

Nippon Steel Corporation, First Quarter FY2022 IR Briefing
(August 4, 2022)
Summary of Q&A¹

Presented by:

Takahiro Mori, Representative Director and Executive Vice President, CFO

Takahiko Iwai, Managing Executive Officer, Head of Accounting & Finance Div.

◆ **Profit/loss and spread**

Q You are expecting the spread to decrease by ¥60 billion from 1Q FY2022 to 2Q FY2022. However, excluding the estimated negative ¥120 billion impact of the carryover, the spread effectively will increase by ¥60 billion. Will you provide us with a breakdown of this spread improvement of ¥60 billion by domestic and overseas business and by direct contract-based sales and spot market sales via distributors.

A As we explained during the presentation, we have asked customers with a quarterly-based contract to reflect the decreased portion of the spread in 1Q in the contract price in 2Q. We are thus expecting an improvement in the spread for direct contract-based sales, excluding the impact of the carryover.

On the other hand, overseas steel prices are weakening considerably from 1Q to 2Q, and spread on export spot market sales are deteriorating accordingly. These factors add up to the improvement of ¥60 billion in total.

Q What are the factors behind the expected increase in underlying profit from an estimated ¥70 billion in 2Q FY2022 to ¥175 billion per quarter for 2H FY2022 (one half of the estimated ¥350 billion for 2H)?

A The biggest factor is the impact of reflecting the increase in external costs such as for raw material and energy including the impact of Yen depreciation in direct contract prices. From 1Q FY2022, the pricing system for direct contract sales was changed to the pre-fixed method but the spread has narrowed because raw material prices rose significantly higher than the level we had assumed at the time of the negotiation of direct contract prices for customers. Most customers have agreed to our proposal to fairly share the fluctuations in external costs including raw material costs throughout the supply chain. We are therefore asking customers with quarterly contracts to reflect the cost increase for 1Q in the price for 2Q and customers with semi-annual contracts to reflect the increase in the price for 2H. This is expected to result in a recovery in the spread and therefore an increase in the underlying profit.

¹ Based on information as of the date of the briefing.

Q On an annual basis, the spread in FY2022 is expected to decrease by ¥70 billion from FY2021. There must be substantial rises in external costs that have not reflected in direct contract prices, particularly in 1H, but please explain what kinds of changes in and out are incorporated in your estimate, including the reduced spread in the export spot market.

As for direct contract-based sales, we shifted to the pre-fixed pricing method from this April. However, as a portion of the deteriorated spread for 1Q as well as for 1H has not been passed on to prices, the spread is deteriorating this fiscal year compared to the previous year.

As for export spot market sales, the market was very strong in FY2021, but export steel prices are falling in 2Q FY2022 and the spread is therefore shrinking. We assume that the low level of spread in 2Q continues in 2H and that the export spread for FY2022 worsens compared to the previous year.

Q About the merits and demerits of the pre-fixed method of direct contract-based sales. With regard to the pricing scheme, if the raw material prices rise after the sales prices are pre-determined, the cost increase is not reflected in the price, and you cannot maintain the spread. Is it correct to understand that there is a scheme whereby you can recoup the missed spread in the subsequent period? Also, are you considering a scheme to reflect the fluctuation of raw material prices in a timely manner in the product prices?

A We believe that the pre-fixed pricing method is the right direction for us to pursue. The basic way of pricing must be that the customer decides how much to buy based on the price determined by the supplier. At the same time, we and our customers have a common understanding that any fluctuation in the external cost after the sales price is pre-fixed will be adjusted in the next term. Currently, the rise in external costs after the pre-fixed pricing is extremely sharp and fluctuating widely, but there will also be times when external costs fall. So we think that the fluctuation effect should even out over the long run and the adjusting mechanism should work. It is impossible to supply products without deciding the price and we firmly believe that the pre-fixed method is appropriate.

Further, we may think about optimizing the contract period in order to reflect external cost fluctuations in product prices in a timely manner. While some customers have already changed to quarterly contracts, there are still some customers with semi-annual contracts. We will focus on pursuing the optimum contract period based on the circumstances of each customer.

Q What is your outlook for raw material prices and exchange rates in 2H FY 2022? It appears you have assumptions on the spread but not on prices for HRC or raw materials. However, given your estimate of no inventory valuation gain nor loss for 2H, you must be assuming raw material prices of around \$300 for coking coal, over \$100 for iron ore, and an exchange rate of around ¥130-139 per dollar. What is your view on this? In addition, judging from current raw material market developments, main raw material prices may fall below expectations in 2H. In that case, should

there be room for an improvement in the spread over the current forecast?

