

Kobe Steel's Consolidated Financial Results for the First Nine Months of Fiscal 2018 (April 1 – December 31, 2018)

February 5, 2019

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: February 8, 2019
 Dividend payments begin: —
 Supplementary 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 Nine Months of FY2018 (April 1 – December 31, 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 3Q	1,448,359	5.0	38,240	(46.8)	27,199	(56.2)	45,033	(19.3)
FY2017 3Q	1,379,317	13.3	71,839	—	62,078	—	55,823	—

Note: Comprehensive income FY2018 3Q: 30,431 million yen [(54.8%)] FY2017 3Q: 67,358 million yen [—%]

	Net income per share	Diluted net income per share
	Yen	Yen
FY2018 3Q	124.30	—
FY2017 3Q	154.10	—

(2) Consolidated financial position

	Total assets	Net assets	Equity capital ratio
	Million yen	Million yen	%
FY2018 3Q	2,334,481	819,684	32.4
FY2017	2,352,114	790,984	31.6

Reference: Equity capital FY2018 3Q: 756,147 million yen FY2017: 742,588 million yen

2. Dividends

	Annual dividends				
	1Q	2Q	3Q	4Q	Total
	Yen	Yen	Yen	Yen	Yen
FY2017	—	0.00	—	30.00	30.00
FY2018	—	10.00	—		
FY2018 Forecast				10.00	20.00

Revision to dividend forecast in FY2018 3Q: Yes

For more information, please refer to “Announcement on Revision to Dividend Forecast for Fiscal 2018, ending March 31, 2019” dated February 5, 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
Full year	1,990,000	5.8	45,000	(49.4)	25,000	(64.9)	35,000	(44.6)	96.60

Revision to consolidated forecast in FY2018 3Q: Yes

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)

	FY2018 3Q	FY2017
Number of issued shares (including treasury stock)	364,364,210 shares	364,364,210 shares
Number of shares of treasury stock	2,053,791 shares	2,118,007 shares
Average number of shares (3Q)	362,290,182 shares	362,251,695 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 nine months of fiscal 2018 (April 1–December 31, 2018) has continued on a moderate recovery supported by increased personal spending from improvements in employment and income conditions and by firm corporate capital investment, although it was affected temporarily by a series of natural disasters. In overseas economies, economic recovery trends continued mainly in the United States and Southeast Asia while China showed some slowdown in economic growth.

In this economic environment, the sales volume of steel products in the Kobe Steel Group decreased, compared with the same period last year, owing to temporary trouble with production equipment at Kakogawa Works and the impact of natural disasters, although demand mainly in the domestic automotive sector continued to be firm. The sales volume of aluminum rolled products decreased, 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 recovery in sales volume following the resolution of equipment problems at a plant in Thailand and firm demand for automotive terminals. Sales of hydraulic excavators increased, compared with the same period last year, owing to continued firm demand mainly in China.

As a result, consolidated net sales for the first nine months of fiscal 2018 increased 69.0 billion yen, compared with the same period last year, to 1,448.3 billion yen. However, owing to lower sales volume from equipment trouble, operating income decreased 33.5 billion yen, compared with the same period last year, to 38.2 billion yen. Ordinary income decreased 34.8 billion yen, compared with the same period last year, to 27.1 billion yen. As for extraordinary income, Kobe Steel posted a gain of 32.7 billion yen from transferring 75 percent of its shares in Shinko Real Estate Co., Ltd. to Tokyo Century Corporation and NIPPON TOCHI-TATEMONO Co., Ltd. Net income attributable to owners of the parent decreased 10.7 billion yen to 45.0 billion yen.

The main progress of the Fiscal 2016–2020 Group Medium-Term Management Plan launched in April 2016 follows below.

