News Release

Japan Credit Rating Agency, Ltd.

18-D-0131
May 8, 2018

Highlights of Major Shipping Companies' Financial Results for Fiscal Year Ended March 2018

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 2018 (FY2017) and earnings forecasts for FY2018 of Japan's three major shipping companies (collectively, the "Companies"): Nippon Yusen Kabushiki Kaisha (NYK), Mitsui O.S.K. Lines, Ltd. (MOL) and Kawasaki Kisen Kaisha, Ltd. (K Line).

1. Industry Trend

The resilience of the shipping market is generally dull. This probably is due primarily to the slack supply-demand balance as, despite a steady increase in cargo movements, the lingering tonnage oversupply situation is weighing on. Also because of growing significance of disturbing factors like trade friction, full-scale market recovery is assumed to require some more time, suggesting that the tough business environment will continue for a while.

The containership market is lackluster mainly because tonnage supply keeps expanding due to a shift to ultra-large ships with the capacity of 10,000 TEUs or more to achieve an economy of scale. In particular, freight rates on Asia to Europe routes, where the ultra-large ships are beginning to operate, have been sluggish. Even though cargo movements are expected to remain steady with modest recovery in the global economy, the resilience of freight rates will likely stay weak due to a looser supply-demand balance.

The dry bulk market has been picking up since hitting bottom in 2016. Contributing factors here include robust demand for transporting iron ore, coking coal and other commodities and faster improvement in tonnage supply-demand compared to other types of vessels. Although there are factors to be noted, including the U.S.-China trade conflict, modest market recovery will likely continue.

The tanker market has been stagnant. While crude oil demand is expected to keep growing gradually in China and India, this positive factor will be more than offset by the expected significant inflows of newly built vessels up until the end of this year, further widening the supply-demand gap. Even though there are some favorable materials, such as an increase in scrapping, improvement in supply-demand balance can hardly be expected, and the market will probably keep weakening for the time being.

2. Financial Results

Overall performance turned for the better in FY2017 for the Companies (Chart 1). The combined ordinary income came to 61.4 billion yen with a sharp increase from a loss of 25.9 billion yen in FY2016, as downward pressures on the income arising from higher fuel oil prices, start-up costs for Ocean Network Express (ONE), an integrated company for container shipping, etc. were absorbed by improvement in the containership and dry bulk businesses with market recovery. Of particular note, K Line attained an income of 1.9 billion yen, turning around from a loss of 52.3 billion yen, thanks to structural reforms and cost-cutting efforts, which altogether came to a saving of 44.9 billion yen.

The combined net income attributable to owners of parent decreased from 399.9 billion yen for FY2016 to 16.8 billion yen for FY2017. NYK and K Line, which posted a loss in FY2016, achieved a surplus thanks to a higher ordinary income and gains on sale of fixed assets. MOL, on the other hand, suffered a loss for the first time in two years as it recognized 73.4 billion yen as a loss related to business restructuring, a majority of which is provisions for losses related to the charter-out of vessels to ONE, losses on liquidation of its agencies, etc.

As regards the FY2018 forecasts, the income level itself has yet to fully return to the previous level, the Companies will nevertheless likely stay on the upward trend. The combined ordinary income is expected to increase by 85.0 billion yen (Chart 1). Despite the impacts of higher fuel oil prices and a stronger yen, the growth will probably be driven by a modest improvement in the shipping market, contribution from the LNG carrier business based on medium- to long-term contracts, synergies created at ONE, etc. That said, the Companies will remain focused on making ship operations more efficient in the car carriers business, but this segment's income contribution will still likely be low.

ONE's net income attributable to owners of parent for FY2018 is forecast at 11.0 billion yen on the premise that freight rates will remain on a par with the FY2017 levels and that the cargo volume will grow moderately. Furthermore, of the projected synergies of 110.0 billion yen, including a reduction in variable and general administrative expenses and streamlined ship operations and operating costs, ONE aims to report around 60% in its initial fiscal year. Meanwhile, because the Companies will incur temporary expenses associated with business withdrawal, the income for the containership business will probably not fully recover until FY2019 or later. This segment's ordinary income forecast for FY2018 is 1.5 billion yen for NYK and 0.5 billion yen for MOL, while K Line projects 4.8 billion yen in loss.

On the financial front, the combined D/E ratio (on average; without considering the equity content of the subordinated loans of MOL and K Line) continues to rise, coming to 2.0 at the end of March 2017 versus 1.9 a year earlier (Chart 2). While MOL reported 47.3 billion yen in net loss attributable to owners of parent for FY2017 and a lower equity capital than the previous year, the ratio improved only limitedly for NYK and K Line because of not much profit accumulation.

Looking at the prospects of the Companies for the financial structure, improvement in equity capital through profit accumulation will likely be slow also in FY2018, suggesting that enhancement of the financial base will require time. The D/E ratio at the end of FY2018 is expected to stay at 1.72 for NYK and 2.15 for MOL, as opposed to 1.78 and 2.19 a year earlier, respectively.

