

Highlights of Major Cement Companies' Financial Results for Fiscal Year Ended March 2022

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 2022 (FY2021) and earnings forecasts for FY2022 of Japan's major cement companies* (the "Companies").

* This report covers two major specialized cement companies, Sumitomo Osaka Cement Co., Ltd. ("Sumitomo Osaka Cement") and TAIHEIYO CEMENT CORPORATION ("TAIHEIYO CEMENT"), and three major companies that operates the cement business along with other businesses, Mitsubishi Materials Corporation ("Mitsubishi Materials"), UBE Corporation (former Ube Industries, Ltd.; "UBE") and Tokuyama Corporation ("Tokuyama"). For the latter three, only cement-related businesses are reviewed.

1. Industry Trend

Japan's domestic cement demand fell 2.0% over the year to 37.87 million tons in FY2021, down for the third consecutive year. In the outlook for domestic demand at the beginning of the year, it was expected that the off-season period for construction works after the Olympic Games would end and demand would recover, especially in the private sector. However, in actuality, not only public-sector demand was sluggish due partly to the completion of large-scale public works, but growth in private-sector demand was also stagnant because of delays in construction works due to a lack of labor and the COVID crisis, unseasonable weather and so forth. Cement exports, on the other hand, increased 3.3% over the year to 11.48 million tons in FY2021, growing for three years straight as cement manufacturers are enhancing exports in response to the decline in domestic demand.

According to the FY2022 forecast announced by the Japan Cement Association in February 2022, domestic demand is expected to remain almost flat from the previous year at 38.00 million tons. While public-sector demand is projected to decline partly because of a likely cut in the public construction budget, private-sector demand is expected to increase as, for one thing, redevelopment projects in urban areas are predicted to get into full swing with growth in capital expenditures in offices, stores and warehouses. That said, domestic demand is still feared to weaken. Factors like the resumption of economic activities abroad and Russia's invasion of Ukraine have led to a surge in the prices of building materials. Moreover, high construction costs partly owing to rising personnel expenses due to the labor shortage may discourage private-sector investment.

2. Financial Results

Net sales and operating income of the Companies combined for the cement-related businesses decreased 20.3% and 51.5% over the year to 1.3191 trillion yen and 46.8 billion yen, respectively, in FY2021. The decline in net sales is attributable to changes in revenue recognition standards and so forth, and in fact the Companies all achieved sales growth. Operating income, on the other hand, fell sharply for the Companies alike due to a surge in energy prices, especially for coal, and delays in the price pass-through.

In FY2021, Sumitomo Osaka Cement saw both net sales and operating income fall 23.0% and 58.6% over the year to 184.2 billion yen and 6.8 billion yen, respectively. Domestic sales volume was 8.34 million tons, and export volume 1.54 million tons, respectively improving 0.7% and 7.8%, from the previous year. Net sales grew for both the Cement-related and High-Performance Product businesses, if the impact of revenue recognition standards is not considered. Operating income rose in the High-Performance Product business thanks in part to the robust sales of electronic materials for semiconductor manufacturing equipment but fell sharply in the Cement-related businesses due to soaring coal prices. TAIHEIYO CEMENT, too, reported lower net sales and operating income, falling 18.0% and 26.3% over the year to 708.2 billion yen and 46.7 billion yen, respectively. Domestic sales volume dropped 3.0% to 13.36 million tons, while export volume improved 9.8% to 4.15 million tons. Net sales grew in all segments, if the impact of revenue recognition standards is not considered. Operating income was solid in the U.S. cement business but plunged in the domestic cement-related businesses due to soaring coal prices. In terms of the financial structure, Sumitomo Osaka Cement saw an increase in interest-bearing debt and

a decrease in shareholders' equity due to the acquisition of treasury stock, while the financial structure continues to improve for TAIHEIYO CEMENT thanks to the increase in shareholders' equity through profit accumulation, despite larger interest-bearing debt.

3. Highlights for Rating

For FY2022, Sumitomo Osaka Cement forecasts an 11.7% year-on-year growth in net sales to 205.8 billion yen but a 17.1% drop in operating income to 5.7 billion yen. While the High-Performance Product business will continue to fare well, the Cement-related Products business is expected to report a loss partly due to a further rise in coal prices and delays in the price pass-through. Despite soaring coal prices, Tokuyama expects to reduce the loss in the cement business by passing through such prices and cutting manufacturing costs. TAIHEIYO CEMENT has yet to determine its FY2022 earnings forecast for the reason that reasonable calculation is not possible at this point because trends in coal prices, etc. are unpredictable due to the Russia-Ukraine situation, etc. As for Mitsubishi Materials and UBE, they no longer disclose the cement segment's results because the cement-related businesses became an equity-method affiliate following the establishment of Ube-Mitsubishi Cement Corporation.

