

Highlights of Blast Furnace Steelmakers' Financial Results for Fiscal Year Ended March 2021

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 March 2021 (FY2020) and earnings forecasts for FY2021 of Japan's 3 blast furnace steelmakers: NIPPON STEEL CORPORATION ("NIPPON STEEL"), JFE Holdings, Inc. ("JFE") and Kobe Steel, Ltd. ("KOBELCO").

1. Industry Trend

Japan's crude steel production for FY2020 was 82.79 million tons, a significant decrease from 98.24 million tons in FY2019 (Chart 1). The main reason for the drop is that demand from the manufacturing industry fell sharply in the first half of FY2020 due to the expansion of COVID-19 pandemic. On the other hand, the second half of FY2020 saw a recovery in demand, especially from automotive-related industries. Although the COVID-19 pandemic has been expanding again since December 2020, there has been no significant change in the customers' production trend, and the impact on steel demand has been limited.

The price of iron ore has been rising since May 2020. This is due to the fact that crude steel production in China, which recovered from the COVID-19 pandemic earlier, has been remaining at a high level, which has increased demand for iron ore. In order to cope with the high raw material prices, blast furnace steelmakers are raising steel prices.

The overseas steel market prices fell sharply in April to May 2020 due to the drop in demand caused by the expansion of COVID-19 pandemic. However, from June 2020 onward, the overseas steel market prices turned upward thanks to the tightening of supply and demand for steel products in Asia against the backdrop of strong demand in China and the higher prices of raw materials. As overseas steel prices rose at a pace faster than the increase in raw material costs, the metal spread (difference between raw material prices and product prices) in the exports of blast furnace steelmakers improved.

2. Financial Results

The total revenue of the 3 companies for FY2020 (net sales for KOBELCO) was 9,762.1 billion yen (down 15.3% from the previous year) (Chart 2). Production and sales volumes declined for each company due to drop in demand caused by expansion of the COVID-19 pandemic. On the other hand, their total operating income (gross profit less SG&A expenses and depreciation expenses for NIPPON STEEL and JFE) improved to 117.0 billion yen (up 36.3% year-on-year). Despite the impact of the decline in production and sales volumes, they covered it by reductions in fixed costs such as labor and repair expenses, as well as variable costs, while a decrease in depreciation expenses due to the recording of impairment losses at each company in FY2019 and a change in the depreciation method at NIPPON STEEL also contributed to the improvement. In addition, early release of banking of blast furnaces and quick shift to increased production in response to recovery in demand in the second half of FY2020 also contributed to the improved performance. On the other hand, total profit attributable to owners of the parent (net income attributable to owners of the parent for KOBELCO) was a loss of 31.0 billion yen (697.2 billion yen loss in FY2019), the second consecutive year of losses. The main reason for the loss was that NIPPON STEEL posted losses related to the suspension of domestic facilities and withdrawal from overseas operations. However, the loss was reduced with the absence of impairment losses recorded by each company in FY2019.

On the financial front, total balance of interest-bearing debt (after evaluation of equity content of subordinated loans) of the 3 companies at the end of FY2020 was 4,853.1 billion yen (up 1.4% from the end of FY2019) (Chart 3). In addition to the continued difficult business performance, capital expenditures were at a high level. On the other hand, total equity attributable to owners of the parent (after evaluation of equity content of subordinated loans, equity capital for KOBELCO) of the 3 companies increased to 5,649.5 billion yen (up 5.6%; same as above). The increase was thanks to NIPPON STEEL increasing its subordinated loan (300 billion yen was redeemed before maturity and

450 billion yen was newly raised) and improvement in other comprehensive income at each company thanks to higher stock prices. As a result, DER based on total equity attributable to owners of the parent (same as above) and interest-bearing debt (same as above) of the 3 companies at the end of FY2020 was 0.9x, roughly the same level as at the end of FY2019.