3. Highlights for Rating

JCR is closely looking at ONE's performance. The containership business has often been loss-making for the Companies, posing a challenge to management for many years. Going forward, by generating synergies of over 60.0 billion yen in its first year of foundation, ONE is expected to move toward constantly attaining a profit in its operations. JCR will in the meantime keep an eye on whether ONE can not only leverage its competitive edge to increase presence in the containership industry that has been reorganized on a global scale but also create synergies as planned. Close attention will also be paid to whether the temporary expenses that each of the Companies included in their budget for ONE's foundation will stay within the planned amount.

How far the market conditions will recover for capesize and other dry bulk carriers will be a key in improving the FY2018 results. At the moment, a drastic improvement in the markets for containerships and tankers can hardly be expected because of the softened supply and demand situation, whereas the dry bulk market will probably remain fairly steady. NYK forecasts 33.0 billion yen in the profit from the bulk shipping business for FY2018 with a huge increase of 23.4 billion yen from FY2017's 9.6 billion yen.

Another challenge facing the Companies is to improve the equity ratio and D/E ratio. The combined D/E ratio (on average; without considering the equity content of the subordinated loans of MOL and K Line) as of March 31, 2018 was 2.0 versus 1.3 at the end of FY2014, i.e. before the business slump. Given that financial strength has declined over the past few years, expanding the equity capital is especially vital. For NYK with Negative rating outlook, JCR will closely watch progress in the efforts to improve the financial structure through profit accumulation, asset liquidation, early termination of charter agreements, etc., which will be reflected in the future rating. As for MOL and K Line with Stable rating outlook, the reporting of a loss related to business restructuring for the containership business in FY2017 and FY2016, respectively, was a primary cause of a net loss attributable to owners of parent. Even though this will lead to better periodic earnings in the future, it has in fact lowered financial durability for now. JCR considers it not necessary to review the rating immediately in case of limited erosion of the equity capital at a time when business is recovering, but, in the event that business deteriorates when the financial strength is weak, then the rating is more likely to be exposed to downward pressures.

Masayoshi Mizukawa, Tadashi Ono

(Chart 1) Financial Results of 3 Major Shipping Companies

(JPY 100 mn, %)

		Net Sales	YOY Change	Operating Income	YOY Change	Ordinary Income	YOY Change	Ordinary Income / Net Sales	Net Income Attributable to Owners of Parent	YOY Change
NYK (9101)	FY2016	19,238	*-15.3*	-180	-	10	*-98.3*	0.1	-2,657	-
	FY2017	21,832	*13.5*	278	-	280	-	1.3	201	-
	FY2018F	18,050	*-17.3*	370	*33.0*	400	*42.8*	2.2	290	*43.8*
MOL (9104)	FY2016	15,043	*-12.1*	25	*10.1*	254	*-29.9*	1.7	52	-
	FY2017	16,523	*9.8*	226	*786.7*	314	*23.8*	1.9	-473	-
	FY2018F	11,300	*-31.6*	230	*1.4*	400	*27.1*	3.5	300	-
K Line (9107)	FY2016	10,301	*-17.2*	-460	-	-523	-	-5.1	-1,394	-
	FY2017	11,620	*12.8*	72	-	19	-	0.2	103	-
	FY2018F	7,545	*-35.1*	50	*-30.7*	50	*154.8*	0.7	70	*-32.6*
Total	FY2016	44,584	*-14.7*	-615	-	-259	-	-0.6	-3,999	-
	FY2017	49,976	*12.1*	577	-	614	-	1.2	-168	-
	FY2018F	36,895	*-26.2*	650	*12.6*	850	*38.3*	2.3	660	-

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

(Chart 2) Financial Structure of 3 Major Shipping Companies

(JPY 100 mn, times)

		Equity Capital	Interest-bearing Debt	D/E Ratio	EBITDA	Interest-bearing Debt / EBITDA	Operating Cash Flow	Investing Cash Flow
NYK (9101)	FY2015	7,736	9,278	1.2	1,613	5.8	1,428	-468
	FY2016	5,224	9,344	1.8	839	11.1	279	-1,446
	FY2017	5,518	9,713	1.8	1,261	7.7	890	-1,379
MOL (9104)	FY2015	5,409	10,219	1.9	1,053	9.7	2,091	-266
	FY2016	5,719	11,019	1.9	1,016	10.8	176	-739
	FY2017	5,112	11,001	2.2	1,239	8.9	983	-1,008
K Line (9107)	FY2015	3,553	4,808	1.4	622	7.7	396	-295
	FY2016	2,194	5,138	2.3	41	122.8	-439	-248
	FY2017	2,170	4,735	2.2	544	8.7	11	-228
Total	FY2015	16,700	24,305	1.5	3,289	7.4	3,916	-1,031
	FY2016	13,139	25,501	1.9	1,897	13.4	16	-2,434
	FY2017	12,801	25,450	2.0	3,045	8.4	1,886	-2,616

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

<Reference>

Issuer: Nippon Yusen Kabushiki Kaisha

Long-term Issuer Rating: A Outlook: Negative

Issuer: Mitsui O.S.K. Lines, Ltd.

Long-term Issuer Rating: A- Outlook: Stable

Issuer: Kawasaki Kisen Kaisha, Ltd.

Long-term Issuer Rating: BBB Outlook: Stable

Japan Credit Rating Agency, Ltd.
Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026