

# Kobe Steel's Consolidated Financial Results for First Half of Fiscal 2018 (April 1 – September 30, 2018)

October 30, 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: November 13, 2018  
 Dividend payments begin: December 3, 2018  
 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 Half of FY2018 (April 1 – September 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 1H	958,239	5.6	23,131	(55.0)	9,345	(79.6)	33,399	(15.2)
FY2017 1H	907,058	11.3	51,407	65.9	45,780	271.6	39,390	858.6

Note: Comprehensive income FY2018 1H: 30,851 million yen [(29.3%)] FY2017 1H: 43,660 million yen [---%]

	Net income per share	Diluted net income per share
	Yen	Yen
FY2018 1H	92.19	---
FY2017 1H	108.73	---

### (2) Consolidated Financial Position

	Total assets	Net assets	Equity capital ratio
	Million yen	Million yen	%
FY2018 1H	2,309,385	822,655	32.9
FY2017	2,352,114	790,984	31.6

Reference: Equity capital FY2018 1H: 759,788 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			---	---	---

Revision to dividend forecast in FY2018 2Q: No  
 The dividend for the end of fiscal 2018 is undetermined.

### 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	2,030,000	7.9	50,000	(43.8)	25,000	(64.9)	35,000	(44.6)	96.60

Revision to consolidated forecast in FY2018 2Q: 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: Yes

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

	FY2018 1H	FY2017
Number of issued shares (including treasury stock)	364,364,210 shares	364,364,210 shares
Number of shares of treasury stock	2,051,843 shares	2,118,007 shares
Average number of shares (1H)	362,279,696 shares	362,253,010 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 to 6.

# 1. Qualitative Information on Consolidated Operating Results

## (1) Qualitative Information on Consolidated Operating Results

Japan's economy in the first half of fiscal 2018 (April 1-September 30, 2018) continued on a gradual recovery trend supported by improvement 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.

Under this economic environment, in the Kobe Steel Group the sales volume of steel products decreased, compared with the same period last year, due to temporary trouble with the 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 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 recovery in sales volume following the resolution of equipment problems at a plant in Thailand and firm demand for 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, consolidated sales in the first half of fiscal 2018 increased 51.1 billion yen, compared with the same period last year, to 958.2 billion yen. Operating income decreased 28.2 billion yen, compared with the same period last year, to 23.1 billion yen, because of a decrease in sales volume due to equipment trouble and inventory valuation effects. Ordinary income decreased 36.4 billion yen, compared with the same period last year, to 9.3 billion yen. As for extraordinary income, Kobe Steel posted a gain of 36.3 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 5.9 billion yen, compared with the same period last year, to 33.3 billion yen.

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

Growth strategies in the three core business areas	Materials businesses	<ul style="list-style-type: none"> <li>• In an effort to reduce the weight of cars, the Iron &amp; Steel segment has decided to make capital investments in automotive ultra-high-strength steel. (April 2018)</li> <li>• In an effort to reduce the weight of cars, the Aluminum &amp; Copper segment has decided to expand its U.S. production facility for automotive aluminum extrusions. (August 2018)</li> </ul>
	Machinery businesses	<ul style="list-style-type: none"> <li>• In the Construction Machinery segment, restructuring the hydraulic excavator business in China has been largely completed. (June 2018)</li> </ul>
	Electric power business	<ul style="list-style-type: none"> <li>• 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)</li> <li>• For the new power generation project, Kobe Steel re-entered into an environmental preservation agreement with the city of Kobe. (August 2018)</li> <li>• Project finance was organized to procure funds for the new power generation project. (August 2018)</li> <li>• Kobe Steel has begun construction work on the new power generation project, having completed all the necessary legal procedures to start construction work. (October 2018)</li> </ul>
Strengthening the management foundation		The AI Project Promotion Department was established in the Technical Development Group. The purpose is to improve efficiency in development and achieve greater sophistication using artificial intelligence. (October 2018)

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 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 half 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 the 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 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.

