Improving Corporate Value in a Rapidly Changing Environment

Eiji Hayashida

President and CEO
JFE Holdings, Inc.

JFE is engaged in engineering, trade and related businesses centered on the company's core steel business.

Since JFE's founding in 2002, the company has undertaken various restructurings to ensure its sustainable long-term growth while striving to serve society beneficially. JFE employees are trained to enhance our coexistence with the global environment and to rigorously uphold ethical business practices. Through such efforts, we work to increase our corporate value for all stakeholders.

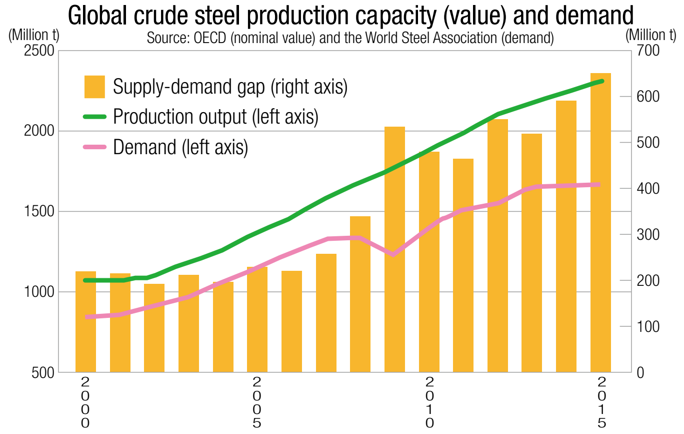
JFE is currently targeting sustainable growth and improved corporate value under its Fifth Medium-term Business Plan. This plan was introduced in the spring of 2015 to lay out core business strategies from FY2015 to FY2017. The major strategies include strengthening the profit base in Japan, increasing overseas business profitability by leveraging technical superiority, and diversifying human resources and the Group's combined strengths in wide-ranging fields. But since the summer of 2015, the environment surrounding the steel business has grown increasingly harsh, particularly because of the stagnant Chinese economy. Herein, I would like to report on such circumstances and explain how we intend to respond.

Soundly pursuing our plan by strengthening our technical prowess, human resources, and the group's combined strengths

Slow recovery in steel business due to a weakening international market

Up to the end of the 20th century, global crude steel production hovered at around 700 to 800 million tons per year. But the start of the 21st century witnessed a surge in demand from developing countries like China, ushering in a period of strong earnings for the global steel industry. Although demand plummeted following the Lehman shock in 2008, the falloff was soon offset by the robust Chinese economy. However, this eventually led to instability in the international steel market, where minor fluctuations in demand from China resulted in wild fluctuations in raw material prices. In 2014, China experienced its first negative growth in steel demand, which precipitated an oversupply that substantially depressed the international market. Our earnings were supported somewhat by the decline in raw material prices, but once Chinese demand started falling further in 2015, the country's steel industry began to export aggressively. Steel product prices quickly plummeted and the international market now finds itself in the worst shape it has been in a dozen or so years. Notably, difficult conditions persist for highly value-added steel products, such as those in which we specialize.

Global crude steel production capacity (value) and demand



Recent conditions for each group business reflecting domestic and foreign trends

Earnings also were tepid in our trading business, which is strongly tied to our steel business. The Chinese government had been planning to scrap small, inefficient steel production facilities, but then not much was done because it would have cut jobs. While more muscle has been put into pursuing the plan this year, there is little hope that it will produce results quickly. A realistic expectation is that it will take several years to restore a supply/demand balance, so I feel we must work on the premise that harsh conditions will persist for some time in both our steel and trade businesses.

With regard to our engineering business, we were anticipating a decline in Japanese demand, so for the past few years we have been proactively expanding businesses overseas. We have narrowed our pursuit of new orders to focus mainly on Southeast Asia, but this area also has been impacted by the sluggish Chinese economy, so the value of overseas orders fell short of our target. In Japan, however, we leveraged our competitiveness to beef up sales. As a result, the values of the orders we received in FY2015 came to a record 509.4 billion yen, which was ahead of our medium-term target.

Japan Marine United, our equity-method shipbuilding affiliate, had a good year. Despite a global slowdown in orders for bulk carriers and tankers, it won a number of orders for new ship models, such as large-scale container ships, gas tankers and warships, so it will maintain a solid construction volume for the coming two and a half years. The costs of development and design for new ship models is by no means small, but we are forging ahead with this business by staying in the black in both the past and current fiscal years.

Hot-rolled steel prices in China

Responding to harsh environment with growth measures

Global market conditions for steel should gradually recover as China responds to the situation and other factors take hold. If the global economic recession is prolonged, however, the recovery could be drawn out, so we intend to work under the assumption that an upturn may not come, even while remaining hopeful. Under almost any scenario, harsh conditions are likely to persist for the time being, but we remain determined to make our utmost efforts to increase earnings in our flagship steel business.

Specifically, we intend to boost our share of the high-end steel market, which differs from the heavily price-competitive market for generic products. We also will cut costs by improving production efficiency, and by upgrading and repairing facilities for increased product and cost competitiveness over the medium to long term. In addition, we will engage in further hiring and training to rejuvenate our workforce. While current conditions differ from what we originally envisioned when fashioning our current medium-term business plan, what we need to do remains relatively unchanged. It might take us somewhat longer to achieve our profit targets, but we will resolutely forge ahead nonetheless.

In addition to improving earnings in each business sector, we intend to support investment by improving cash flow through efforts like asset compression, thereby striking a balance between earnings and the financial footing of our group as a whole.

Corporate structure that enhances governance

In Japan, numerous measures have been taken in recent years to improve corporate governance, including implementation of the Tokyo Stock Exchange's Corporate Governance Code. Also, in advance of such measures, JFE Holdings proactively introduced outside directors, established new internal structures and enhanced training to improve governance. In FY2015, corporate transparency was upgraded by establishing the Nominating Committee and the Remuneration Committee. Outside executives hold a majority of the seats on the two committees.

After a string of corporate scandals in the business worlds of Japan and overseas beginning last year, JFE Group members have committed to collectively and individually review their understanding of ethical needs and requirements as members of society and as professionals. We plan to return to our core principles to ensure thorough compliance.

Meeting the expectations of stakeholders

While my conjecture is that business conditions will remain harsh, as the CEO I am determined to lead JFE in meeting the expectations of stakeholders in every way possible. In working toward this goal, I intend to inspire progress and remain both positive and enthusiastic, and I would greatly appreciate your support.