

Kobe Steel's Consolidated Financial Results for First Quarter of Fiscal 2018 (April 1 – June 30, 2018)

August 1, 2018

Company name: Kobe Steel, Ltd.
 Code number: 5406
 Stock exchanges listed: Tokyo and Nagoya, Japan
 Website: <http://www.kobelco.co.jp/english/>
 Representative: Mitsugu Yamaguchi, President, CEO and Representative Director
 Filing of quarterly report: August 1, 2018
 Dividend payments begin: ---
 Supplemental information available: Yes
 IR Briefing: Yes (in Japanese only)
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(Sums of less than 1 million yen have been omitted.)

1. Consolidated results for First Quarter of FY2018 (April 1 – June 30, 2018)

(1) Consolidated operating results

(% of change from the corresponding period of the previous year)

	Net sales		Operating income		Ordinary income		Net income attributable to owners of the parent	
	Million yen	%	Million yen	%	Million yen	%	Million yen	%
FY2018 1Q	478,318	10.0	13,831	(54.4)	12,749	(54.9)	12,659	(49.4)
FY2017 1Q	435,008	7.6	30,302	138.6	28,254	519.8	25,009	---

Note: Comprehensive income FY2018 1Q: 6,042 million yen [(73.6%)] FY2017 1Q: 22,859 million yen [---%]

	Net income per share	Diluted net income per share
	Yen	Yen
FY2018 1Q	34.94	---
FY2017 1Q	69.03	---

(2) Consolidated financial position

	Total assets	Net assets	Equity capital ratio
	Million yen	Million yen	%
FY2018 1Q	2,328,847	799,036	31.6
FY2017	2,352,114	790,984	31.6

Reference: Equity capital FY2018 1Q: 736,196 million yen FY2017: 742,588 million yen

2. Dividends

	Annual dividends				
	1Q	2Q	3Q	4Q	Total
FY2017	Yen ---	Yen 0.00	Yen ---	Yen 30.00	Yen 30.00
FY2018	---				
FY2018 Forecast		10.00	---	---	---

Revision to dividend forecast in FY2018 1Q: Yes

The dividend for the end of fiscal 2018 is undetermined.

For more information, please refer to "Announcement on Revision to Earnings Forecast and Interim Dividend Forecast for Fiscal 2018, ending March 31, 2019."

3. Consolidated earnings forecast for FY2018 (April 1, 2018-March 31, 2019)

(% of change from the corresponding period of the previous year)

	Net sales		Operating income		Ordinary income		Net income attributable to owners of the parent		Net income per share
	Million yen	%	Million yen	%	Million yen	%	Million yen	%	Yen
1H	1,000,000	10.2	20,000	(61.1)	10,000	(78.2)	30,000	(23.8)	82.81
Full year	2,030,000	7.9	55,000	(38.1)	35,000	(50.8)	45,000	(28.8)	124.22

Revision to consolidated forecast in FY2018 1Q: Yes

For more information, please refer to “Announcement on Revision to Earnings Forecast and Interim Dividend Forecast for Fiscal 2018, ending March 31, 2019.”

Notes

- (1) Changes in number of material subsidiaries in fiscal year
(Changes in specified subsidiaries due to changes in scope of consolidation): No
- (2) Adoption of specific accounting procedures for preparing the quarterly consolidated financial statements: No
- (3) Changes in accounting policies, estimates and restatement on the preparation of consolidated financial statements
- Changes in accounting policies due to revised accounting standards: No
 - Other changes: No
 - Changes in accounting estimates: No
 - Restatement: No

- (4) Number of issued shares (common stock)

Number of issued shares (including treasury stock)
Number of shares of treasury stock
Average number of shares (1Q)

	FY2018 1Q	FY2017
Number of issued shares (including treasury stock)	364,364,210 shares	364,364,210 shares
Number of shares of treasury stock	2,117,553 shares	2,118,007 shares
Average number of shares (1Q)	362,246,041 shares	362,254,584 shares

Explanation on the Appropriate Use of the Forecast and Other Special Items

The above forecast is based on currently available information as of today.
Actual results may differ considerably due to various changeable conditions in the future.
For preconditions on the forecast and other related factors, please refer to page 5.

