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Highlights of Major Special Steel Manufacturers' Financial Results for Fiscal Year Ended March 2019

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 2019 (FY2018) and earnings forecasts for FY2019 of 4 major special steel manufacturers: Daido Steel Co., Ltd. ("Daido Steel"), Sanyo Special Steel Co., Ltd. ("Sanyo Special Steel"), AICHI STEEL CORPORATION ("AICHI STEEL"), and Mitsubishi Steel Mfg. Co., Ltd. ("Mitsubishi Steel Mfg.")

1. Industry Trend

Special steel production volume (on a hot rolled special steel production basis) of 20.60 million tons in FY2018 remained almost unchanged from the volume in FY2017 (Chart 1). Although there was slowdown in demand for industrial machinery particularly semiconductor production equipment in the second half of FY2018, there was no significant change in demand for special steel as a whole in FY2018 with demand for the main automotive industry remained solid in general.

Price of steel scrap, primary raw material of steel, was relatively stable in FY2018. Time lag of steel scrap surcharge was a factor for the 4 companies' profit decrease in FY2017 where the scrap price was increasing, but in FY2018 removal of the time lag occurred in FY2017 is considered to have become a factor for their profit increase.

Costs other than raw materials cost such as costs for electrodes and refractories and transportation expenses have risen. In particular, price of electrodes significantly increased at the end of FY2017 and further increased in FY2018. As it is necessary for the companies to separately negotiate with customers for the passing of these costs, to which the surcharge is not applied, on to the price, it is necessary to closely watch whether they can appropriately pass the increased costs on to the selling prices.

In anticipation of a decline of demand for special steels due to vehicle electrification and reduction of weight over a medium and long term, each company is strengthening earnings base through investments for enhancement of production capacity of products which are expected to grow in terms of demand in the future such as magnet and also overseas business investments. While these efforts will increase profits in the medium and long term, they may become a factor for placing downward pressure on the profit due to an increase of depreciation burden in the short run.

2. Financial Results

The 4 companies' total net sales increased 9.6% year-on-year to 1,115.7 billion yen, their total ordinary income decreased 10.1% year-on-year to 55.2 billion yen, and their total net Income attributable to owners of the parent also decreased 15.1% year-on-year to 35.6 billion yen (Chart 2). The net sales increased thanks to their revisions to the selling prices, following the increased costs for auxiliary materials such as electrodes and transportation cost. Their total income, on the other hand, decreased because the price hike fell short of covering the increased costs, despite the removal of the time lag of steel scrap surcharge becoming a factor for the income increase.

The specialty steel sales volume in total of the 3 companies excluding Mitsubishi Steel Mfg., which did not disclose the volume, on an unconsolidated basis, increased 2.4% year-on-year in FY2018 to 3.595 million tons from 3.51 million tons in FY2017. AICHI STEEL particularly increased its specialty steel sales volume 4.9% year-on-year in FY2018. The strong demand for domestic automakers, which are its primary customers, is considered to have contributed to boosting the sales volume.

As of the end of FY2018, the 4 Companies' aggregate equity ratio was 47.2% (49.0% a year earlier) (Chart 3). All 4 companies decreased their equity ratio due partly to the increased working capital as well as their aggressive capital expenditures for enhancement of production capacity for products which are expected to grow in terms of demand in the future and improvement of productivity. All companies, however, made capital investment in consideration of balance with cash flow, which limited deterioration of their financial structures to a small degree.

3. Highlights for Rating

The 4 companies' total ordinary income is expected to decline for 2 years in a row in FY2019, down 5.5% year-on-year. There are concerns about prolongation of adjustment phase of demand for industrial machinery against the backdrop of U.S.-China trade friction. Daido Steel and Sanyo Special Steel expect their sales to drop in FY2019. In addition, the increasing costs other than cost of primary raw materials such as electrodes and transportation cost which were a factor for the profit decrease in FY2018 will continue in FY2019, pushing downward pressure on their business performance. Their depreciation expenses are increasing along with their increasing capital expenditures, which will be a factor for the profit decrease.

