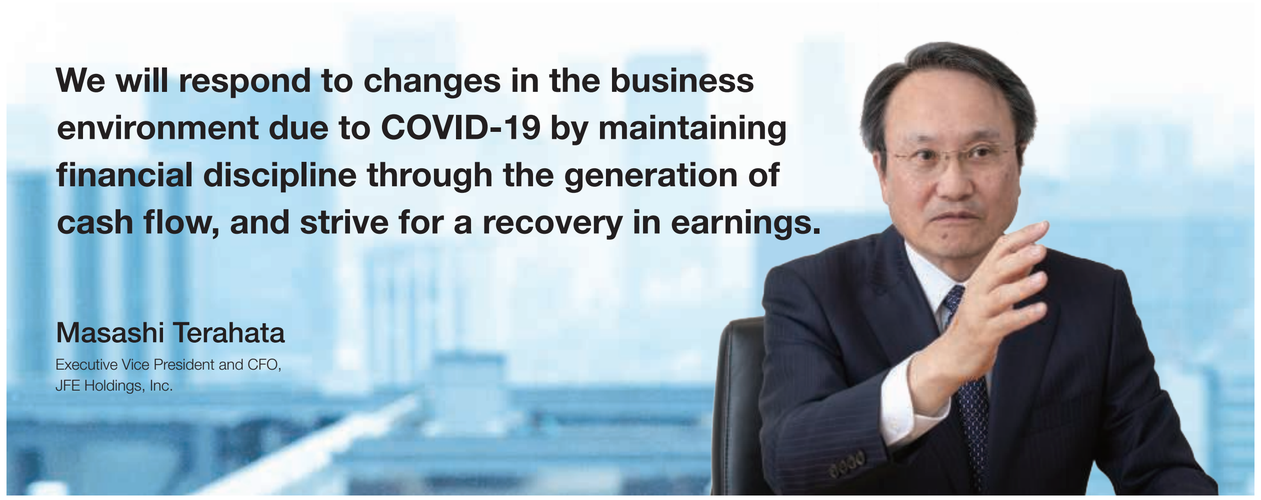
Financial Strategies

Message from the CFO



We will respond to changes in the business environment due to COVID-19 by maintaining financial discipline through the generation of cash flow, and strive for a recovery in earnings.

Masashi Terahata

Executive Vice President and CFO,
JFE Holdings, Inc.

Overview of FY2019 results

In FY2019, the steel business recorded its first segment loss ever (8.7 billion yen) in the history of the JFE Group, while the JFE Group's consolidated business profit*1 was 37.8 billion yen. In view of the harsh business environment, JFE Steel decided to restructure the steel business, and the East Japan Works recorded impairment losses. Loss attributable to owners of the parent company after tax and other expenses was 197.7 billion yen.

As for cash flow, the balance of interest-bearing liabilities at the end of March 2020 was 1,814.3 billion yen, an increase of 290.5 billion yen (including a 105.7 billion yen increase in lease obligations at the beginning of the period due to the application of a new accounting standard for leases) compared to the end of the previous fiscal year, due to a high level of capital investments in the steel business.

As a result, the debt/EBITDA ratio as of the end of March 2020 was 6.7 times, with a D/E ratio of 96%*2.

*1 Business profit is profit before tax excluding financial income and one-time items of materially significant value.
*2 After equity assessment of subordinated loans by a ratings agency

Major financial indicators

	JGAAP (Japanese Generally Accepted Accounting Principles)		IFRS (International Financial Reporting Standards)	
	FY2016	FY2017	FY2018	FY2019
ROE (%)	3.7	7.6	8.6	(11.1)
Ordinary income / Business profit (billion yen)	84.7	216.3	232.0	37.8
Capital investment (billion yen; construction basis)	234.7	257.2	329.5	391.3
Debt/EBITDA ratio (times)	4.9	3.4	3.6	6.7
D/E ratio (%)	51.4	58.1	68.2	96.4

Business forecast for FY2020 and emergency countermeasures

The spread of COVID-19 since the end of the previous fiscal year has brought a dramatic slowdown in the global economy, and the JFE Group faces the most challenging situation in its history. We are currently implementing emergency measures to improve profits and cash flows across the entire Group, in order to ride out this crisis.