Due to the lack of disclosed data, it is difficult to capture the whole picture of the FY2022 earnings forecasts. However, given that the prices of energies such as coal have gone up even after the Companies announced a raise in cement prices at the end of 2021 and that there have been delays in price negotiations, it is surmised that the Companies' cement business will continue to struggle.

The first point of focus for the sake of rating for FY2022 is how far the aforementioned cement price increases penetrate the market. The implementation of price increases has been delayed from the initial plan, and JCR will keep an eye on it and its impact on overall performance. It is also assumed that the Companies cannot fully benefit from price increases as coal prices continue to rise. In the event that coal prices go up further, the Companies may raise cement prices again before the end of FY2022. Attention will thus be paid to changes in future coal prices and the Companies' response. The cement industry in recent years has been exhibiting structural weaknesses in the domestic cement business, such as shrinking domestic demand and difficulty in the price pass-through. The Companies should therefore work to solve these structural problems as much as possible.

Secondly, JCR is watching the efforts made to strengthen businesses other than domestic cement. The domestic cement business was in deficit for both of the two specialized cement companies in FY2021, but overall performance deteriorated only limitedly compared to when the cement business ailed in the past, as Sumitomo Osaka Cement was supported by the High-Performance Products business and TAIHEIYO CEMENT by the overseas cement business. As the earnings environment continues to be severe for the domestic cement business even in FY2022, strengthening other businesses has become vital for the Companies, and JCR will keep an eye on their efforts to that end.

Thirdly, JCR is looking at balance between the financial structure and investment. The two specialized cement companies' interest-bearing debt had long been on a downtrend but turned upward at the end of FY2021 as expenditures for the CO₂ reduction measures, in addition to growth investment and capital spending to deal with aging facilities, are growing. JCR will watch how the Companies will control balance between these expenditures and the financial structure at a time when cash flow generation capacity is somewhat weakening.

Naoki Kato, Hajime Inoue

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

(JPY 100 mn, %)

		FY2017	FY2018	FY2019	FY2020	FY2021	FY2022F
Sumitomo Osaka Cement (5232)	Net Sales	2,204	2,249	2,205	2,170	1,597	1,754
	Operating Income	161	112	125	132	17	-11
TAIHEIYO CEMENT (5233)	Net Sales	8,606	9,056	8,743	8,479	6,778	-
	Operating Income	609	616	559	574	404	-
MITSUBISHI MATERIALS (5711)	Net Sales	1,923	2,536	2,475	2,158	2,098	-
	Operating Income	194	197	122	66	32	-
UBE (4208)	Net Sales	2,388	3,210	3,030	2,828	2,215	-
	Operating Income	123	144	145	147	34	-
Tokuyama (4043)	Net Sales	873	923	872	908	503	630
	Operating Income	45	32	38	45	-19	-15
Total	Net Sales	15,994	17,975	17,325	16,543	13,191	-
	Operating Income	1,132	1,101	989	964	468	-
	Operating Income Margin	7.1%	6.1%	5.7%	5.8%	3.5%	-
Percent change in Total from the previous year	Net Sales	7.3%	12.4%	-3.6%	-4.5%	-20.3%	-
	Operating Income	-8.2%	-2.7%	-10.2%	-2.6%	-51.5%	-

Notes:

- Sumitomo Osaka Cement: Cement, mineral resources and cement-related products businesses
Net Sales refer to sales to outside customers.
- TAIHEIYO CEMENT: Cement, mineral resources, environmental and construction materials businesses
- MITSUBISHI MATERIALS: Cement business
There were inter-segment transfers in FY2018 and FY2020.
- UBE: Construction materials business
FY2018 figures are affected by the integration with other segments.
- Tokuyama: Cement business
FY2021 figures are affected by inter-segment transfers.

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

(Chart 2) Business Performance of Specialized Cement Companies

(JPY 100 mn, %)

		FY2017	FY2018	FY2019	FY2020	FY2021	FY2022F
Sumitomo Osaka Cement	Net Sales	2,448	2,510	2,451	2,392	1,842	2,058
	Operating Income	189	141	161	166	68	57
	Operating Income Margin	7.8	5.6	6.6	6.9	3.7	2.8
	Net Income	146	77	109	117	96	68
	Shareholders' Equity	2,024	1,922	1,967	2,037	2,010	-
	Interest-bearing Debt	618	611	526	514	566	696
	Equity Ratio	59.4	59.2	61.3	61.8	60.7	-
TAIHEIYO CEMENT	Net Sales	8,711	9,160	8,843	8,639	7,082	-
	Operating Income	651	660	610	636	467	-
	Operating Income Margin	7.5	7.2	6.9	7.4	6.6	-
	Net Income	385	434	391	468	289	-
	Shareholders' Equity	3,952	4,147	4,367	4,709	5,106	-
	Interest-bearing Debt	2,886	2,796	2,661	2,481	2,706	-
	Equity Ratio	38.7	40.1	42.3	45.1	46.3	-

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: Positive



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