1. Qualitative Information on Consolidated Operating Results

(1) Qualitative Information on Consolidated Operating Results

Japan's economy in the first quarter of fiscal 2018 (April 1-June 30, 2018) continued on a gradual recovery trend supported by recovery in personal spending on the back of improvements in the employment situation and income environment and by firm corporate capital investments. In overseas economies, China showed some slowdown in economic growth while economic recovery trends continued mainly in the United States and Southeast Asia.

In this economic environment in the Kobe Steel Group, the sales volume of steel products decreased, compared with the same period last year, with the shutdown of upstream process equipment at Kobe Works and consolidation to Kakogawa Works along with other factors, although demand mainly in the domestic automotive sector continued to be firm. The sales volume of aluminum rolled products declined, compared with the same period last year, as demand for can stock for beverage cans decreased. The sales volume of copper rolled products increased, compared with the same period last year, owing to firm demand for semiconductors and automotive terminals. Unit sales of hydraulic excavators increased, compared with the same period last year, owing to continued firm demand mainly in China.

As a result, sales for the consolidated first quarter of fiscal 2018 increased 43.3 billion yen, compared with the same period last year, to 478.3 billion yen. Operating income decreased 16.4 billion yen, compared with the same period last year, to 13.8 billion yen impacted by inventory valuation. Ordinary income* decreased 15.5 billion yen, compared with the same period last year, to 12.7 billion yen. As for extraordinary income, Kobe Steel posted 3.9 billion yen as gain on the acquisition of a subsidiary (gain on negative goodwill etc.) associated with turning Shinko Wire Company, Ltd. into a subsidiary. Net income attributable to owners of the parent decreased 12.3 billion yen to 12.6 billion yen.

Under its Fiscal 2016-2020 Group Medium-Term Management Plan launched in April 2016, Kobe Steel is establishing three core business areas: materials, machinery and electric power. The progress of its growth strategies in these areas are as follows:

- Materials businesses: Tackling weight reduction in cars, the Iron & Steel segment has decided to make capital investments in automotive ultra high-strength steel.
- Machinery businesses: In the Construction Machinery segment, restructuring the hydraulic excavator business in China has been largely completed.
- Electric power business: To procure funds for a new power generation project in the city of Kobe, Kobe Steel established Kobelco Power Kobe No. 2, Inc. to supply electric power.

In addition, Kobe Steel has been involved in misconduct concerning products, etc. that did not meet official standards or customers' specifications (also known as "nonconforming products"). Inspection results were falsified or fabricated to appear as if the products had met the required standards or specifications, and the products were shipped or provided to customers. Kobe Steel is currently carrying out the measures described in the "Report on Misconduct in Kobe Steel Group" dated March 6, 2018 to prevent recurrence. Please refer to the following URL for the progress of measures to prevent a recurrence.

<http://www.kobelco.co.jp/english/progress/relapse-prevention/index.html>

Conditions in the business segments for the first quarter of fiscal 2018 follow below.

Iron & Steel

The sales volume of steel products decreased, compared with the same period last year. Demand was firm mainly in the automotive sector in Japan, but upstream process equipment was shut down at Kobe Works and consolidated to Kakogawa Works. Sales prices increased, compared with the same period last year, affected by the rise in raw material prices.

Sales of steel castings and forgings decreased compared with the same period last year, owing to lower demand for ships. Sales of titanium products increased, compared with the same period last year, owing to expanded sales to the aircraft sector and other factors.

As a result, segment sales for the consolidated first quarter increased 2.7%, compared with the same period

last year, to 179.1 billion yen. Ordinary income decreased 12.2 billion yen to 0.8 billion yen, impacted by inventory valuation.

As an initiative under its Medium-Term Management Plan, Kobe Steel has decided on capital investments centered on the new construction of a continuous annealing line for steel sheet at Kakogawa Works to meet the growing demand for automotive ultra high-strength steel. Construction work has already commenced.

Welding

The sales volume of welding materials decreased compared with the same period last year. Although demand in the energy sector in China and the automotive sector in Thailand and Indonesia increased, demand from the shipbuilding industry was sluggish mainly in China and South Korea.

Sales of welding systems were at a similar level to the same period last year, as demand continued to be firm for architectural steel frames in Japan.

As a result, segment sales for the consolidated first quarter were at a similar level to the same period last year at 19.7 billion yen. Ordinary income decreased 0.6 billion yen, compared with the same period last year, to 0.5 billion yen.