Consequently, segment sales for the consolidated first half of fiscal 2018 were 359.5 billion yen, similar to the same period last year. Ordinary income worsened 20.1 billion yen, compared with the same period last year, to ordinary loss of 1.7 billion yen, because of a decrease in sales volume due to equipment trouble, inventory valuation effects and other factors.

### **Welding**

The sales volume of welding materials was similar to 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 sector was sluggish mainly in East Asia.

Sales of welding systems decreased compared with the same period last year owing to changes in the composition of orders, although demand continued to be firm for architectural steel frames in Japan.

As a result, segment sales for the consolidated first half of fiscal 2018 were similar to the same period last year at 39.8 billion yen. Ordinary income decreased 1.6 billion yen, compared with the same period last year, to 0.9 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 and recovery in sales volume following the resolution of equipment problems at a plant in Thailand.

As a result, segment sales for the consolidated first half of fiscal 2018 increased 4.0 percent, compared with the same period last year, to 181.3 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 6.2 billion yen compared with the same period last year to 1.6 billion yen, owing to the lower sales volume of aluminum rolled products, the rising energy costs, and the impact of the misconduct.

### **Machinery**

Orders in the consolidated first half of fiscal 2018 increased 8.1 percent, compared with the same period last year, to 72.5 billion yen, owing to a recovery in compressor demand 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 half of fiscal 2018 stood at 128.9 billion yen.

Segment sales for the consolidated first half of fiscal 2018 increased 19.5 percent, compared with the same period last year, to 84.2 billion yen owing to steady progress in fulfilling current orders. Ordinary income increased 1.3 billion yen, compared with the same period last year, to 0.8 billion yen.

### **Engineering**

Orders in the consolidated first half of fiscal 2018 increased 29.1 percent, compared with the same period last year, to 72.2 billion yen, owing to firm orders in the waste treatment business. The backlog of orders in the consolidated first half of fiscal 2018 came to 201.2 billion yen.

Segment sales for the consolidated first half of fiscal 2018 increased 15.4 percent, compared with the same period last year, to 55.4 billion yen owing to steady progress in fulfilling current orders. Ordinary income decreased 0.6 billion yen, compared with the same period last year, to 1.0 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, owing to firm demand mainly in North America and other markets. 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.

As a result, segment sales for the consolidated first half of fiscal 2018 increased 12.2 percent, compared with the same period last year, to 204.9 billion yen. Ordinary income increased 2.0 billion yen, compared with the same period last year, to 13.5 billion yen.

### **Electric Power**

Segment sales for the consolidated first half of fiscal 2018 increased 8.8 percent, compared with the same period last year, to 35.8 billion yen. However, ordinary income worsened 6.9 billion yen, compared with the same period last year, to ordinary loss of 3.6 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., demand 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, segment sales for the consolidated first half of fiscal 2018 decreased 23.9%, compared with the same period last year, to 22.2 billion yen. Ordinary income decreased 0.8 billion yen, compared with the same period last year, to 0.8 billion yen.

## **(2) Qualitative Information on Consolidated Earnings Forecast**

Japan's current economy continues to gradually recover with improvements in the employment situation and income environment. In overseas markets, recovery trends continued 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 as seen from abroad and other factors.

In light of these circumstances, Kobe Steel forecasts the following conditions in its business segments for the third quarter of fiscal 2018 (October-December 2018) and onward.

### **Iron & Steel**

For steel products, demand mainly in the automotive sector is anticipated to remain firm.

For steel castings and forgings, demand for shipbuilding is forecast to continue being weak, but for titanium products, firm demand in the aircraft sector is projected to continue.

## **Welding**

For welding materials, demand from the shipbuilding sector is anticipated to continue being weak.

For welding systems, tax breaks will continue, and demand for architectural steel frames in Japan is expected to remain firm for the time being.