Growth strategies in the three core business areas	Materials businesses	<p><u>Iron & Steel segment</u></p> <ul style="list-style-type: none"> ● As an initiative to reduce the weight of cars, this segment decided to make capital investments in automotive ultra-high-strength steel. (April 2018) ● As an initiative to develop a global supply network for special steel wire rods, this segment decided to expand the production facility of Kobe Special Steel Wire Products (Pinghu) Co., Ltd., a wire rod processing base in China. (December 2018) <p><u>Aluminum & Copper segment</u></p> <ul style="list-style-type: none"> ● As an initiative to reduce the weight of cars, this segment decided to expand the production facility of Kobelco Aluminum Products & Extrusions Inc., its U.S. production base for automotive aluminum extrusions. (August 2018) ● As an initiative to reduce the weight of cars, this segment completed the expansion of the production facility of Kobe Aluminum Automotive Products, LLC, its U.S. production base for automotive aluminum forgings, decided in April 2017. (January 2019)
	Machinery businesses	<p><u>Construction Machinery segment</u></p> <ul style="list-style-type: none"> ● Restructuring of the hydraulic excavator business in China has been largely completed. (June 2018) ● This segment decided to expand the production capacity of the Itsukaichi Factory to build a production system capable of meeting demand from a firm global market. (November 2018)
	Electric power business	<p><u>New power generation project in Kobe</u></p> <ul style="list-style-type: none"> ● To procure funds for a new power generation project in the city of Kobe, Kobe Steel established Kobelco Power Kobe No. 2, Inc. for the purpose of supplying electric power. (May 2018) ● Kobe Steel re-entered into an environmental preservation agreement with the city of Kobe. (August 2018) ● Project finance was organized to procure funds for the new power generation project. (August 2018)

		<ul style="list-style-type: none"> • Kobe Steel began construction work on the new power generation project, having completed all the necessary legal procedures to start construction work. (October 2018)
Strengthening the management foundation		<ul style="list-style-type: none"> • The AI Project Promotion Department was established in the Technical Development Group for the purpose of strengthening manufacturing capabilities, improving efficiency and achieving greater sophistication in product development by utilizing artificial intelligence. (October 2018)

In addition, Kobe Steel was 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 a recurrence. Please refer to the following link for information on the progress of the measures to prevent a recurrence.

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

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

Iron & Steel

The sales volume of steel products decreased, compared with the same period last year, owing to temporary trouble with production equipment at Kakogawa Works and the impact of natural disasters, although demand was firm mainly in the automotive sector in Japan. Sales prices increased, compared with the same period last year, affected by the rise in main raw material prices and other factors.

Sales of steel castings and forgings decreased, compared with the same period last year, owing to changes in the product mix. 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 in the first nine months of fiscal 2018 increased 3.8 percent, compared with the same period last year, to 558.9 billion yen. However, ordinary income decreased 16.7 billion yen, compared with the same period last year, to 3.1 billion yen, because of lower sales volume due to equipment trouble and natural disasters.

Welding

The sales volume of welding materials was similar to the same period last year. Although demand increased in the automotive sector overseas, demand from the shipbuilding sector was sluggish mainly in East Asia.

Sales of welding systems were similar to the same period last year owing to continued firm demand for architectural steel frames in Japan.

As a result, consolidated segment sales in the first nine months of fiscal 2018 increased 3.2 percent, compared with the same period last year at 62.0 billion yen. Ordinary income decreased 1.5 billion yen, compared with the same period last year, to 2.3 billion yen owing to higher raw material costs.

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 automotive terminals and recovery in sales volume following the resolution of equipment problems at a copper tube plant in Thailand.

As a result, consolidated segment sales in the first nine months of fiscal 2018 increased 4.2 percent, compared with the same period last year, to 271.8 billion yen owing to a rise in sales prices in association with higher ingot prices, although the sales volume of aluminum rolled products decreased. Ordinary income decreased 9.8 billion yen compared with the same period last year to 1.0 billion yen owing to lower sales volume of aluminum rolled products, higher energy costs, and the impact of the misconduct.

Machinery

Consolidated orders in the first nine months of fiscal 2018 increased 18.2 percent, compared with the same period last year, to 113.6 billion yen, owing to a recovery in compressor demand in the oil refining field and higher demand in the petrochemical sector in Asia and the Middle East, and other factors. The backlog of orders in the first nine months of fiscal 2018 stood at 137.1 billion yen.

Consolidated segment sales in the first nine months of fiscal 2018 increased 9.7 percent, compared with the same period last year, to 121.6 billion yen owing to steady progress in fulfilling current orders. Ordinary income increased 0.3 billion yen, compared with the same period last year, to 1.4 billion yen.

Engineering

Orders in the first nine of fiscal 2018 increased 4.4 percent, compared with the same period last year, to 104.2 billion yen, owing to firm orders in the waste treatment business. The backlog of orders in the first nine months of fiscal 2018 came to 199.4 billion yen.

Segment sales in the first nine months of fiscal 2018 increased 11.0 percent, compared with the same period last year, to 89.9 billion yen owing to steady progress in fulfilling current orders for mainly large projects. However, ordinary income decreased 2.2 billion yen, compared with the same period last year, to 2.7 billion yen owing to changes in the types of projects and other factors.