JCR is paying attention to trend of demand for special steel. In particular, demand for industrial machinery, which has been weakening since the second half of 2018, is a concern. As shown by the fact that the U.S. government is studying additional increase of tariff rates on China, the U.S.-China trade war is intensifying. Demand for industrial machinery might further fall due to factors such as slowdown of Chinese economy. Although there has been no significant drop of production by Japanese automakers, demand for the main automotive industry might weaken due to the intensification of the trade friction. JCR sees it is necessary to closely watch trend of customer industries.

Countermeasures against the increased electrode cost and other costs are the biggest issue. All companies raised price in a stepwise manner in the face of these increased costs. The electrode price is expected to further rise in FY2019. JCR will pay attention to whether the companies can swiftly pass these increasing costs on to the selling price.

In the face of tougher business environments due to the heightened risk of slowdown of demand and increasing costs, all companies implemented capital investments for the purpose of keeping and improving their earnings capacity. The total capital expenditures of the 4 companies in total are expected to continue to increase to 99.7 billion yen in FY2019 from 71.9 billion yen in FY2018 (Chart 4). Sanyo Special Steel, in particular, is expected to significantly increase its capital expenditures to 27 billion yen in FY2019 from 10.6 billion yen in FY2018 due to factors including reforms of production structure at the No.2 plant. Other 3 companies also plan to increase their capital expenditures for increasing production of products, for which demands are rising. These investments will increase their depreciation burden and will become a factor for an increase of costs in the short run, but will increase their earnings capacity in the medium term through improvement of production efficiency and changes in the product mix. JCR will continue to check their implementation of capital investments and effects from those investments.

All companies increased their interest-bearing debt along with an increase of their capital expenditures. The increasing trend will continue into FY2019, but each company will be able to secure a certain level of operating cash flow. Thus, it is less likely that their financial structure will significantly worsen.

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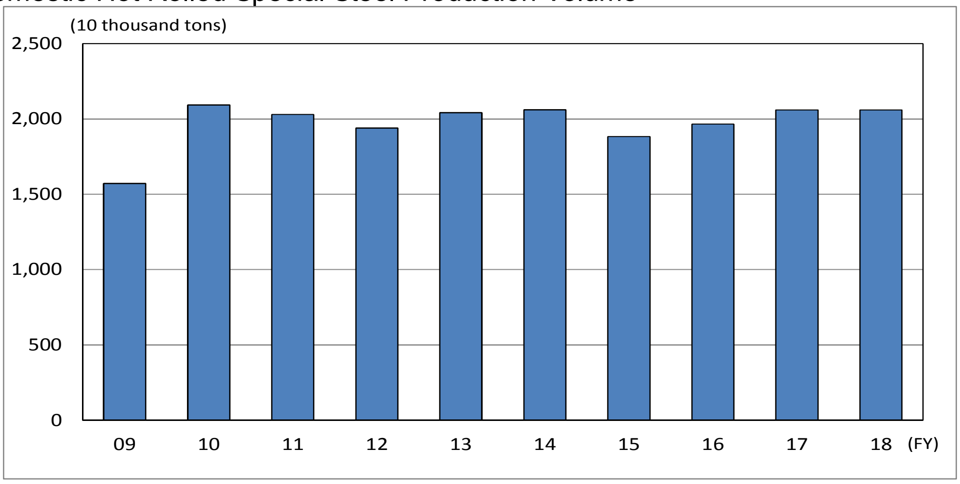
(Chart 1) Domestic Hot Rolled Special Steel Production Volume



Source: Prepared by JCR based on The Japan Iron and Steel Federation

(Chart 2) Consolidated Financial Performance of 4 Major Special Steel Manufacturers

(JPY 100 mn, %)