3. Highlights for Rating

The 3 companies are expected to return to profitability for the first time in 3 fiscal years, with total profit attributable to owners of the parent (same as above) of 395.0 billion yen in FY2021. Increases in production and sales volumes, cost reductions, and improvements in inventory valuation gains (losses) are expected to contribute to the improved performance.

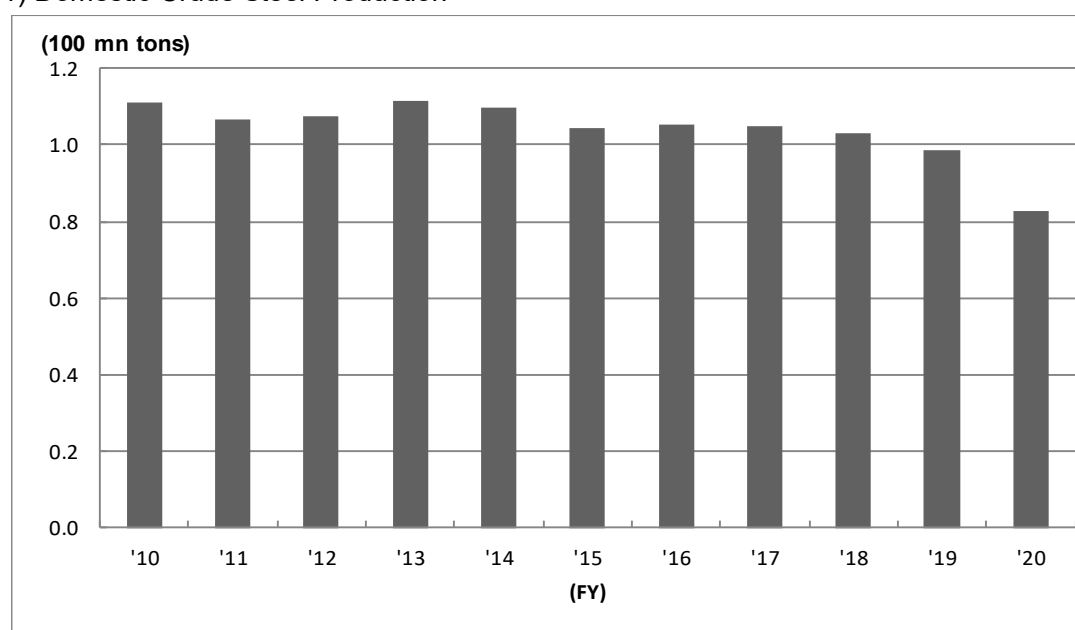
The total non-consolidated crude steel production of the 3 companies in FY2021 is expected to be around 73.1 million tons (compared to 61.57 million tons in FY2020), which is less than the 75.08 million tons produced in FY2019, but an increase in production volume is planned. The increase in production is with the recovery in demand, especially from the manufacturing industry. On the other hand, there is still a risk that demand for steel products will be depressed due to factors such as the rekindling of trade friction between the U.S. and China and a decline in automobile production caused by a shortage of semiconductors for automobiles. Trends in the customer industries and the sustainability of demand recovery will be the focus of attention.

Trends in overseas steel supply and demand and steel market conditions have a significant impact on the profitability of exports for each company. Overseas steel market prices have been rising since June 2020 and are currently at historically high levels. In addition, if China's domestic demand slows down and steel exports increase, steel market prices will fall due to easing of supply and demand, and the metal spread for exports may shrink. On the other hand, in February 2021, China Iron and Steel Association announced its policy to reduce crude steel production in 2021 compared to 2020 as part of its efforts to reduce carbon dioxide emissions. In addition, in May 2021, the Chinese government abolished the refund of value-added tax on steel exports in order to curb crude steel production. If China's steel export volume declines as a result of these measures, Asian steel market prices are expected to remain high in the future with the tightening of supply and demand, and the high profitability of exports is expected to be maintained for the time being. It is necessary to continue to monitor trends in China, the largest steel producer and consumer, and Asian steel market conditions.