- A We assume that the spread on export spot market sales will stay at an extremely low level as in 2Q. Although we think that weather factors may slightly push up material prices, this effect can be eliminated if we focus on the spread, which affects earnings. Raw material prices for 2H are assumed to remain at the levels you have indicated. In terms of profit management in Domestic steelbusiness, we have a harsher view on the exchange rate, assuming ¥140 per dollar for both 3Q and 4Q. Based on recent market developments, the price of coking coal may fall below the expected price, which may push up earnings.

Q If the price of coking coal stays at around the current \$200 level and the exchange rate is at ¥130 instead of your estimate of ¥140, how would the lower-than-expected raw material interests and the higher-than-expected spread affect your business?

- A The depreciation of the yen would worsen profits in the domestic steel business but have a slightly positive impact on a total consolidated basis. Therefore, even if the yen appreciates to ¥130 from our assumed rate of ¥140, our overall consolidated business profits should not change significantly.

If the price of coking coal continues to be around \$200, the positive effect of spread upswing in the domestic steel business would be greater than the negative effect of lower raw material interests. On the other hand, fluctuation in external costs includes not only the price of coking coal, but also rising energy costs and other factors. Our policy is to fairly share the burden of fluctuations in external costs across the overall supply chain. We are therefore not considering raising profit by an increased spread resulting from changes in raw material prices. However, conceivably, that is exactly what could happen over the short run, if actual external costs go down.

Q In explaining the cost structure, you said that the ratio of variable costs to fixed costs was reversed to represent 70% of the total and that it has become more important to raise the marginal profit per ton of steel by improving sales prices and lowering variable costs, rather than to reduce the fixed cost per ton of steel by increasing production and shipment volumes.

In the past, you tried to secure volume with exports, but it appears that you plan to reduce export volume in 2H due to the deterioration in the export spot market. In the future, you may make more aggressive efforts to keep reducing exports in order to increase added value per ton. I also think that you may potentially reduce exports from domestic bases and switch to exports from your Southeast Asian bases. Will you share your views on these ideas?

- A Your point about reducing exports from Japan is exactly in line with our intention in implementing the production facility structural measures. We are currently expanding our global production bases, which expands our options. We believe our ultimate goal is to ship products from the most appropriate location by using the most appropriate method, but the trend of favoring local production and local consumption has to be taken into consideration. So, local production comes first and then as an applied operation, we

may think about which location is the best for exports to which destination among the various options we have in using localized bases.

Q Although the spread on export spot market sales is worsening, it appears that the negative effect on profits is less than in the past. Does this indicate the effect of your strategy to shift to a more sophisticated order mix with a focus on strategic products and a reduction in exports of commodity-grade products?

A Yes, we have strived to establish a structure that relies less on exports by reducing production capacity through the production facility structural measures and by reducing exports of commodity-grade products. We are also reducing export volume because the spread on exports is narrowing at present. As a result, the effects of spread deterioration are becoming relatively small.

◆ Overseas Business

Q The breakdown of underlying consolidated business profit is shown in five categories from this briefing. Does the "Overseas steel business" category include exports from steel mills in Japan?

A No. The overseas steel business refers to the businesses of overseas steel production and sales bases and does not include exports from domestic steel mills. Please see the definitions of the five categories in the slides showing the breakdown of underlying consolidated business profit on pages 40-41 of the IR material. Exports are a part of the domestic steel business, and the profit fluctuation factors related to exports are included in the analysis items for production and shipment volume and for sales prices and mix.

◆ Resumption of operation of the No. 3 blast furnace at the Nagoya Works

Q The Nagoya No. 3 blast furnace has completed its relining but its resumption of operation has been postponed. What will allow the furnace to resume operation?

A The relining of the Nagoya No. 3 blast furnace has been completed but we will make a comprehensive judgment regarding the best time to resume its operation for us and for the market, by taking into account demand trends in the market. We will not resume operation based on a single, non-continuous factor. For your information, we are not considering at all the banking of other blast furnaces at this point.

Note: We announced on August 16 that the Nagoya No. 3 blast furnace will resume operation by around the end of August 2022.

End

This document is not a disclosure document under the Financial Instruments and Exchange Act, and its issuer does not guarantee the accuracy or completeness of the information herein. In addition, the forward-looking statements in this document were made by the Company based on information available at the time of the briefing and contain uncertainties. Therefore, please do not rely solely on this document to make any investment decisions. The Company shall not be liable for any loss or damage arising from the use of this document.