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 increased, compared with the same period last year. Although unit sales of crawler cranes in Japan declined because of delays in pre-shipment inspection following the crane collapse accident that occurred at Kobe Steel's Takasago Works in July 2018, demand was firm mainly in North America and other overseas markets..

As a result, consolidated segment sales in the first nine months of fiscal 2018 increased 11.0 percent, compared with the same period last year, to 297.1 billion yen. Ordinary income increased 6.7 billion yen, compared with the same period last year, to 22.6 billion yen, owing to higher unit sales of hydraulic excavators and the reversal of a part of the allowance for retained receivables in the hydraulic excavator business in China.

Electric Power

Consolidated segment sales in the first nine months of fiscal 2018 increased 7.5 percent, compared with the same period last year, to 54.3 billion yen. However, ordinary income worsened 7.9 billion yen, compared with the same period last year, to ordinary loss of 3.2 billion yen, due to incurring temporary costs in association with fund procurement for the new power generation project in the city of Kobe.

Other Businesses

At Kobelco Research Institute, Inc., orders fell in the testing and research business. In addition, Shinko Real Estate Co., Ltd., a consolidated subsidiary, was excluded from the scope of consolidation of the company in the second-quarter consolidated accounting period. It is now included as an affiliate accounted for by the equity-method.

As a result, consolidated segment sales in the first nine months of fiscal 2018 decreased 38.9 percent, compared with the same period last year, to 29.3 billion yen. Ordinary income decreased 1.8 billion yen, compared with the same period last year, to 1.7 billion yen.

(2) Qualitative Information on Consolidated Earnings Forecast

Japan's current economy continues on a moderate recovery with improvements in the employment and income situation. In overseas markets, recovery trends are projected to continue mainly in the United States and Southeast Asia. However, it is necessary to keep a close watch due to continuing concern on the impact of protectionist trade policies seen abroad and other factors on economic trends.

In light of this economic environment and as a result of certain assumptions on uncertain factors, including main raw material prices and sales volume, Kobe Steel has revised downward its forecast for net sales for the full fiscal 2018. Kobe Steel has also left unchanged from the previous forecast its outlook for ordinary income and net income attributable to owners of the parent for the full fiscal 2018.

Dividends

Kobe Steel aims to pay dividends on a continuous and stable basis. Dividends are decided after taking into full consideration the Company's financial condition, business performance, future capital needs and other factors. On this basis, Kobe Steel has decided to pay a year-end dividend of 10 yen per share for fiscal 2018 (or a total of 20 yen for the full fiscal 2018 year).

*** 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 9 Months
	Ended Mar. 31, 2018	Ended Dec. 31, 2018
Current Assets		
Cash and deposits	165,526	168,176
Notes and accounts receivable	324,811	308,328
Merchandise and finished goods	159,910	167,819
Work-in-process	136,530	147,765
Raw materials and supplies	152,007	169,448
Other	84,185	104,714
Allowance for doubtful accounts	(4,672)	(4,275)
Total current assets	1,018,298	1,061,978
Fixed Assets		
Property, plant and equipment		
Buildings and structures	279,270	257,322
Machinery and equipment	433,414	427,890
Land	192,158	143,657
Other	76,846	90,099
Total property, plant and equipment	981,689	918,970
Intangible fixed assets	40,807	39,603
Investments and other assets		
Investments in securities	197,839	187,464
Other	169,729	172,555
Allowance for doubtful accounts	(56,250)	(46,090)
Total investment and other assets	311,318	313,929
Total fixed assets	1,333,815	1,272,503
Total assets	2,352,114	2,334,481

