	Operating Income	141	161	166	68	-85	61
	Operating Income Margin	5.6	6.6	6.9	3.7	-4.2	2.7
	Net Income	77	109	117	96	-57	60
	Shareholders' Equity	1,922	1,967	2,037	2,010	1,824	
	Interest-bearing Debt	611	526	514	566	997	904
	Equity Ratio	59.2	61.3	61.8	60.7	51.2	
TAIHEIYO CEMENT	Net Sales	9,160	8,843	8,639	7,082	8,095	9,200
	Operating Income	660	610	636	467	44	580
	Operating Income Margin	7.2	6.9	7.4	6.6	0.6	6.3
	Net Income	434	391	468	289	-332	400
	Shareholders' Equity	4,147	4,367	4,709	5,106	4,949	
	Interest-bearing Debt	2,796	2,661	2,481	2,706	4,035	4,000
	Equity Ratio	40.1	42.3	45.1	46.3	39.0	

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

<Reference>

Issuer: Sumitomo Osaka Cement Co., Ltd.

Long-term Issuer Rating: A Outlook: Stable

Issuer: TAIHEIYO CEMENT CORPORATION

Long-term Issuer Rating: A Outlook: Stable

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