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May 23, 2019

Highlights of Blast Furnace Steelmakers' Financial Results for Fiscal Year Ended March 2019

The following is 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 March 2019 (FY2018) and earnings forecasts for FY2019 of Japan's four blast furnace steelmakers: NIPPON STEEL CORPORATION ("NIPPON STEEL"), JFE Holdings, Inc. ("JFE"), Kobe Steel, Ltd. ("KOBELCO") and NIPPON STEEL NISSHIN CO., LTD. ("NIPPON STEEL NISSHIN").

1. Industry Trend

Japan's crude steel production fell for the second year in a row in FY2018 to 102.89 million tons, down 1.9% from the previous year (Chart 1). While demand was strong in general, especially in construction and automotive industries, growth in production volume was weak due to natural disasters, production disruptions, etc.

Production volume is projected to turn around in FY2019 to exceed 105 million tons as steel demand is expected to remain brisk while the impact of production disruptions and other factors seen in FY2018 will cease. That said, because production facilities are operating at full capacity for most of Japan's steelmakers, a huge increase in the volume can hardly be expected.

Steel prices in the domestic market are staying high. As contributing factors, the supply-demand balance has been tight, and companies have been raising steel prices in response to a hike in the prices of refractories, ferroalloys and other auxiliary materials and also in transportation costs. Given that iron ore prices are rising because of the Vale mining accident in Brazil and cyclones hitting Australia, steel prices are hardly likely to go down in FY2019 either.

Asia's steel market remained strong in the first half of FY2018, widening the metal spread, i.e. a difference between the prices of primary raw materials and product prices, in export transactions. It plummeted in the third quarter partly because of concerns about a decline in China's domestic demand due to the U.S.-China trade conflict but has been improving since the fourth quarter. That said, in the event that such conflict intensifies going forward, slowing down China's economy and weakening domestic demand there, China may increase steel exports to other Asian countries, resulting in a market slump. So far, no major changes in the steel exports are observed, but continued attention must be paid to China's moves.

2. Financial Results

The combined operating income—gross profit less SG&A expenses for NIPPON STEEL and JFE—of three blast furnace steelmakers except NIPPON STEEL NISSHIN that is included in NIPPON STEEL's consolidated results (collectively, the "Companies") came to 454.1 billion yen in FY2018, down 18.2% from the previous year (Chart 2). A decline in production volume due to natural disasters and production disruptions and growth in costs dragged down the income, more than offsetting the positive impact of the improved metal spread.

The Companies appear to have made good progress in their endeavor to push up steel prices. Looking at the average unit price, it increased by 23,200 yen from 68,000 yen in the first half of FY2016 to 91,200 yen in the second half of FY2018 for NIPPON STEEL. For JFE, it rose from 58,600 yen to 82,500 yen with an increase of 23,900 yen during the same period. This indicates that the Companies have more or less achieved the target price raise of 20,000 yen/ton.

On the financial front, the interest-bearing debt (after the evaluation of equity content of subordinated loans; the same applies hereinafter) grew for all of the Companies, bringing the combined total to 4,378.4 billion yen as of the end of FY2018, up 9.1% from a year before. This increase was led by the Companies' aggressive capital spending and NIPPON STEEL's fairly large-scale business investments, including the consolidation of Sanyo Special Steel Co., Ltd. and Ovako AB. Meanwhile, the combined equity attributable to owners of the parent (after the evaluation of equity content of subordinated loans; the same applies hereinafter; equity capital for KOBELCO) of the

Companies grew 2.6% over the year to 6,171.7 billion yen with an increase in such equity for NIPPON STEEL and JFE thanks to profit accumulation. Consequently, the combined DER, i.e. interest-bearing debt divided by equity attributable to owners of the parent, as of the end of FY2018 stood at 0.7, remaining flat from a year before (Chart 3).

3. Highlights for Rating

For FY2019, NIPPON STEEL stated, when releasing its FY2018 results, that it is unable to provide financial forecasts because of difficulty in reasonable calculation due in part to ongoing negotiations with customers as to possible improvement in steel prices. Meanwhile, JFE expects its business profit to slip 22.4% on year to 180.0 billion yen, while KOBELCO forecasts a 13.4% drop in ordinary income to 30.0 billion yen. As for JFE, while expecting an increase in production volume with the resolution of production disruptions and reductions in costs, it still projects the profit decline as a slump in overseas steel markets, coupled with other factors, will narrow the metal spread and unrealized gains on inventories will decrease. KOBELCO expects the drop due in part to higher fixed costs in materials businesses, including depreciation and maintenance costs, and the elimination of reversal of allowance for doubtful accounts that was reported for the construction machinery business in FY2018.