		Net Sales	YOY	Ordinary Income	YOY	Ordinary Income/Net Sales Ratio	Net Income*	YOY
Daido Steel (5471)	FY2017	5,052	13.5	361	37.0	7.2	239	46.0
	FY2018	5,432	7.5	343	▲4.9	6.3	211	▲11.4
	FY2019 Forecasts	5,300	▲2.4	315	▲8.3	5.9	240	13.3
Sanyo Special Steel (5481)	FY2017	1,574	13.6	106	▲9.2	6.8	70	▲9.6
	FY2018	1,858	18.0	94	▲11.5	5.1	77	9.8
	FY2019 Forecasts	3,150	69.5	100	6.0	3.2	70	▲9.3
AICHI STEEL (5482)	FY2017	2,362	11.0	117	71.6	5.0	81	60.9
	FY2018	2,573	8.9	113	▲3.8	4.4	65	▲20.5
	FY2019 Forecasts	2,620	1.8	100	▲11.7	3.8	61	▲6.2
Mitsubishi Steel Mfg. (5632)	FY2017	1,187	14.5	28	▲11.7	2.4	29	▲17.1
	FY2018	1,293	9.0	1	▲95.9	0.1	2	▲90.3
	FY2019 Forecasts	1,370	5.9	7	498.3	0.5	3	7.1
Total	FY2017	10,176	13.0	614	27.4	6.0	420	28.3
	FY2018	11,157	9.6	552	▲10.1	4.9	356	▲15.1
	FY2019 Forecasts	12,440	11.5	522	▲5.5	4.2	374	4.8

*Net Income Attributable to Owners of Parent
Source: Prepared by JCR based on financial materials of above companies

(Chart 3) Financial Structure of 4 Major Special Steel Manufacturers

(JPY 100 mn, times, %)

End of		Interest-bearing Debt	Equity Capital	D/E Ratio	Equity Ratio
Daido Steel (5471)	FY2016	1,413	2,601	0.5	45.3
	FY2017	1,594	2,844	0.6	44.3
	FY2018	1,742	2,855	0.6	43.9
Sanyo Special Steel (5481)	FY2016	275	1,223	0.2	66.7
	FY2017	440	1,275	0.3	61.0
	FY2018	913	1,956	0.5	52.3
AICHI STEEL (5482)	FY2016	545	1,430	0.4	52.4
	FY2017	473	1,518	0.3	55.2
	FY2018	596	1,526	0.4	52.6
Mitsubishi Steel Mfg. (5632)	FY2016	337	604	0.6	44.7
	FY2017	420	626	0.7	40.9
	FY2018	422	590	0.7	38.5
Total	FY2016	2,572	5,856	0.4	50.2
	FY2017	2,929	6,265	0.5	49.0
	FY2018	3,674	6,928	0.5	47.2

Note: interest-bearing debt covers corporate bonds, CP and borrowings
Source: Prepared by JCR based on financial materials of above companies

(Chart 4) Capital Expenditures of 4 Major Special Steel Manufacturers

(JPY 100 mn)

		Capital Expenditures	Depreciation Expense
Daido Steel (5471)	FY2017	356	207
	FY2018	344	231
	FY2019 Forecasts	386	244
Sanyo Special Steel (5481)	FY2017	81	90
	FY2018	106	93
	FY2019 Forecasts	270	145
AICHI STEEL (5482)	FY2017	190	138
	FY2018	209	144
	FY2019 Forecasts	255	165
Mitsubishi Steel Mfg. (5632)	FY2017	53	36
	FY2018	60	44
	FY2019 Forecasts	86	49
Total	FY2017	680	472
	FY2018	719	513
	FY2019 Forecasts	997	603

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

<Reference>

Issuer: Daido Steel Co., Ltd.

Long-term Issuer Rating: A Outlook: Stable

Issuer: Sanyo Special Steel Co., Ltd.

Long-term Issuer Rating: A Outlook: Stable

Issuer: AICHI STEEL CORPORATION

Long-term Issuer Rating: A Outlook: Stable

Issuer: Mitsubishi Steel Mfg. Co., Ltd.

Long-term Issuer Rating: BBB+ Outlook: Stable

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