LIABILITIES	FY2017	FY2018 9 Months
	Ended Mar. 31, 2018	Ended Dec. 31, 2018
Current liabilities		
Notes and accounts payable	457,126	443,860
Short-term borrowings	205,732	112,887
Current portion of Bonds	14,000	22,215
Income and enterprise taxes payable	8,551	4,657
Provisions	61,736	38,090
Other	153,146	139,240
Total current liabilities	<u>900,293</u>	<u>760,950</u>
Long-term liabilities		
Bonds and notes	132,000	111,837
Long-term borrowings	387,133	496,030
Net defined benefit liability	70,946	76,578
Provisions	3,268	3,973
Other	67,489	65,427
Total long-term liabilities	<u>660,836</u>	<u>753,846</u>
Total liabilities	<u>1,561,130</u>	<u>1,514,797</u>
NET ASSETS		
Stockholders' equity		
Common stock	250,930	250,930
Capital surplus	102,314	102,218
Retained earnings	395,542	424,468
Treasury stock, at cost	(2,671)	(2,616)
Total stockholders' equity	<u>746,115</u>	<u>775,000</u>
Accumulated other comprehensive income		
Unrealized gains or losses on securities, net of taxes	17,333	5,953
Unrealized gains or losses on hedging derivatives, net of taxes	(9,913)	(12,865)
Land revaluation differences, net of taxes	(3,406)	(3,406)
Foreign currency translation adjustments	10,185	7,059
Remeasurements of defined benefit plans, net of taxes	(17,726)	(15,594)
Total accumulated other comprehensive income	<u>(3,527)</u>	<u>(18,853)</u>
Non-controlling interests	<u>48,396</u>	<u>63,536</u>
Total net assets	<u>790,984</u>	<u>819,684</u>
Total liabilities and net assets	<u>2,352,114</u>	<u>2,334,481</u>

Consolidated Statements of Income

(In millions of yen)

	FY2017 9 Months	FY2018 9 Months
	Ended Dec. 31, 2017	Ended Dec. 31, 2018
Net sales	1,379,317	1,448,359
Cost of sales	1,164,187	1,247,595
Gross profit	215,130	200,763
Selling, general and administrative expenses	143,290	162,523
Operating income	71,839	38,240
Non-operating income		
Interest income	1,786	2,262
Dividend income	3,718	4,235
Reimbursement of seconded employees' salaries	2,807	2,989
Equity in income of equity method companies	4,585	2,724
Other	5,870	13,151
Total non-operating income	18,768	25,364
Non-operating expenses		
Interest expense	9,126	7,284
Seconded employees' salaries	7,196	7,757
Commission for syndicate loan	104	6,121
Other	12,102	15,242
Total non-operating expenses	28,530	36,405
Ordinary income	62,078	27,199
Extraordinary income		
Gain on sale of investment securities	9,140	31,485
Gain on acquisition of subsidiary	—	4,892
Total extraordinary income	9,140	36,377
Extraordinary loss		
Loss on disaster	—	3,659
Total extraordinary loss	—	3,659
Income before income taxes and non-controlling interests	71,218	59,917
Income taxes		
Current	11,414	11,425
Deferred	5,562	1,222
Total income taxes	16,976	12,647
Income before non-controlling interests	54,241	47,269
Net income (loss) attributable to non-controlling interests	(1,581)	2,235
Net income attributable to owners of the parent	55,823	45,033

Consolidated Statements of Comprehensive Income

(In millions of yen)

	<u>FY2017 9 Months</u>	<u>FY2018 9 Months</u>
	<u>Ended Dec. 31, 2017</u>	<u>Ended Dec. 31, 2018</u>
Income before non-controlling interests	54,241	47,269
Other comprehensive income (loss)		
Unrealized gains or losses on securities, net of taxes	8,582	(10,645)
Unrealized gains or losses on hedging derivatives, net of taxes	(935)	(3,168)
Foreign currency translation adjustments	485	(2,856)
Remeasurements of defined benefit plans, net of taxes	1,043	2,242
Share of other comprehensive gains and losses related to equity method companies	3,940	(2,409)
Total other comprehensive income (loss)	13,116	(16,838)
Comprehensive Income (loss)	<u>67,358</u>	<u>30,431</u>
Breakdown of total comprehensive income (loss) attributed to:		
Stockholders of the parent interests	69,171	29,727
_ Non-controlling interests	(1,812)	703

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 of 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.

With regard to item 2 of the above-mentioned civil complaints, a securities class action in the United States concerning Kobe Steel's ADR, a settlement was reached in September 2018 for Kobe Steel to pay settlement money to the plaintiffs and for the plaintiffs to withdraw their lawsuit. Preliminary approval by the court and notification of the members of the class action lawsuit have been made, and a court hearing for final approval of the settlement is scheduled in February 2019. On this matter, the said settlement amount has been posted as a provision in the second quarter consolidated accounting period of fiscal 2018.

In regard to the indictment on the alleged violation of the Unfair Competition Prevention Act, a second court hearing was conducted in January 2019, and a decision is planned to be made in March 2019. At the present time, the amount of the final penalty has not been determined.

It is difficult to reasonably estimate the final penalties, compensation for damages, and other outcomes at this time in regard to the investigation by the U.S. Department of Justice and the above-mentioned civil

complaints (excluding item 2 above), 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.

In addition, 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