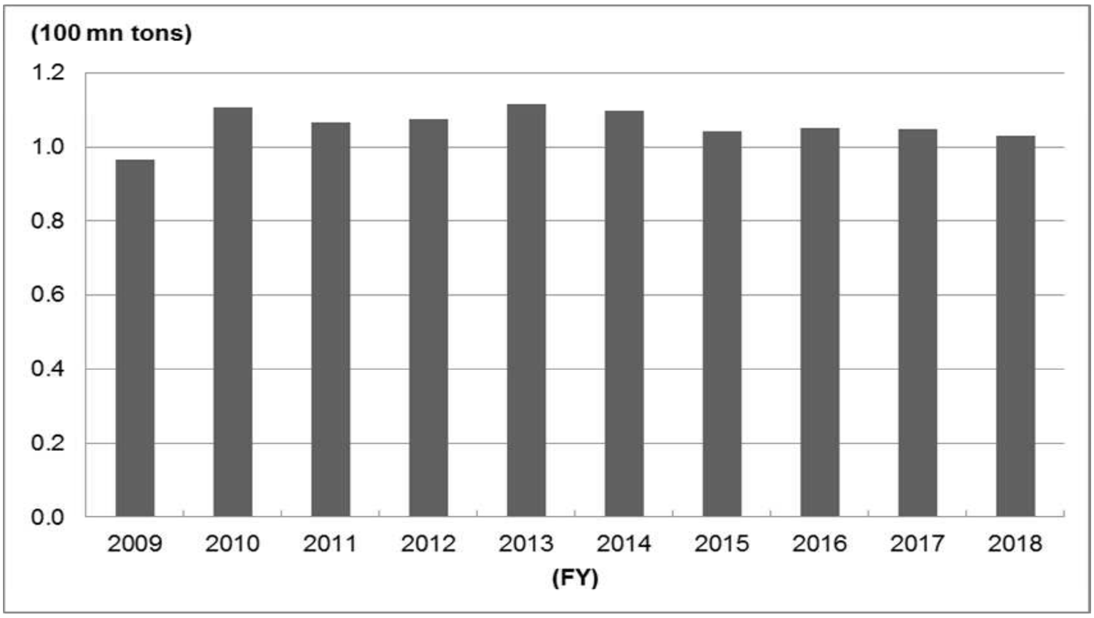
While the Companies have more or less achieved their initial target of raising steel prices by 20,000 yen/ton, NIPPON STEEL is still half way to attaining the target of improving the margin by 5,000 yen/ton. A rise in the prices of ferroalloys and other auxiliary materials as well as transportation costs, etc., which pushed down the margin for the Companies in FY2018, is expected to continue into FY2019, thus dragging down the overall performance even more. It is highly important that the Companies appropriately reflect these cost increases in product prices in order to maintain and even improve profitability. Going forward, whether they can implement price hikes will be closely watched.

Another challenge facing the Companies is to curtail production disruptions. In FY2018, JFE encountered operational problems with its blast furnaces in Kurashiki, Chiba and Fukuyama, which, coupled with the impact of natural disasters, led to a decrease in crude steel production of JFE Steel Corporation alone by approximately 2.70 million tons. NIPPON STEEL and KOBELCO, too, though not as significant as JFE, saw some production disruptions, putting downward pressures on their crude steel production. Causes of these troubles vary widely, but major ones appear to include: greater burden on production facilities due to product upgrades; generation changes at production sites; and aging of facilities. Therefore, reducing the occurrence of these troubles through appropriate facility maintenance, etc. is also a key to improving business performance for the Companies.

The Companies plan to continue aggressive capital investments into FY2019, and NIPPON STEEL will likely see cash outflow because of business investments, including the scheduled joint acquisition of Essar Steel India Limited. Consequently, financial indicators are expected to weaken from FY2018. That said, JCR assumes that, recognizing the importance of retaining financial health, the Companies will continue their efforts to curb the deterioration of financial conditions through cash generation measures, including reduction in assets.

Masayoshi Mizukawa, Akihiro Kondo

(Chart 1) Domestic Crude Steel Production



(Source: Prepared by JCR based on data of The Japan Iron and Steel Federation)

(Chart 2) Financial Results of Four Blast Furnace Steelmakers

(JPY 100 mn, %)

		Revenue	YOY Change	Gross Profit - SG&A Exp.	YOY Change	Business Profit	YOY Change	Business Profit / Revenue	Profit Attributable to Owners of the Parent	YOY Change
NIPPON STEEL (5401)	FY2017	57,129	*21.6*	2,302	-	2,887	*69.9*	5.1	1,808	*31.8*
	FY2018	61,779	*8.1*	2,180	*-5.3*	3,369	*16.7*	5.5	2,511	*38.9*
	FY2019F	N/A								
JFE (5411)	FY2017	36,272	-	2,359	-	2,183	-	6.0	976	-
	FY2018	38,736	*6.8*	1,878	*-20.4*	2,320	*6.3*	6.0	1,635	*67.5*
	FY2019F	-	-	-	-	1,800	*-22.4*	-	-	-