Each company has been taking various cash measures such as cutting back on capital expenditures and reducing assets, but their ability to generate cash flow has declined against the backdrop of declining profits, and their financial structure did not improve in FY2020. Going forward, JCR expects that all companies will improve their business performance and that their financial structure will start to improve through interest-bearing debt reduction and accumulation of profits.

Masayoshi Mizukawa, Akihiro Kondo

(Chart 1) Domestic Crude Steel Production



(Source: Prepared by JCR based on data of The Japan Iron and Steel Federation and the Ministry of Economy, Trade and Industry)

(Chart 2) Financial Results of 3 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)	FY2019	59,215	-4.2	373	-82.9	(2,844)	-	-	(4,315)	-
	FY2020	48,292	-18.4	961	157.4	1,100	-	2.3	(324)	-
	FY2021F	60,000	24.2	-	-	4,500	308.9	7.5	2,400	-
JFE (5411)	FY2019	37,297	-3.7	386	-79.4	378	-83.7	1.0	(1,977)	-
	FY2020	32,272	-13.5	(95)	-	(129)	-	-	(218)	-
	FY2021F	39,300	21.8	-	-	2,000	-	5.1	1,300	-

		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)	FY2019	18,698	-5.2	98	-79.6	(80)	-	-	(680)	-
	FY2020	17,055	-8.8	303	208.2	161	-	0.9	232	-
	FY2021F	18,700	9.6	550	80.9	450	178.0	2.4	250	7.6

		Revenue	YOY Change	Gross Profit - SG&A Exp.	YOY Change	Net Income	YOY Change
Total	FY2019	115,210	-4.2	858	-81.1	(6,972)	-
	FY2020	97,621	-15.3	1,170	36.3	(310)	-
	FY2021F	118,000	20.9	-	-	3,950	-

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

*1: Figures for NIPPON STEEL and JFE are based on IFRS, and figures for KOBELCO are based on J-GAAP.

*2: Revenue under Total is Net Sales for KOBELCO.

*3: Net Income under Total is the sum of Net Income Attributable to Owners of the Parent based on J-GAAP and Profit Attributable to Owners of the Parent based on IFRS.

(Chart 3) Financial Structure of 3 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)	FY2018	33,807	22,192	0.7	6,266	3.5	4,523	(3,818)
	FY2019	29,416	21,887	0.7	4,547	4.8	4,943	(3,456)
	FY2020	31,349	21,842	0.7	3,870	5.6	4,031	(3,890)
JFE (5411)	FY2018	20,513	13,988	0.7	3,841	3.6	2,682	(3,133)
	FY2019	17,520	16,893	1.0	2,701	6.3	2,610	(3,583)
	FY2020	18,042	16,811	0.9	2,268	7.4	2,472	(1,642)

		Equity Capital	Interest-bearing Debt	D/E Ratio	EBITDA	Interest-bearing Debt / EBITDA	Operating Cash Flow	Investing Cash Flow
KOBELCO (5406)	FY2018	7,395	7,603	1.0	1,508	5.0	671	(286)
	FY2019	6,568	9,066	1.4	1,152	7.9	270	(2,189)
	FY2020	7,103	9,878	1.4	1,312	7.5	1,947	(1,418)

		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	FY2018	61,717	43,784	0.7	11,616	3.8	7,877	(7,237)
	FY2019	53,505	47,846	0.9	8,401	5.7	7,824	(9,229)
	FY2020	56,495	48,531	0.9	7,451	6.5	8,452	(6,951)

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

*4: Figures after evaluation of equity content of hybrid products for NIPPON STEEL and JFE

*5: EBITDA is gross profit - SG&A expenses + depreciation expenses.

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

<Reference>

Issuer: NIPPON STEEL CORPORATION

Long-term Issuer Rating: AA- Outlook: Negative

Issuer: JFE Holdings, Inc.

Long-term Issuer Rating: AA- Outlook: Negative

Issuer: JFE Steel Corporation

Long-term Issuer Rating: AA- Outlook: Negative

Issuer: Kobe Steel, Ltd.

Long-term Issuer Rating: A- Outlook: Stable

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