Aluminum & Copper

The sales volume of aluminum rolled products decreased, compared with the same period last year, owing to lower demand for can stock for beverage cans.

The sales volume of copper rolled products increased, compared with the same period last year, owing to firm demand for semiconductors and automotive terminals.

As a result, segment sales for the consolidated first quarter increased 4.8%, compared with the same period last year, to 93.1 billion yen owing to a rise in sales prices associated with an increase in ingot prices, although the sales volume of aluminum rolled products decreased. Ordinary income decreased 3.7 billion yen compared with the same period last year to 2.4 billion yen, impacted by the misconduct and inventory valuation.

Machinery

Orders in the consolidated first quarter increased 14.4%, compared with the same period last year, to 32.8 billion yen, owing to compressor demand recovering in the oil refining field, an increase in demand for after-sales services in the petrochemical sector in Asia and the Middle East, and other factors. The backlog of orders in the consolidated first quarter stood at 130.7 billion yen.

Segment sales for the consolidated first quarter increased 45.9%, compared with the same period last year, to 44.2 billion yen. Ordinary income increased 0.7 billion yen, compared with the same period last year, to 1.0 billion yen.

Engineering

Orders in the consolidated first quarter increased 59.9%, compared with the same period last year, to 51.4 billion yen, owing to firm orders in the waste treatment business. The backlog of orders in the consolidated first quarter came to 207.7 billion yen.

Segment sales for the consolidated first quarter increased 31.5%, compared with the same period last year, to 25.0 billion yen owing to steadily fulfilling current orders. Ordinary income increased 0.1 billion yen, compared with the same period last year, to 0.4 billion yen.

Construction Machinery

Unit sales of hydraulic excavators increased, compared with the same period last year, owing to firm demand mainly in China.

Unit sales of crawler cranes also increased, compared with the same period last year, owing to a recovery of demand in North America and other areas.

As a result, segment sales for the consolidated first quarter increased 15.8%, compared with the same period last year, to 101.3 billion yen. Ordinary income increased 3.5 billion yen, compared with the same period last year, to 7.5 billion yen.

As an initiative under its Medium-Term Management Plan, Kobelco Construction Machinery Co., Ltd. has restructured its excavator business in China. It has completed the reorganization of its production system with Chengdu (inland area) focusing on the Chinese market and Hangzhou (coastal area) serving as a base for exports. In addition, it has generally completed reducing the number of dealers, consolidating them, and restructuring the sales management system.

Electric Power

Segment sales for the consolidated first quarter were at a similar level to the same period last year at 14.0 billion yen. Ordinary income declined 2.5 billion yen, compared with the same period last year, to a loss of 0.0 billion yen owing to higher maintenance costs of the Kobe Power Plant and other factors.

As an initiative under its Medium-Term Management Plan, Kobe Steel has established Kobelco Power Kobe No. 2, Inc. through a simplified incorporation-type company split to supply electric power. The company is working to raise funds for the new power generation project in Kobe.

Other Businesses

At Kobelco Research Institute, Inc., demand was firm in the semiconductor inspection equipment business. At Shinko Real Estate Co., Ltd., the residential property sales business and the leasing business were at similar levels to the same period last year.

As a result, segment sales for the consolidated first quarter increased 8.8%, compared with the same period last year, to 14.5 billion yen. Ordinary income decreased 0.4 billion yen, compared with the same period last year, to 0.6 billion yen.

With regard to Shinko Real Estate Co., Ltd., Kobe Steel transferred a portion of its issued shares held in that subsidiary to Tokyo Century Corporation and NIPPON TOCHI-TATEMONO Co., Ltd. on July 1, 2018 to build a strategic alliance relationship and to achieve synergy by utilizing mutual customer bases, business know-how and the ability to provide financing as well as reinforce the business.

(2) Qualitative Information on Consolidated Earnings Forecast

In comparison to the previous earnings forecast made on April 27, 2018, in the construction machinery business, unit sales of hydraulic excavators in China are on an upward trend. As a result, Kobe Steel revises upward its forecast for net sales, operating income, ordinary income and net income attributable to owners of the parent for the first half of fiscal 2018.