		Net Sales	YOY Change	Operating Income	YOY Change	Ordinary Income	YOY Change	Ordinary Income / Net Sales	Net Income Attributable to Owners of the Parent	YOY Change
KOBELCO (5406)	FY2017	18,811	*10.9*	889	*812.0*	711	-	3.8	631	-
	FY2018	19,718	*4.8*	482	*-45.7*	346	*-51.3*	1.8	359	*-43.1*
	FY2019F	20,070	*5.0*	450	*-6.8*	300	*-13.4*	1.4	250	*-30.4*
NIPPON STEEL NISSHIN (–)	FY2017	6,141	*16.9*	178	*127.2*	188	*214.7*	3.1	130	-
	FY2018	6,315	*2.8*	-16	-	22	*-88.3*	0.3	-	-

		Revenue	YOY Change	Gross Profit - SG&A Exp.	YOY Change	Net Income	YOY Change
Total	FY2017	112,213	-	5,551	-	3,416	-
	FY2018	120,234	*7.1*	4,541	*-18.2*	4,506	*31.9*

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

*1: Figures for NIPPON STEEL and JFE are IFRS-based.
*2: “Revenue” under “Total” is “Net Sales” for KOBELCO.
*3: “Gross Profit - SG&A Exp.” under “Total” is “Operating Income” for KOBELCO.
*4: “Net Income” under “Total” is the sum of “Net Income Attributable to Owners of the Parent” under J-GAAP and “Profit Attributable to Owners of the Parent” under IFRS.
*5: “Total” excludes NIPPON STEEL NISSHIN that is included in NIPPON STEEL’s consolidated results.

(Chart 3) Financial Structure of Four Blast Furnace Steelmakers

(JPY 100 mn, times)

		Equity Attributable to Owners of the Parent	Interest-bearing Debt	D/E Ratio	EBITDA	Interest-bearing Debt / EBITDA	Operating Cash Flow	Investing Cash Flow
NIPPON STEEL (5401)	FY2016	30,982	19,418	0.6	4,435	4.4	4,842	-3,437
	FY2017	32,869	20,077	0.6	5,968	3.4	4,855	-3,631
	FY2018	33,807	22,192	0.7	6,266	3.5	4,523	-3,818
JFE (5411)	FY2016	21,408	11,004	0.5	2,904	3.8	1,854	-1,637
	FY2017	19,877	12,662	0.6	4,185	3.0	3,283	-2,164
	FY2018	20,513	13,988	0.7	3,841	3.6	2,682	-3,133

		Equity Capital	Interest-bearing Debt	D/E Ratio	EBITDA	Interest-bearing Debt / EBITDA	Operating Cash Flow	Investing Cash Flow
KOBELCO (5406)	FY2016	6,739	7,969	1.2	1,118	7.1	1,417	-1,378
	FY2017	7,425	7,388	1.0	1,972	3.7	1,908	-1,615
	FY2018	7,395	7,603	1.0	1,579	4.8	671	-286
NIPPON STEEL NISSHIN (–)	FY2016	2,332	2,250	1.0	372	6.0	575	-375
	FY2017	2,335	2,240	1.0	539	4.2	443	-277

		Equity Attributable to Owners of the Parent	Interest-bearing Debt	D/E Ratio	EBITDA	Interest-bearing Debt / EBITDA	Operating Cash Flow	Investing Cash Flow
Total	FY2016	59,129	38,392	0.6	8,831	4.3	8,690	-6,829
	FY2017	60,172	40,128	0.7	12,126	3.3	10,047	-7,412
	FY2018	61,717	43,784	0.7	11,686	3.7	7,877	-7,237

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

*6: Figures after the evaluation of equity content of subordinated loans for NIPPON STEEL and JFE

*7: For FY2016, NIPPON STEEL and JFE's figures are actual results under J-GAAP, and "Equity Attributable to Owners of the Parent" is equity capital.

*8: For FY2017 and FY2018, EBITDA for NIPPON STEEL and JFE is: gross profit - SG&A expenses + depreciation expenses.

*9: "Equity Attributable to Owners of the Parent" under "Total" is the sum of "Equity Capital" under J-GAAP and Equity Attributable to Owners of the Parent" under IFRS.

*10: "EBITDA," "Interest-bearing Debt / EBITDA," "Operating Cash Flow" and "Investing Cash Flow" under "Total" include NIPPON STEEL NISSHIN, while other items exclude NIPPON STEEL NISSHIN that is included in NIPPON STEEL's consolidated results.

<Reference>

Issuer: NIPPON STEEL CORPORATION

Long-term Issuer Rating: AA- Outlook: Stable

Issuer: JFE Holdings, Inc.

Long-term Issuer Rating: AA- Outlook: Stable

Issuer: JFE Steel Corporation

Long-term Issuer Rating: AA- Outlook: Stable

Issuer: Kobe Steel, Ltd.

Long-term Issuer Rating: A Outlook: Negative

Issuer: NIPPON STEEL NISSHIN CO., LTD.

Long-term Issuer Rating: A+ Outlook: Stable

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