

Highlights of Blast Furnace Steelmakers' 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 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 volume for FY2021 increased 15.5% to 95.63 million tons from 82.79 million tons for FY2020 (Chart 1). The factor causing the increase is that many of customers have come out from the slump caused by the impact of COVID-19 pandemic, and the demand recovered. On the other hand, the impact of shortage of semiconductors and parts is continuing for a long period of time in the automotive industry; therefore, demand recovery for products for the said industry is still slow.

The raw material prices are soaring. The supply-demand conditions of coking coal became tight backed by a curb on the operation in the production areas in China, and the price surged in September 2021. In April 2022, the price further increased as countries banned import of coking coal produced in Russia, which caused the tight supply-demand condition of coking coals produced in the countries other than Russia. The price of iron ore had fallen since August 2021 as China curbed the production volume of crude steel and the demand became weak. Despite the fact, the price is rising again at present partly backed by disruption of supply chains entailed by deteriorated Ukraine situation.

For FY2021, a significant change in profitability of exports was observed between the first half and second half. From April 2020 to September 2021, steel product prices in Asia were on the rise due to improved balance of supply-demand backed by the demand recovery in countries and a reduction in production volume of crude steel in China. The metal spread (difference between the raw material prices and product prices) in exports for blast furnace steel manufacturers improved as the prices of steel product increased faster than the pace of rising raw material price. On the other hand, steel product prices have been falling since October 2021 due to weakened demand caused by the economic slowdown in China. While steel product market is peaking out, profitability of exports is deteriorating due to rising raw material prices.

2. Financial Results

The total operating income of the 3 blast furnace steelmakers for FY2021 (gross profit less SG&A expenses for NIPPON STEEL and JFE) was 1,074.4 billion yen (9.2 times as large as that of the previous fiscal year) (Chart 2). The increase was contributed by increased production and sales volumes, expanded metal spread in exports, progress of price increase in the confirmed transactions in Japan. The total operating income of the 3 companies exceed 1 trillion yen for the first time in 13 years since FY2008, 1,086.4 billion yen (including former Sumitomo Metal Industries, Ltd. and former Nippon Steel Nisshin Co., Ltd.), though the figure cannot be simply compared to that for other fiscal years as the accounting standard is not uniform. The total operating income for the 3 companies excluding valuation gain and loss of inventories (same as above) also substantially increased to 554.4 billion yen (3 times as large as that of the previous fiscal year). In relation to the improvement in the operating income, the total profit attributable to owners of the parent (net income attributable to owners of the parent for KOBELCO) turned profitable for the first time in three fiscal years to 985.4 billion yen in total, as opposed to a loss of 31.0 billion yen for FY2020.

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 FY2021 increased 1.0% from the end of the previous fiscal year (Chart 3). In addition to executing capital investments exceeding the amount of depreciation expenses in each company, working capital requirements increased as the raw material prices rose. The 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 20.0% from the end of the previous fiscal year. All the 3 companies substantially improved performance and made progress in profit accumulation.

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 FY2021 improved to 0.7x from 0.9x at the end of the previous fiscal year.

3. Highlights for Rating

While future environment is extremely unforeseeable including the conflict between Russia and Ukraine, NIPPON STEEL and JFE have not disclosed the performance forecast for FY2022 as they found it would be difficult to estimate the performance in a reasonable way and others. On the other hand, KOBELCO projects ordinary income to decrease 14.2% from the previous fiscal year to 80 billion yen for FY2022; however, this is largely attributable to deteriorated valuation gain and loss of inventories. Where the valuation gain and loss is excluded, the ordinary income is expected to increase 75.8% from the previous fiscal year to 76 billion yen. The profits will likely be contributed by expansion of the metal spread through elimination of the time lag between the rise in raw material prices and corresponding sales price revisions in the steel business.

Production volume of crude steel in Japan for FY2022 is expected to be almost flat from the previous fiscal year; however, various factors may put downward pressure on the demand. While the COVID-19 pandemic has not come to the end globally, the impact will still likely remain in the supply chains such as shortage of semiconductors and automotive components, and this gives a rise of concern that the recovery of auto production takes time. In addition, demand for steel products may possibly decrease caused by a worldwide economic slowdown originating from the deteriorated Ukraine situation. Therefore, continuity of the demand recovery needs to be watched.