## **Aluminum & Copper**

For aluminum rolled products, demand for can stock for beverage cans is anticipated to continue declining, but demand in the automotive sector and for aluminum disks is anticipated to continue being firm.

For copper rolled products, demand for automotive terminals and semiconductors is anticipated to continue being firm.

## **Machinery**

Demand for compressors in the oil refining field is expected to continue on an upward trend, but the difficult environment is anticipated to continue. For plastic processing machinery, demand for after-sales services in the petrochemical industry mainly in Asia, the Middle East and other areas is anticipated to continue being firm.

## **Engineering**

In the waste treatment sector, demand is anticipated to be steady into the future.

In the ironmaking plant field, prices for iron units are recovering, but poor investment opportunities are expected to continue for the time being, except for some areas.

## **Construction Machinery**

Demand for hydraulic excavators is anticipated to continue being firm mainly in China.

Demand for crawler cranes is anticipated to continue recovering, but in Japan unit sales will continue to be affected by the crane collapse accident.

## **Electric Power**

The Kobe Power Plant plans to provide a steady supply of electric power through continued stable operation.

## **Other Businesses**

Kobelco Research Institute, Inc. anticipates firm demand in the semiconductor inspection equipment business.

As a result, consolidated net sales in the Kobe Steel Group are forecast to reach approximately 2,030.0 billion yen for the full fiscal year. Ordinary income is anticipated to be approximately 25.0 billion yen. Net income attributable to owners of the parent is anticipated to be approximately 35.0 billion yen.

## **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 1H
	Ended Mar. 31, 2017	Ended Sep. 30, 2018
<b>Current Assets</b>		
Cash and deposits	165,526	181,464
Notes and accounts receivable	324,811	299,553
Merchandise and finished goods	159,910	164,095
Work-in-process	136,530	137,954
Raw materials and supplies	152,007	164,214
Other	84,185	83,284
Allowance for doubtful accounts	(4,672)	(4,703)
Total current assets	1,018,298	1,025,863
<b>Fixed Assets</b>		
<b>Property, plant and equipment</b>		
Buildings and structures	279,270	256,913
Machinery and equipment	433,414	433,867
Land	192,158	142,836
Other	76,846	86,178
Total property, plant and equipment	981,689	919,795
<b>Intangible fixed assets</b>	40,807	39,661
<b>Investments and other assets</b>		
Investments in securities	197,839	209,094
Other	169,729	169,477
Allowance for doubtful accounts	(56,250)	(54,507)
Total investment and other assets	311,318	324,064
Total fixed assets	1,333,815	1,283,521
<b>Total assets</b>	2,352,114	2,309,385

<b>LIABILITIES</b>	<b>FY2017</b>	<b>FY2018 1H</b>
	<b>Ended Mar. 31, 2017</b>	<b>Ended Sep. 30, 2018</b>
<b>Current liabilities</b>		
Notes and accounts payable	457,126	433,251
Short-term borrowings	205,732	122,067
Current portion of Bonds	14,000	26,140
Income and enterprise taxes payable	8,551	6,885
Provisions	61,736	52,745
Other	153,146	136,690
Total current liabilities	<u>900,293</u>	<u>777,780</u>
<b>Long-term liabilities</b>		
Bonds and notes	132,000	111,945
Long-term borrowings	387,133	458,099
Net defined benefit liability	70,946	73,492
Provisions	3,268	3,698
Other	67,489	61,713
Total long-term liabilities	<u>660,836</u>	<u>708,949</u>
<b>Total liabilities</b>	<u>1,561,130</u>	<u>1,486,729</u>
<b>NET ASSETS</b>		
<b>Stockholders' equity</b>		
Common stock	250,930	250,930
Capital surplus	102,314	102,218
Retained earnings	395,542	416,484
Treasury stock, at cost	(2,671)	(2,614)
Total stockholders' equity	<u>746,115</u>	<u>767,019</u>
<b>Accumulated other comprehensive income</b>		
Unrealized gains or losses on securities, net of taxes	17,333	18,681
Unrealized gains or losses on hedging derivatives, net of taxes	(9,913)	(10,697)
Land revaluation differences, net of taxes	(3,406)	(3,406)
Foreign currency translation adjustments	10,185	4,541
Remeasurements of defined benefit plans, net of taxes	(17,726)	(16,350)
Total accumulated other comprehensive income	<u>(3,527)</u>	<u>(7,230)</u>
<b>Non-controlling interests</b>	<u>48,396</u>	<u>62,867</u>
<b>Total net assets</b>	<u>790,984</u>	<u>822,655</u>
<b>Total liabilities and net assets</b>	<u>2,352,114</u>	<u>2,309,385</u>