On the other hand, lower quantities of steel are anticipated owing to temporary production trouble, and auxiliary raw material costs are also anticipated to be higher. As a result, operating income, ordinary income and net income attributable to owners of the parent for the full fiscal 2018 are unchanged from the previous forecast.

Dividends

Kobe Steel aims to pay dividends on a continuous and stable basis. Dividends are decided after taking into full account the Company's financial condition, business performance, future capital needs and other factors. On this basis, Kobe Steel had decided on a policy to pay an interim dividend of 10 yen per share for the first half of fiscal 2018. The year-end dividend for the end of fiscal 2018 has not yet been determined.

*** Definition of Ordinary Income (Loss)**

Ordinary income (loss) under accounting principles generally accepted in Japan (Japanese GAAP) is a category of income (loss) that comes after operating income (expenses) and non-operating income (expenses), but before extraordinary income and loss. It is also called "pretax recurring profit" or simply "pretax profit."

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Balance Sheets

(In millions of yen)

ASSETS	FY2017	FY2018 1Q
	Ended Mar. 31, 2018	Ended Jun. 30, 2018
Current Assets		
Cash and deposits	165,526	126,845
Notes and accounts receivable	324,811	304,012
Merchandise and finished goods	159,910	169,653
Work-in-process	136,530	143,877
Raw materials and supplies	152,007	156,016
Other	84,185	82,684
Allowance for doubtful accounts	(4,672)	(4,681)
Total current assets	1,018,298	978,406
Fixed Assets		
Property, plant and equipment		
Buildings and structures	279,270	281,798
Machinery and equipment	433,414	436,084
Land	192,158	206,385
Other	76,846	79,418
Total property, plant and equipment	981,689	1,003,688
Intangible fixed assets	40,807	39,653
Investments and other assets		
Investments in securities	197,839	187,651
Other	169,729	174,487
Allowance for doubtful accounts	(56,250)	(55,038)
Total investment and other assets	311,318	307,099
Total fixed assets	1,333,815	1,350,441
Total assets	2,352,114	2,328,847

LIABILITIES	FY2017	FY2018 1Q
	Ended Mar. 31, 2018	Ended Jun. 30, 2018
Current liabilities		
Notes and accounts payable	457,126	451,973
Short-term borrowings	205,732	137,168
Current portion of Bonds	14,000	26,140
Income and enterprise taxes payable	8,551	4,358
Provisions	61,736	45,022
Other	153,146	156,744
Total current liabilities	900,293	821,407
Long-term liabilities		
Bonds and notes	132,000	111,945
Long-term borrowings	387,133	440,089
Net defined benefit liability	70,946	76,899
Provisions	3,268	3,683
Other	67,489	75,785
Total long-term liabilities	660,836	708,404
Total liabilities	1,561,130	1,529,811
NET ASSETS		
Stockholders' equity		
Common stock	250,930	250,930
Capital surplus	102,314	102,266
Retained earnings	395,542	397,278
Treasury stock, at cost	(2,671)	(2,672)
Total stockholders' equity	746,115	747,802
Accumulated other comprehensive income		
Unrealized gains or losses on securities, net of taxes	17,333	15,941
Unrealized gains or losses on hedging derivatives, net of taxes	(9,913)	(10,457)
Land revaluation differences, net of taxes	(3,406)	(3,406)
Foreign currency translation adjustments	10,185	3,365
Remeasurements of defined benefit plans, net of taxes	(17,726)	(17,048)
Total accumulated other comprehensive income	(3,527)	(11,605)
Non-controlling interests	48,396	62,839
Total net assets	790,984	799,036
Total liabilities and net assets	2,352,114	2,328,847

Consolidated Statements of Income

(In millions of yen)

	FY2017 1Q	FY2018 1Q
	Ended Jun. 30, 2017	Ended Jun. 30, 2018
Net sales	435,008	478,318
Cost of sales	358,091	410,616
Gross profit	76,916	67,702
Selling, general and administrative expenses	46,614	53,871
Operating income	30,302	13,831
Non-operating income		
Interest income	654	624
Dividend income	2,377	2,698
Reimbursement of seconded employees' salaries	996	1,161
Equity in income of equity method companies	1,945	1,541
Other	2,504	2,771
Total non-operating income	8,478	8,796
Non-operating expenses		
Interest expense	3,000	2,570
Seconded employees' salaries	2,342	2,735
Other	5,184	4,572
Total non-operating expenses	10,526	9,878
Ordinary income	28,254	12,749
Extraordinary income		
Gain on sale of investment securities	6,779	—
Gain on acquisition of subsidiary	—	3,942
Total extraordinary income	6,779	3,942
Income before income taxes and non-controlling interests	35,033	16,691
Income taxes		
Current	6,360	3,625
Deferred	2,463	(465)
Total income taxes	8,823	3,160
Income before non-controlling interests	26,209	13,531
Net income attributable to non-controlling interests	1,200	871
Net income attributable to owners of the parent	25,009	12,659