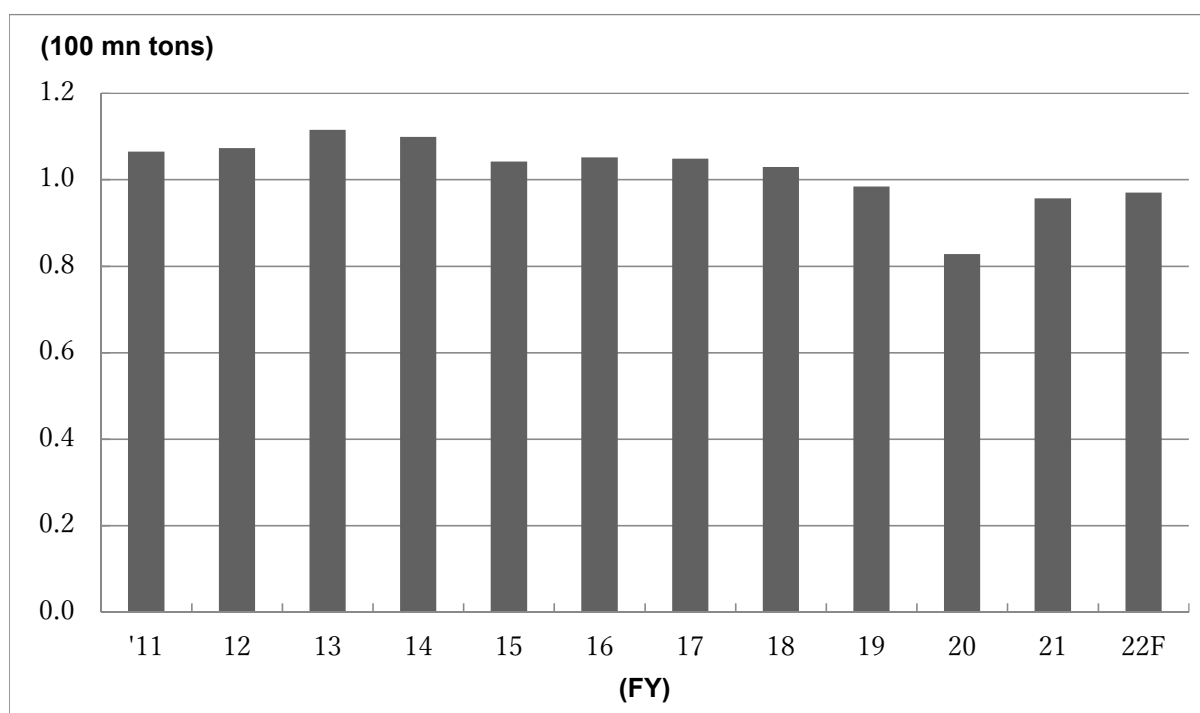
JCR is paying attention to the trends in sales price for confirmed transactions. Blast furnace steelmakers are indicating its stronger stance toward price increase, and making progress in price revisions. However, energy and logistics costs are increasing due to the soaring crude oil prices. Where these factors are not reflected in prices, profits of the companies will be under a downward pressure. JCR will check whether the companies will be able to ensure the profitability by realizing appropriate sales prices.

While raw material prices are soaring, steel product market in Asia is rising limitedly, and profitability of exports is deteriorating. Easing demand-supply of steel products caused by the economic slowdown in China is the constraint on the market conditions. Where recovery of economy in China will not be advanced due to prolongation of lockdown, etc., demand of steel products will become weaker and may cause delay in metal spread recovery.

Upon improving the business environment, the Companies' financial conditions have recovered due to increased cash flow generation ability. Although the companies are unable to avoid bearing a certain amount of investment to respond to environmental requirements, renew aged facilities, among others, JCR will keep an eye on whether the companies will be able to keep improving the financial structure by securing solid 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)	FY2020	48,292	(18.4)	961	157.4	1,100	-	2.3	(324)	-
	FY2021	68,088	41.0	6,768	603.6	9,381	752.5	13.8	6,373	-
	FY2022F	N/A								
JFE (5411)	FY2020	32,272	(13.5)	(95)	-	(129)	-	-	(218)	-
	FY2021	43,651	35.3	3,100	-	4,164	-	9.5	2,880	-
	FY2022F	N/A								

		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)	FY2020	17,055	(8.8)	303	208.2	161	-	0.9	232	-
	FY2021	20,825	22.1	876	188.2	932	475.9	4.5	600	158.6
	FY2022F	23,700	13.8	800	(8.7)	800	(14.2)	3.4	600	(0.1)

		Revenue	YOY Change	Gross Profit - SG&A Exp.	YOY Change	Net Income	YOY Change
Total	FY2020	97,621	(15.3)	1,170	36.3	(310)	-
	FY2021	132,566	35.8	10,744	817.9	9,854	-
	FY2022F	-	-	-	-	-	-

(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)	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)
	FY2021	38,417	22,783	0.6	10,074	2.3	6,156	(3,788)
JFE (5411)	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)
	FY2021	21,226	17,150	0.8	5,623	3.1	2,987	(2,880)

		Equity Capital	Interest-bearing Debt	D/E Ratio	EBITDA	Interest-bearing Debt / EBITDA	Operating Cash Flow	Investing Cash Flow
KOBELCO (5406)	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)
	FY2021	8,153	9,084	1.1	1,927	4.7	1,688	(1,615)

		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	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)
	FY2021	67,797	49,019	0.7	17,625	2.8	10,831	(8,284)

(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: 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: Stable

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