As revenue measures, we are proceeding with cost reductions of 100 billion yen in the steel business. In terms of cash flow, we will reduce capital investment in the steel business in Japan under the Sixth Medium-term Business Plan, originally planned at 1 trillion yen over three years, by a total of 130 billion yen, adding another 30 billion yen to the reduction of 100 billion yen decided in the previous fiscal year. Moreover, we will increase the asset reductions of 150 billion yen decided in the previous fiscal year, including the sale of strategic shareholdings, inventory reductions and land sales Group-wide, by a further 20 billion yen. This will generate 170 billion yen in cash by the end of FY2020. Specifically, we will progressively sell our strategic shareholdings based on our policy to not hold such shares, in principle. At the same time, we will also reduce our main raw material inventory to the lowest levels ever, and reduce our product inventories through the optimization of operations.

In the business forecast for FY2020 (announced in August), which incorporates these emergency measures, we regrettably anticipate a business loss of 125 billion yen for the first half of the fiscal year, due to the impact of factors including volume decreases and a decrease in subsidiary companies' profits in the steel business. In the second half of the fiscal year however, we plan for a business profit of 25 billion yen, as the engineering business and trading business contribute to profit in addition to the steel business returning to profitability based on a recovery in the level of activity in customer industries, particularly the automotive sector and the steady implementation of initiatives aimed at improving profits. We forecast a full year business loss of 100 billion yen, and a loss attributable to owners of the parent company of 100 billion yen.

As for fund procurement in FY2020, we have moved up our plans for funds procurement in order to ensure liquidity amid the unclear outlook for the economic and financial environment. In addition to raising 60 billion yen through the issue of corporate bonds in July, we actively borrow from financial institutions, and have procured total funds of around 300 billion yen by the end of September. The balance of cash and deposits as of September 30, 2020 is forecast to total 130 billion yen, an increase of around 40 billion yen compared to the end of the previous fiscal year, while interest-bearing liabilities are forecast to total 1,950 billion yen, an increase of around 130 billion yen. Interest-bearing liabilities have increased, partly due to the deterioration in performance in FY2019, but we regard the maintenance of financial discipline as a key issue for management, in order to continue investment in sustainable growth for the future. We aim to reduce interest-bearing liabilities through the steady implementation of cash flow measures and recovering profitability.

Results for FY2019 and business forecast for FY2020

(Billions of yen)

	FY2019 results	FY2020 forecast (announced in August)		
	Full-year	First half	Second half	Full-year
Business profit	37.8	(125.0)	25.0	(100.0)
Steel business	(8.7)	(145.0)	0.0	(145.0)
Engineering business	23.1	6.0	15.0	21.0
Trading business	27.0	5.5	6.5	12.0
Adjustment	(15.9)	1.5	(4.5)	(3.0)
Total segment profit	25.3	(132.0)	17.0	(115.0)
Profit attributable to owners of the parent company	(197.7)	(110.0)	10.0	(100.0)

*Impairment losses of 238.8 billion yen were disclosed as a one-time item of a materially significant value for FY2019

Urgent revenue and cash flow measures

1 **Steel business: cost reduction**
100 billion yen reduction: Cumulative reduction of 100 billion yen absorbing cost increases due to lower production

2 **Steel business: reduction in capital investment in Japan** (cf. 1 trillion yen over 3 years in the Sixth Medium-term Business Plan)
130 billion yen reduction: A further 30 billion yen in addition to the 100 billion yen reduction announced in November 2019

3 **JFE Group asset reductions** (inventory reductions, reduction of strategic shareholdings, etc.)
170 billion yen reduction: A further 20 billion yen in addition to the 150 billion yen reduction announced in November 2019

Initiatives to return to profit in FY2021

The restructuring of the steel business, decided in the previous fiscal year, entails a review of production systems in FY2023 to reduce annual fixed costs by 60 billion yen and annual depreciation expense by 25 billion yen with the aim of building a lean, strong and resilient structure to continue to maintain our competitive strength into the future. Currently however, we are experiencing a harsh business environment due the sudden slowdown in the world economy, and face the huge challenge of riding out these conditions until our strategy brings results.

JFE Steel is already engaged in measures to ensure a return to profitability in FY2021. The business environment next fiscal year is difficult to predict at present, but assuming a crude steel production level equivalent to the second half of FY2020 (24 million tons per year) in the steel business, the launch of the new upstream processing facility at the West Japan Works will surely reduce production costs, in addition to the effects of increased production volumes. Even with the recent dramatic decrease in production, JFE Steel's manufacturing capabilities are steadily improving, thanks to a range of initiatives to control variable costs, and a return to profit is fully achievable through the continuation of thorough cost reductions. We do anticipate some risk of lower than expected production volumes, but we will ensure the return to profit through initiatives to continue improvement in sales price levels and further reductions in fixed costs.

