

## Highlights of Blast Furnace Steelmakers' Financial Results for Fiscal Year Ended March 2020

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 2020 (FY2019) and earnings forecasts for FY2020 of Japan's three blast furnace steelmakers (collectively, the "Companies"): NIPPON STEEL CORPORATION ("NIPPON STEEL"), JFE Holdings, Inc. ("JFE") and Kobe Steel, Ltd. ("KOBELCO").

### 1. Industry Trend and Impact of COVID-19 Pandemic

Japan's crude steel production for FY2019 was 98.42 million tons, falling below 100 million tons for the first time in a decade (Chart 1). While demand showed increased signs of a slowdown in the manufacturing industry on the whole due to the prolonged U.S.-China trade conflict, it weakened also in the construction industry as the Tokyo 2020 Olympic and Paralympic Games-related demand has run its course. Moreover, automotive and other industries have been affected by the novel coronavirus since February 2020, resulting in less demand. Steel demand is expected to drop further in FY2020 due to the coronavirus disease (COVID-19) pandemic. It is still uncertain, at this point, when this pandemic will be curbed and to what extent steel demand will be affected. However, should this go on longer, it is feared that steel production may be slashed in FY2020, compared with FY2019.

Iron ore prices began rising at the end of FY2018 and kept growing toward the first half of FY2019. As a contributing factor here, crude steel production increased because of a rise in infrastructure-related demand in China, boosting needs for iron ores. The prices fell in the second half of FY2019 but still remained at higher levels than in FY2018. Even though coking coal prices have shown no major hikes after falling in the first half of FY2019, increases in iron ore prices have had greater impact on blast furnace steelmakers, pushing up their costs.

While demand for steel sheets slowed down in China due to the trade conflict with the U.S., Asian steel markets sagged in FY2019 partly because of an increase in steel exports from India and Russia. Moreover, a fall in demand in the coronavirus-affected countries since February 2020 has pushed down market prices further. All in all, lower steel prices combined with higher raw material costs overseas have narrowed the metal spread, i.e. a difference between the prices of primary raw materials and product prices, in export transactions for blast furnace steelmakers.

### 2. Financial Results

The Companies' combined operating income—gross profit less SG&A expenses for NIPPON STEEL and JFE—came to 85.8 billion yen in FY2019, plunging by as much as 81.1% from the previous year (Chart 2). Negative factors include: a drop in profitability due to higher raw material costs and lower market prices for steel overseas; and fall in production volume. Also, profit attributable to owners of the parent of 450.6 billion yen for FY2018 turned into a loss of 697.2 billion yen (net loss attributable to owners of the parent for KOBELCO). NIPPON STEEL recorded impairment losses on business assets at constantly loss-making works and assets to be inactivated (396.6 billion yen in total), and so did JFE (approximately 220 billion yen) due to the optimization of domestic production operations, amid the deteriorating business environment. KOBELCO too posted impairment losses on fixed assets (49.9 billion yen) due to a decline in demand and productivity, delays in the start-up of facilities, etc. As regards the coronavirus, it had only a limited impact on the Companies' FY2019 results due to a time lag.

On the financial front, as of the end of FY2019, the Companies' combined interest-bearing debt (after the evaluation of equity content of subordinated loans; the same applies hereinafter) amounted to 4,784.6 billion yen, up 9.3% from a year before, as all three companies made large capital spending and decreased operating cash flow. Moreover, the combined equity attributable to owners of the parent (after the evaluation of equity content of subordinated loans; equity capital for KOBELCO; the same applies hereinafter) fell 13.3% from a year before to 5,350.5 billion yen due to loss reporting by

the Companies. Consequently, the combined DER, i.e. interest-bearing debt divided by equity attributable to owners of the parent, stood at 0.9x, deteriorating from 0.7x a year before (Chart 3).

### 3. Highlights for Rating

According to their respective announcements, the Companies have yet made business forecasts for FY2020 partly because the impact of the COVID-19 pandemic is unpredictable.

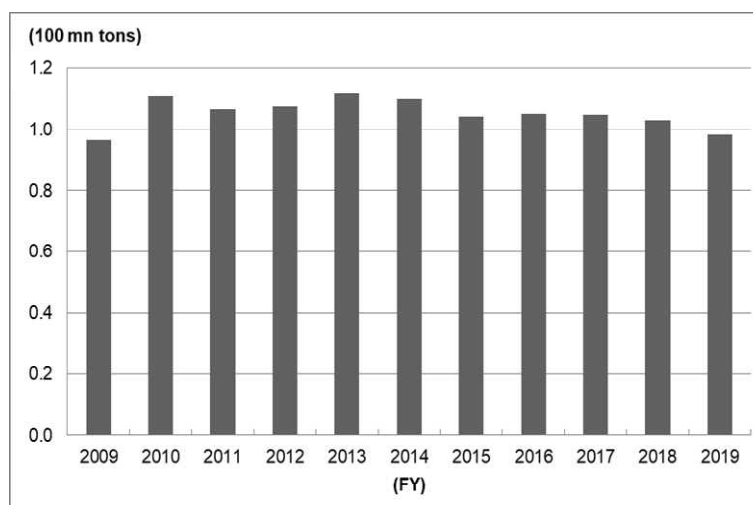
Customers are now more likely to slow down production activities due to the COVID-19 pandemic, as indicated by the shutdown of plants by some automakers. Steel demand is expected to keep falling at home and abroad for a while, especially in the manufacturing industry, which is feared to result in less domestic crude steel production than FY2019. Therefore, the Companies will likely see a decrease in sales volume, as well as in productivity due to a drop in production volume. Profitability is also expected to weaken as downward pressure on steel prices for retailing and exports will grow stronger. Given these factors, the Companies' performance is expected to weaken, but to what degree depends on how the pandemic evolves going forward. Utmost attention will probably be paid to when the pandemic will be brought under control and how far demand will recover afterwards, as well as to changes in crude steel production, when looking at the Companies' performance for FY2020.

