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# Highlights of Major Cement Companies' Financial Results for Fiscal Year Ended March 2019

The followings 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 2019 (FY2018) and earnings forecasts for FY2019 of Japan's major cement companies*.

*:This report is for two major specialized cement companies (Sumitomo Osaka Cement Co., Ltd. ("SOC") and TAIHEIYO CEMENT CORPORATION ("TAIHEIYO")), and three other major companies which are engaged in businesses other than cement business ( Mitsubishi Materials Corporation, Ube Industries, Ltd. and Tokuyama Corporation). For the latter, only cement-related businesses are included.

## 1. Industry Trend

Japan's domestic cement demand increased in FY2018 for the second consecutive year, up 1.7% year-on-year to 42.59 million tons. By district, the number of Kanto 1 (Saitama, Chiba, Tokyo, and Kanagawa) increased by 4.0% from the previous fiscal year as a result of construction related to the Tokyo Olympic and Paralympic Games and large-scale redevelopment work. Hokuriku (Toyama, Ishikawa, Fukui, and Niigata) also increased by 22.7% as a result of the extension of the Shinkansen etc. Exports fell 12.2% to 10.37 million tons for the first time in five years. Affected by the recovery of domestic demand, priority was given to for domestic.

According to forecasts for cement demand in FY2019 made public by Japan Cement Association in February 2019, domestic demand will be 43 million tons and exports will be 11 million tons, and both are expected to exceed the results of last year. Domestic demand is expected to increase for public works and urban redevelopment projects, although construction related to the Tokyo Olympic and Paralympic Games will end in the first half of the year. Exports are expected to continue to have persistent demand against the backdrop of infrastructure development projects in Asian countries and the Oceania region.

Each company announced a policy of raising the price of cement by about 1,000 yen per ton from the shipment in April 2018, and negotiated with major customers. Nevertheless, negotiations were delayed partly due to a series of natural disasters, and the price increase in FY2018 appears to have been limited to around 300 yen. Some customers have not yet reached an agreement, and each company will continue to focus on price increase negotiations.

## 2. Financial Results

In the cement-related business, net sales of the total of five cement manufacturers rose 4.5% year on year and operating income fell 10.6% year on year in FY2018. Although domestic demand for cement was firm, cost increases such as rising coal prices and increased logistics costs could not be absorbed by price increases. By company, only TAIHEIYO increased the income, but its income in domestic business declined same as the other company. Forecasts for FY2019 are for higher sales and income. In addition to continued strong domestic demand for cement, the effects of the delayed increase in cement prices and contributes from overseas businesses are expected.

Regarding operating income for FY2018 of the two specialized cement companies, SOC declined the income for the third consecutive year, down 25.3% to 14.1 billion yen. On the other hand, TAIHEIYO increased the income for the third consecutive year, up 1.4% to 66 billion yen. At SOC, sales of optical communication components for new transmission methods and materials for rechargeable battery cathode materials, both in Advanced Materials segment, were sluggish, in addition to that the mainstay Cement-Related business income decline. At TAIHEIYO, despite a decline in the domestic cement business, the overseas cement business grew steadily due to higher shipments in the U.S. and a recovery in prices in China, boosting operating income. The two companies expect operating income to increase for FY2019, but the outlook for domestic cement business is different. SOC plans to boost the income due to higher sales volumes and higher prices, but TAIHEIYO expects the income to decline because it cannot absorb higher energy costs and logistics costs by raising prices. The two companies' financial structure tended to improve until FY2017 due to reduction in interest-bearing debt etc. However, the pace of reduction in interest-bearing debt slowed in FY2018. Capital investments are increasing to cope with the aging of facilities and the rationalization of production. The same trend is expected to continue in FY2019.

3. Highlights for Rating

As in the previous fiscal year, JCR pays attention to the trend of the increase in cement prices. The price increase this time was considered to be different from the recent price increase negotiations in that each company was in line, but it has not been able to achieve satisfactory results. Each company's earnings forecasts for FY 2019 seem to include price increases to customers that have not yet been concluded the negotiation, and price increases will have a significant impact on earnings. They are also important to assess the earnings constitution and level of the domestic cement business in the future.

Attention needs to be paid to the domestic demand for cement in FY2019. Domestic demand in recent years has been sluggish due to labor shortage of at construction sites, and there is a growing view that it will not drop significantly even after the Tokyo Olympic and Paralympic Games. However, the outlook for orders to major general contractors has recently declined from the previous fiscal year, and uncertainty has been growing in the future of construction investment trends. As demand for the Tokyo Olympic and Paralympic Games is ending, if domestic demand decreases, there will be uncertainty for the future.

Strengthening the profitability of businesses other than domestic cement is also a medium-to long-term challenge. Domestic cement demand is currently solid, but it is inevitable to decline over the long term. It is important to improve the profitability of other businesses to compensate for the decline in the profitability of the domestic cement business. In recent years, TAIHEIYO has maintained a high level of operating income. Strong performance of the U.S. cement business has underpinned its profitability. At SOC, on the other hand, the non-cement segment's optoelectronics and battery materials are weak, and profitability is declining as it does not compensate for the decline in the income in the domestic cement business.