In the engineering business, the volume of orders received has grown due to an increase in large scale projects, primarily public works including environmental and social infrastructure vital for life in society, and we expect to continue to secure stable profits. Additionally, we expect an increase in profit in the trading business, with a recovery in the demand for steel.

The spread of COVID-19 has made it extremely difficult to forecast economic trends. We are responding to these changes in the environment however, and striving to achieve a recovery in profits in FY2021. At the same time, we are considering moving up the implementation of restructuring at JFE Steel and study ways to achieve results earlier. We will reinforce our revenue base, and structure our finances to prepare for investment in future growth.

Returns to shareholders

In FY2019, we paid an interim dividend of 20 yen per share, but made the regrettable decision not to pay a year-end dividend, in view of the substantial deterioration in financial results. In light of the current profit/loss status, we decided not to pay an interim dividend in FY2020 (announced in August). The year-end dividend is yet to be determined, and we will make a decision by closely observing trends in business performance in the second half of FY2020 and the next fiscal year.

Trends in dividend payout

	FY2016	FY2017	FY2018	FY2019
Profit per share (yen/share)	117.8	250.9	283.8	(343.4)
Dividend per share (yen/share)	30.0	80.0	95.0	20.0
Dividend payout ratio (%)	25.5	31.9	33.5	–

Financial Highlights

The JFE Group adopted International Financial Reporting Standards (IFRS) from FY2018, in place of the generally accepted accounting principles in Japan (JGAAP).

(Billions of yen)