## Consolidated Statements of Income

(In millions of yen)

	FY2017 1H	FY2018 1H
	Ended Sep. 30, 2017	Ended Sep. 30, 2018
<b>Net sales</b>	907,058	958,239
<b>Cost of sales</b>	761,610	826,962
<b>Gross profit</b>	145,448	131,277
<b>Selling, general and administrative expenses</b>	94,040	108,145
<b>Operating income</b>	51,407	23,131
<b>Non-operating income</b>		
Interest income	1,212	1,499
Dividend income	2,466	2,149
Reimbursement of seconded employees' salaries	1,847	2,112
Equity in income of equity method companies	3,644	3,157
Other	4,739	6,193
Total non-operating income	13,909	15,112
<b>Non-operating expenses</b>		
Interest expense	6,163	4,902
Seconded employees' salaries	4,816	5,412
Commission for syndicate loan	70	5,974
Other	8,485	12,608
Total non-operating expenses	19,536	28,898
<b>Ordinary income</b>	45,780	9,345
<b>Extraordinary income</b>		
Gain on sale of investment securities	9,076	31,485
Gain on acquisition of subsidiary	—	4,892
Total extraordinary income	9,076	36,377
<b>Income before income taxes and non-controlling interests</b>	54,857	45,723
<b>Income taxes</b>		
Current	13,795	11,150
Deferred	(820)	(354)
Total income taxes	12,974	10,795
<b>Income before non-controlling interests</b>	41,882	34,927
<b>Net income attributable to non-controlling interests</b>	2,492	1,528
<b>Net income attributable to owners of the parent</b>	39,390	33,399

## Consolidated Statements of Comprehensive Income

(In millions of yen)

	<b>FY2017 1H</b>	<b>FY2018 1H</b>
	<b>Ended Sep. 30, 2017</b>	<b>Ended Sep. 30, 2018</b>
<b>Income before non-controlling interests</b>	41,882	34,927
<b>Other comprehensive income (loss)</b>		
Unrealized gains or losses on securities, net of taxes	3,207	1,575
Unrealized gains or losses on hedging derivatives, net of taxes	(1,176)	(795)
Foreign currency translation adjustments	(1,465)	(6,391)
Remeasurements of defined benefit plans, net of taxes	680	1,469
Share of other comprehensive gains and losses related to equity-method companies	532	66
Total other comprehensive income (loss)	1,778	(4,075)
<b>Comprehensive Income (loss)</b>	<b>43,660</b>	<b>30,851</b>
Breakdown of total comprehensive income (loss) attributed to:		
Stockholders of the parent interests	41,595	29,716
Non-controlling interests	2,064	1,134

## 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.

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 (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.

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.

In addition, 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. The plaintiffs have submitted a motion for an order approving the settlement to the court. After preliminary approval by

the court, notification of the members of the class action lawsuit, and final approval by the court, the settlement is anticipated to be finalized. On this matter, the said settlement amount has been posted as a provision in the second quarter consolidated accounting period of fiscal 2018.

**Notes on significant changes in the amount of stockholders' equity**

None