

# Japanese merger creates world's 2nd largest steel firm

Nippon Steel, the nation's number one steel company and third-ranked rival Sumitomo Metal Industries will combine to form a giant second only to India's ArcelorMittal.

Two of Japan's biggest steelmakers will formally merge, creating the world's second largest firm in the sector as they look to outpace their Chinese and South Korean rivals.

Nippon Steel (IW1000/82), the nation's number one steel company and third-ranked rival Sumitomo Metal Industries (IW1000/66) will combine to form a giant second only to India's ArcelorMittal (IW1000/35).

Global competition in the steel industry has intensified in recent years even as demand has been spurred by emerging economies such as China, which are undertaking massive construction, infrastructure and manufacturing projects.

But economic fears have weighed on steel demand and Japanese producers have struggled with an unfavorable exchange rate, which saw the yen hit record highs against the dollar late last year.

Even with their economies of scale, Nippon Steel & Sumitomo Metal Corp., will still be a distant second to behemoth ArcelorMittal, with less than half of its annual production.

In 2011, ArcelorMittal produced 97.2 million tons of crude steel, while Nippon Steel, ranked sixth-largest, and Sumitomo Metal, ranked 27th, produced a combined 46.1 million tons, according to the World Steel Association.

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## Industry faces tough economic climate

The launch comes at a difficult time for the Japanese steel industry. It is "not a very good environment", Hiroshi Tomono, Sumitomo Metal president, who will become the new company's number two, the Yomiuri Shimbun daily reported.

"We have an overwhelming advantage in terms of quality, but (production) costs are our problem," Tomono said.

A senior Nippon Steel official said the Japanese firm would do well at the top end of the market, but would face difficulties competing with the lower cost bases of other Asian steelmakers.

"We have a significant competitive edge in terms of highly-functional steel products, but Chinese and South Korean steelmakers are catching up with us in terms of middle-level steel products," business daily Nikkei quoted the unnamed official as saying.

Nippon Steel and Sumitomo Metal filed 908 international patent applications between 2006 and 2010, nearly four times that of South Korea's Posco and nine times the number ArcelorMittal submitted, Japanese dailies said.

The merged company will aim to realign and strengthen a

global network "in response to increasing worldwide demand for steel and the local procurement needs of Japanese steel consumers operating overseas," they said in a statement.

It will focus on reorganising and expanding manufacturing, processing and sales bases in emerging countries, namely China, Brazil, India and Southeast Asian countries.

The new company "will aim to achieve 60 to 70 million tons in terms of global production capacity by further accelerating its overseas business development," a statement said.

In doing so, it will follow a path trodden by Japanese automakers, electronics makers and other companies seeking to expand production in foreign markets in search of growth, stronger consumer demand and by way of hedging against foreign exchange risks.

Keiju Kurosaka, an analyst at Mitsubishi UFJ Morgan Stanley Securities, said it was too early to tell if the new company would be a good bet for investors.

"The biggest advantage the merged company will gain is its size. Because of the size it will be able to cut costs further, and because of the size it'll get cash flow enough to survive a period of economic downturn," he said.

"To survive in the global market, it needs to invest actively

in foreign markets where demand is expected to grow in the longer term."

"But we have to wait until a more concrete business plan is announced to see if it will really be a promising investment target or not," he said.

The merger, under the ratio of 0.735 Nippon Steel shares to one Sumitomo Metal share, will be the first in the Japanese steel industry since the creation of the country's number two firm JFE Holdings around a decade ago.

In August, Nippon Steel said it expected to book a 155 billion yen shortfall for the six months through September, nearly doubling its previous loss forecast of 85 billion yen for the period.

It said most of the red ink was tied to a 120 billion yen write-down on two loss-making Japanese mills.

Nippon Steel continued to forecast revenue of 1.95 trillion yen for the first half of the year through September 2012.

Sumitomo Metal has said it expected to book an eight billion yen net loss for the six-months to September, due to one-off stocks valuation losses. ■