As an extremely tough business environment is anticipated for FY2020, the Companies intend to take responsive measures to control a business downturn. NIPPON STEEL will work to cut fixed costs by as much as 200 billion yen by reducing repair and depreciation expenses and variable costs by 50 billion yen or more through the optimization of its operations, etc. JFE aims to achieve cost reductions of 100 billion yen by cutting fixed costs, mainly repair and labor expenses, and variable costs through the realization of effects of capital investments implemented in FY2019. KOBELCO will too take emergency measures to improve profitability on the scale of 20 billion yen centered on reducing fixed costs, and cut costs by 20 billion yen or more centered on materials businesses with capital investment effects, etc. As such, the Companies are quickly responding to rapid changes in the business environment, and JCR views that their efforts are adequate by and large. However, given that additional measures may become necessary depending on how the pandemic unfolds, JCR will closely watch the Companies' future moves.

Cash flow generation capacity is declining as the business environment worsens. Under such circumstances, the Companies plan to take cash generation measures, including reduction in capital spending and assets, with an eye to control financial deterioration. JCR will watch whether the Companies can curb the increase in interest-bearing debt through such efforts while maintaining financial soundness. Because the Companies secure a certain level of liquidity on hand and have unused commitment lines, JCR finds no particular concerns about financing for the time being.

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 Three 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)	FY2018	61,779	8.1	2,180	-5.3	3,369	16.7	5.5	2,511	38.9
	FY2019	59,215	-4.2	373	-82.9	-2,844	-	-	-4,315	-
		N/A								
JFE (5411)	FY2018	38,736	6.8	1,878	-20.4	2,320	6.3	6.0	1,635	67.5
	FY2019	37,297	-3.7	386	-79.4	378	-83.7	1.0	-1,977	-
		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)	FY2018	19,718	4.8	482	-45.7	346	-51.3	1.8	359	-43.1
	FY2019	18,698	-5.2	98	-79.6	-80	-	-	-680	-
		N/A								

		Revenue	YOY Change	Gross Profit - SG&A Exp.	YOY Change	Net Income	YOY Change
Total	FY2018	120,234	7.1	4,541	-18.2	4,506	31.9
	FY2019	115,210	-4.2	858	-81.1	-6,972	-

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

\*1: Figures for NIPPON STEEL and JFE are IFRS-based.

\*2: "Revenue" under "Total" is "Net Sales" for KOBELCO.

\*3: "Gross Profit - SG&A Exp." under "Total" is "Operating Income" for KOBELCO.

\*4: "Net Income" under "Total" is the sum of "Net Income Attributable to Owners of the Parent" under J-GAAP and "Profit Attributable to Owners of the Parent" under IFRS.

## (Chart 3) Financial Structure of Three 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)	FY2017	32,869	20,077	0.6	5,968	3.4	4,855	-3,631
	FY2018	33,807	22,192	0.7	6,266	3.5	4,523	-3,818
		29,416	21,887	0.7	4,547	4.8	4,943	-3,456
JFE (5411)	FY2017	19,877	12,662	0.6	4,185	3.0	3,283	-2,164
	FY2018	20,513	13,988	0.7	3,841	3.6	2,682	-3,133
		17,520	16,893	1.0	2,701	6.3	2,610	-3,583

		Equity Capital	Interest-bearing Debt	D/E Ratio	EBITDA	Interest-bearing Debt / EBITDA	Operating Cash Flow	Investing Cash Flow
KOBELCO (5406)	FY2017	7,425	7,388	1.0	1,972	3.7	1,908	-1,615
	FY2018	7,395	7,603	1.0	1,579	4.8	671	-286
		6,568	9,066	1.4	1,225	7.4	270	-2,189

		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	FY2017	60,172	40,128	0.7	12,126	3.3	10,047	-7,412
	FY2018	61,717	43,784	0.7	11,686	3.7	7,877	-7,237
		53,505	47,846	0.9	8,474	5.6	7,824	-9,229

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

\*5: Figures after the evaluation of equity content of subordinated loans for NIPPON STEEL and JFE

\*6: EBITDA for NIPPON STEEL and JFE is: gross profit - SG&A expenses + depreciation expenses.

\*7: "Equity Attributable to Owners of the Parent" under "Total" is the sum of "Equity Capital" under J-GAAP and "Equity Attributable to Owners of the Parent" under 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: Negative

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