

Nippon Steel Corporation, Third Quarter FY2020 IR Briefing
(Held on February 5, 2021)
Summary of Q&A

Note: Based on information available as of the date of the IR Briefing

Presenters

Katsuhiro Miyamoto, Representative Director and Executive Vice President

Hidetake Ishihara, Managing Executive Officer

Takahiko Iwai, Executive Officer and Head of Accounting & Finance Division

Q Please tell us about your thinking behind the projection of earnings for FY2021. Compared to the second half (2H) of FY2020, I would assume that profit variance factors include increases in the prices of iron ore and coking coal; increases in the prices of oil, alloys, and other materials; the resumption of operation of Kashima's blast furnace; the shut-down of Kure's blast furnace in the first half (1H) of FY2021, and the removal of emergency cost reductions during the period of the production cut. Are there any other factors to be considered?

A The underlying profit excluding one-off factors in 2H FY2020 is ¥125.5 billion. In addition to the items you mentioned, we have adopted the following assumptions. First, we expect the solid export market and business environment to continue and intend to operate the blast furnaces after resumption at their full capacity. Next, we will continue to strive for margin improvement amid a surge in main raw material prices. We will seek to improve the margin of commodity products supported by the tight supply/demand situation in the domestic and export markets, in addition to reflecting the rise in raw material prices in long-term contract prices. Lastly, we also plan to improve costs by taking various measures, including the advancement of structural measures schedule, which should more than offset a slight increase in depreciation expenses. The cost improvement, that stemmed from the emergency measures taken during the COVID-19 pandemic, is expected to lessen but this reduction in FY2021 should be mostly offset by the absence of demerits from the production cut taken in FY2020. In total, we will seek to generate positive cost improvement in FY2021. In aggregate, our aim is to generate more than double the amount of ¥125.5 billion—the underlying profit in 2H FY2020.

Q Your consolidated business profit forecasts for the fourth quarter (4Q) imply a decline from the comparable profit for the third quarter (3Q). Please explain the profit variance

factors.

- A On the surface, profit may appear to deteriorate in 4Q vs. 3Q but this is mainly due to timing and distortion in the allocation of fixed costs and other costs by quarter. Compared to the average fixed cost burden level in 2H, the cost burden is about ¥15 billion lighter in 3Q and about ¥15 billion heavier in 4Q. Excluding this factor, underlying profit is actually expected to improve in 4Q vs. 3Q.

Our product price increase may look smaller compared to the rise in overseas commodity prices but this is caused by a delay in reflecting the commodity price rise in our shipment price, which affects operating profit. Moreover, in the case of domestic commodity products, we expect it will take time for our requested price increase to be reflected in the sales price. In terms of volume, production volume in 4Q is expected to increase by about 1.5 million tons vs. 3Q, as we are in the midst of resuming operation of some blast furnaces in 2H. This will be another factor that will boost profit in 4Q.

- Q After the sale of partnership interests in I/N Tek and I/N Kote, how will you supply products to Japanese automakers' transplants in North America?**

- A We are currently discussing this issue with the customers of I/N Tek and I/N Kote and we will make sure not to cause any inconvenience to our customers. We are studying the possibility of switching to Calvert to supply them, if requested by them.

- Q The level of profit per steel shipment volume is higher in 3Q and in 2H compared to the past. How do you explain the difference?**

- A Due to factors such as the earlier implementation of structural measures concerning production facilities, changes in depreciation methods, and the impact from the posting of an impairment loss in FY2019, the amount of our fixed cost reduction for FY2020 is estimated to be ¥220 billion and the break-even point is also declining accordingly. Moreover, we have strived to shift to higher value-added products by reducing products with lower marginal profit even during the period of shipment volume decline. This improvement in the product mix is also contributing to an improvement in profitability.

- Q Do you anticipate any risk of problems occurring in the future when you increase production?**

- A Concerning the "hard" aspects, we have focused on injecting repair expenses into production facilities and have invested in maintenance in recent years. As for the "soft" aspects, we have implemented various measures, such as the development of workplace-

friendly work process and inspection standards and comparative checklists. These efforts have started to produce outcomes and facility downtime, caused by troubles, has dropped substantially. We are committed to continuing these activities. While overall repair expenses are currently being reduced, we have been selectively injecting repair expenses in tandem with the decline in production volume.

Q On a non-consolidated basis, what level of operating profit do you expect in 2H FY2020?