Financial soundness is also important. The environment for the cement industry is expected to become increasingly severe over the medium to long term. It is important to improve the financial constitution in preparation for future business structural reforms. In recent years, both TAIHEIYO and SOC have been working to reduce interest-bearing debt and strengthen their financial constitution. However, both companies restrained capital investment in the cement business in order to restore their financial strength during the slump in domestic demand. Therefore, troubles such as malfunctions have occurred due to aging of facilities. Both companies plan to increase investments to cope with aging cement facilities and to streamline production. At the same time, they are actively investing in growth. JCR is watching whether they can make these investments while further strengthening their financial position.

Naoki Kato, Hajime Inoue

(Chart 1) Earnings of Cement Business of Cement Companies (including companies engaging in other businesses)

(JPY100 mn, %)

| | | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 forecast |
|---|---|---|---|---|---|---|---|
| Sumitomo Osaka Cement (5232) | Net Sales | 2,150 | 2,127 | 2,118 | 2,204 | 2,249 | 2,302 |
| | Operating Income | 192 | 204 | 183 | 161 | 112 | 131 |
| TAIHEIYO CEMENT (5233) | Net Sales | 8,318 | 8,226 | 7,910 | 8,606 | 9,056 | 9,240 |
| | Operating Income | 599 | 565 | 604 | 609 | 616 | 653 |
| MITSUBISHI MATERIALS (5711) | Net Sales | 1,933 | 1,975 | 1,775 | 1,923 | 1,982 | 2,536 |
| | Operating Income | 173 | 201 | 209 | 194 | 134 | 159 |
| Ube Industries (4208) | Net Sales | 2,224 | 2,373 | 2,272 | 2,388 | 2,502 | 3,300 |
| | Operating Income | 170 | 198 | 162 | 123 | 118 | 150 |
| Tokuyama (4043) | Net Sales | 812 | 854 | 829 | 873 | 923 | 940 |
| | Operating Income | 44 | 58 | 75 | 45 | 32 | 35 |
| TOTAL | Net Sales | 15,436 | 15,554 | 14,904 | 15,994 | 16,713 | 18,318 |
| | Operating Income | 1,178 | 1,226 | 1,232 | 1,132 | 1,012 | 1,128 |
| | Operating Income Margin | 7.6% | 7.9% | 8.3% | 7.1% | 6.1% | 6.2% |
| Change rate of TOTAL compared to the previous year | Net Sales | − | 0.8% | −4.2% | 7.3% | 4.5% | 9.6% |
| | Operating Income | − | 4.1% | 0.5% | −8.2% | −10.6% | 11.5% |

Note:

| | |
|---|---|
| Sumitomo Osaka Cement : | Cement, Mineral Resources and Cement-Related products<br>Net Sales are such sales to outside customers. |
| TAIHEIYO CEMENT : | Cement, Mineral Resources, Environmental and Construction Materials Businesses |
| MITSUBISHI MATERIALS: | Cement Business<br>Transfer "Coal related" belonging to "Others Business" to "Cement Business" for FY2019 forecast |
| Ube Industories: | Cement & Construction Materials<br>Integrate “Energy & Environment” into “Cement & Construction Materials” for FY2019 forecast |
| Tokuyama : | Cement |

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

(Chart 2) Business Performance of Specialized Cement Companies

(JPY100 mn,%)

| | | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 forecast |
|---|---|---|---|---|---|---|---|
| Sumitomo Osaka Cement (5232) | Net Sales | 2,345 | 2,341 | 2,340 | 2,448 | 2,510 | 2,574 |
| | Operating Income | 222 | 236 | 215 | 189 | 141 | 170 |
| | Operating Income Margin | 9.5 | 10.1 | 9.2 | 7.8 | 5.6 | 6.6 |
| | Net Income | 133 | 161 | 162 | 146 | 77 | 120 |
| | Shareholders' Equity | 1,741 | 1,756 | 1,942 | 2,024 | 1,922 | − |
| | Interest-bearing Debt | 843 | 765 | 642 | 618 | 611 | 600 |
| | Equity Ratio | 51.9 | 53.9 | 57.7 | 59.4 | 59.2 | − |
| TAIHEIYO CEMENT (5233) | Net Sales | 8,428 | 8,353 | 7,985 | 8,711 | 9,160 | 9,360 |
| | Operating Income | 654 | 604 | 632 | 651 | 660 | 710 |
| | Operating Income Margin | 7.8 | 7.2 | 7.9 | 7.5 | 7.2 | 7.6 |
| | Net Income | 441 | 364 | 475 | 385 | 434 | 450 |
| | Shareholders' Equity | 3,026 | 3,182 | 3,618 | 3,952 | 4,147 | − |
| | Interest-bearing Debt | 3,991 | 3,945 | 3,409 | 2,886 | 2,796 | 2,780 |
| | Equity Ratio | 29.1 | 31.4 | 35.6 | 38.7 | 40.1 | − |

Source: Prepared by JCR based on 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: Stable

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