	JGAAP										IFRS	
	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2018	**FY2019**
Operating results												
Net sales (JGAAP) / Revenue (IFRS)	2,844	3,195	3,166	3,189	3,666	3,850	3,431	3,308	3,678	3,961	3,873	3,729
Ordinary income (JGAAP) / Business profit[*1] (IFRS)	69	165	52	52	173	231	64	84	216	221	232	37
Income before income taxes (JGAAP) / Profit before tax (IFRS)	70	115	(71)	75	160	226	74	105	213	209	209	(213)
EBITDA[*2] (JGAAP) / EBITDA[*3] (IFRS)	337	428	306	260	368	421	254	279	388	405	428	269
Profit attributable to owners of parent	45	58	(36)	39	102	139	33	67	144	164	163	(197)
Capital expenditures (construction basis)	225	180	197	179	175	225	212	234	257	287	329	391
Depreciation and amortization	248	246	238	194	181	176	177	182	159	172	196	231
Research and development expenses	36	33	34	33	31	32	35	35	34	37	37	38
Financial position												
Total assets	3,918	3,976	4,007	4,107	4,241	4,639	4,234	4,336	4,440	4,648	4,709	4,646
Property, plant and equipment	1,800	1,712	1,644	1,606	1,599	1,629	1,627	1,650	1,702	1,782	1,835	1,717
Shareholders' equity (JGAAP)/ Equity attributable to owners of parent (IFRS)	1,422	1,437	1,414	1,558	1,702	1,938	1,804	1,865	1,949	2,012	1,926	1,627
Net assets (JGAAP) / Equity (IFRS)	1,465	1,478	1,456	1,596	1,745	1,990	1,857	1,921	2,009	2,079	1,991	1,706
Debt outstanding (JGAAP)/ Interest-bearing debt outstanding (IFRS)	1,468	1,496	1,593	1,596	1,534	1,501	1,379	1,375	1,330	1,449	1,523	1,814
Cash flows												
Cash flows from operating activities	389	302	110	287	254	297	267	185	298	235	268	261
Cash flows from investing activities	(236)	(302)	(205)	(163)	(164)	(216)	(137)	(163)	(194)	(284)	(313)	(358)
Free cash flow[*4]	152	0	(95)	123	90	81	129	21	103	(48)	(45)	(97)
Cash flows from financing activities	(321)	23	96	(147)	(105)	(78)	(144)	(18)	(90)	56	51	103
Per share data												
Profit attributable to owners of parent (yen/share)	86	111	(69)	71	177	242	58	118	251	285	284	(343)
Net assets (JGAAP)/ Equity attributable to owners of parent (IFRS) (yen/share)	2,690	2,709	2,628	2,701	2,951	3,362	3,128	3,236	3,382	3,495	3,345	2,826
Dividends (yen/share)	20	35	20	20	40	60	30	30	80	95	95	20
Payout ratio (%)	23.2	31.6	—	28.1	22.5	24.8	51.4	25.5	31.9	33.3	33.5	—
Financial indicators												
Debt/EBITDA ratio[*5] (JGAAP) / Debt/EBITDA ratio[*6] (IFRS) (times)	4.4	3.5	5.2	6.1	4.2	3.6	5.4	4.9	3.4	3.6	3.6	6.7
ROE[*7] (JGAAP) / ROE[*8] (IFRS) (%)	3.3	4.1	(2.6)	2.7	6.3	7.7	1.8	3.7	7.6	8.3	8.6	(11.1)
ROA[*9] (JGAAP) / ROA[*10] (IFRS) (%)	2.2	4.6	1.7	1.6	4.5	5.5	1.7	2.3	5.2	5.1	5.0	0.8
Equity ratio (%)	36.3	36.2	35.3	37.9	40.1	41.8	42.6	43.0	43.9	43.3	40.9	35.0
D/E ratio[*11] (JGAAP) / D/E ratio[*12] (IFRS) (%)	75.5	76.5	83.5	76.9	67.9	59.0	56.9	51.4	58.1	62.0	68.2	96.4
Year-end share price (yen/share)	3,765	2,434	1,778	1,767	1,943	2,654	1,516	1,909	2,144	1,879	1,879	703
Segment information												
Net sales (JGAAP) / Revenue (IFRS)												
Steel	2,281	2,747	2,714	2,499	2,691	2,873	2,445	2,349	2,715	2,808	2,830	2,681
Engineering	294	265	278	267	284	367	397	426	391	485	485	512
Trading				785	1,781	1,934	1,756	1,671	1,907	2,060	1,125	1,084
Ordinary income (JGAAP) / Segment profit[*13] (IFRS)												
Steel	32	134	25	15	126	188	27	40	198	164	161	(8)
Engineering	13	12	14	16	18	18	20	26	19	20	20	23
Trading				7	21	24	15	21	33	35	35	27
Others												
Crude steel production (JFE Steel on a non-consolidated basis) (million t)	25.83	28.80	26.90	27.97	28.67	28.44	27.36	28.14	28.46	26.31	26.31	26.73
Crude steel production (JFE Steel on a consolidated basis) (million t)	28.35	31.47	29.24	30.69	31.58	31.04	29.75	30.41	30.06	27.88	27.88	28.09
Shipment (JFE Steel on a non-consolidated basis) (million t)	23.18	26.25	24.67	25.23	25.52	26.07	25.39	25.70	25.30	23.78	23.78	23.47
Average selling price (JFE Steel on a non-consolidated basis) (thousand yen/t)	70.2	77.9	82.0	70.6	75.7	77.1	66.8	62.8	75.3	81.5	81.5	78.8
Export ratio on a value basis (JFE Steel on a non-consolidated basis) (%)	45.6	46.5	45.0	49.9	48.4	48.1	45.8	44.0	44.4	41.7	41.7	41.5
Employees (JFE Holdings on a consolidated basis) (persons)	53,892	54,400	54,133	57,044	57,210	58,856	59,460	60,439	61,234	62,076	62,083	64,009

*1 Business profit: Profit before tax excluding finance income and one-time items of a materially significant value
*2 EBITDA (JGAAP): Ordinary income + Interest expenses + Depreciation and amortization
*3 EBITDA (IFRS): Business profit + Depreciation and amortization
*4 Free cash flow: Cash flows from operating activities + Cash flows from investing activities
*5 Debt/EBITDA ratio (JGAAP): Debt outstanding / EBITDA
*6 Debt/EBITDA ratio (IFRS): Interest-bearing debt outstanding / EBITDA
*7 ROE (JGAAP): Profit attributable to owners of parent / Shareholders' equity
*8 ROE (IFRS): Profit attributable to owners of parent / Equity attributable to owners of parent
*9 ROA (JGAAP): (Ordinary income + Interest expenses) / Total assets (average)
*10 ROA (IFRS): Business profit / Total assets
*11 D/E ratio (JGAAP): Debt outstanding / Shareholders' equity
For debt having a capital component, a portion of its issue price is deemed to be capital, as assessed by rating agencies.
*12 D/E ratio (IFRS): Interest-bearing debt outstanding / Equity attributable to owners of parent
For debt having a capital component, a portion of its issue price is deemed to be capital, as assessed by rating agencies.
*13 Segment profit: Profit including finance income in business profit