A We are expecting to generate non-consolidated operating profit in 2H FY2020 for the first time in two years. On an underlying basis, excluding a difference in inventory valuation, we expect to generate the first non-consolidated operating profit since 1H FY2016, or in 4.5 years. We believe that we are finally making progress in our long-desired decline in break-even point, as we are likely to be profitable in 2H FY2020 at 18.6 million tons of crude steel production, which is roughly 3 million tons less than the 21.5 million tons recorded in 1H FY2016. With regard to fixed costs in FY2021, we plan to make further improvements through the early implementation of structural measures and other factors, which should more than offset an increase in depreciation expenses and the partial reversal of fixed costs that are being reduced by taking the emergency measures in FY2020.

Q In the previous briefings, you explained that, in the volume recovery phase from production cutbacks, you would focus on improving the product mix rather than exporting as long as a profit margin is ensured. In the current recovery phase in the business environment, will you remind us again of your export policy. Also, please give us an update on the situation regarding overseas operating companies.

A As the current market environment is favorable, we will make sure to accept orders if marginal profit is sufficiently ensured. That is our policy. The situation regarding our overseas operating companies is getting much better. Those in North and Central America and India are expected to be profitable in the current year. The companies in Europe are experiencing some difficulties, given the spread of COVID-19, but their situation is also recovering. Meanwhile, the companies in Indonesia are expected to achieve a sufficient level of improvement from the previous year, despite the delayed recovery of the local economy.

Q How much of an increase in production volume are you expecting in FY2021 relative to the level in 4Q FY2020?

A Our non-consolidated crude steel production in 4Q is projected to be 10.1 million tons, incorporating suspended operation of two blast furnaces in Wakayama and Kure, and

operation of a blast furnace in Kashima, which resumed on January 19(therefore, not yet a full-quarter contribution)). Although we have decided to permanently shut down Wakayama's No. 1 blast furnace in 1H FY2022 and Kure's blast furnaces in 1H FY2021, we may decide whether to resume their operation in the interim, depending on the supply/demand situation. Regardless, I would like you to understand that we are currently operating at full capacity and the current level of production is our effective capacity.

Compared to 4Q FY2020, quarterly production in 1H FY2021 is projected to increase by 0.2-0.3 million tons, supported by full capacity production of Kashima's blast furnace, but then to decrease in 2H as another blast furnace in Kure will be shut down by the end of 1H.

Q How do you see the supply/demand environment in FY2021 for the world and particularly China?

A As you know, China represents 60% of global steel production and consumption. Some in the government are talking about tightening production due to the significant economic recovery, while others are proposing not to approve an increase in production capacity but to reduce it. We believe that the Chinese government is oriented toward economic growth and will maintain solid infrastructure investment and that the current situation of both high commodity product prices and high raw material prices will be sustained.

Demand is also recovering in the rest of the world and the overall supply/demand balance is expected to remain tight. We will carefully assess the situation as well as the impact of the spread of COVID-19 and other factors, in order to develop a plan for FY2021. I should note, however, that we do not expect the current tight supply/demand balance in China to last forever. Until the situation changes, we will continually strive to move up the schedule of structural measures.

Q Will you elaborate on the background of your decision to resume the payment of dividends? Does this indicate your confidence in profit improvement?

A This is based on our comprehensive thinking, including our projected view of a continued tight supply/demand balance for steel products in the world with expected economic growth rates of 5.5% for the world, 4.3% for developed countries, and 6.3% for emerging countries in 2021, in addition to our progress in reducing the break-even point as planned, which has been supported by our current profit improvement and structural measures. We have decided to resume the payment of dividends although the amount is still only ¥10 per share.

Q You have announced a tender offer for Tokyo Rope Manufacturing. Do we need to assume such cases as part of the future restructuring of the Nippon Steel Group?

A Concerning group companies, we have merged former Nisshin Steel and are currently, speedily integrating the resulting redundant functions. The case of Tokyo Rope is rather unique and different. We have about a 7% stake in Tokyo Rope and has been supplying semi-finished steel products to the company and a partner in joint development. While “the combination of wire rods and processing technology” is essential for Tokyo Rope’s competitiveness, we found that Tokyo Rope had some problems in governance and needed to reestablish its management system, in order to maintain its cooperative relationship with us. We had engaged in numerous discussions but did not see an improvement at Tokyo Rope. We have therefore decided to go ahead with tender offer and seek the understanding of other stakeholders in an open environment, with the aim of raising the corporate value of Tokyo Rope and ensuring a common benefit for all shareholders. Upon the completion of the tender offer we intend to resume discussions with Tokyo Rope. Various shareholders have understood our explanation and intention.

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