Consolidated Statements of Comprehensive Income

(In millions of yen)

	FY2017 1Q	FY2018 1Q
	Ended Jun. 30, 2017	Ended Jun. 30, 2018
Income before non-controlling interests	26,209	13,531
Other comprehensive income (loss)		
Unrealized gains or losses on securities, net of taxes	(1,012)	(1,122)
Unrealized gains or losses on hedging derivatives, net of taxes	(1,057)	(518)
Foreign currency translation adjustments	(1,627)	(6,252)
Remeasurements of defined benefit plans, net of taxes	317	1,056
Share of other comprehensive gains and losses related to equity-method companies	30	(652)
Total other comprehensive income (loss)	(3,349)	(7,489)
Comprehensive Income (loss)	22,859	6,042
Breakdown of total comprehensive income (loss) attributed to:		
Stockholders of the parent interests	21,903	4,895
Non-controlling interests	956	1,147

Notes

Notes on premise of a going concern

None

Additional Information

Application of Partial Amendments to Accounting Standard for Tax Effect Accounting, etc.

Kobe Steel applied Partial Amendments to Accounting Standard for Tax Effect Accounting, etc. (ASBJ Statement No. 28) from the first quarter for fiscal 2018. In addition, deferred tax assets have been recorded in "Investments and other assets" and deferred tax liabilities have been recorded in "Long-term liabilities" in the Consolidated Balance Sheets.

Notes on Consolidated Balance Sheets

Contingent liabilities

In the previous consolidated fiscal year, the Kobe Steel Group discovered that misconduct had taken place. Through data falsification and/or fabrication of inspection results, products that did not meet, among others, public standards or customer specifications (the "Affected Products") were shipped or provided to customers as if they had met these requirements (the "Misconduct").

The Kobe Steel Group, with the cooperation of its customers to which the Affected Products were shipped, is proceeding to carry out technical verifications on the impact (including safety) of its Affected Products on customers' products. Safety confirmation has been completed for most of the customers. Although the verification of the safety has not yet been completed for some customers, Kobe Steel at this time has not confirmed cases that would require the immediate suspension of use or immediate recall of the products.

In addition, Kobe Steel was indicted in July 2018 on charges for allegedly violating the Unfair Competition Prevention Act. The Kobe Steel Group has also been under investigation by the U.S. Department of Justice since October 2017 for allegedly selling the Affected Products to customers in the United States.

Furthermore, three civil complaints have been brought against the Kobe Steel Group and other similar lawsuits may be filed in the future. The three civil complaints are as follows:

1. Class actions in Canada seeking compensation for economic loss caused by the automotive metal products manufactured by the Kobe Steel Group and the use of these products in the manufacture of automobiles.
2. A securities class action in the United States based on violations of the U.S. Securities Exchange Act (misrepresentation of the compliance system, etc.) concerning Kobe Steel's American Depository Receipts (ADR)
3. A class action in the United States seeking compensation for economic loss from the decline in the resale value of the plaintiffs' vehicles and other relief, arising from the use of metal products manufactured by Kobe Steel in the manufacture of the vehicles.

It is difficult to reasonably estimate the final penalties, compensation for damages, and other outcomes at this time in regard to the indictment on alleged violation of the Unfair Competition Prevention Act, the investigation by the U.S. Department of Justice and the above-mentioned civil complaints, but they may possibly result in a monetary burden. In addition, there may be additional monetary burden due to compensation cost for the exchange of products by customers, compensation cost relating to the inspections by customers and other actions.

It is possible that these factors will affect Kobe Steel's consolidated financial results. However, as it is difficult to reasonably estimate the impact of these factors at this time, these factors have not been reflected in the consolidated financial statements.

Notes on significant changes in the amount of stockholders' equity

None