Nippon Steel & Sumitomo Metal Corporation FY2017 IR Briefing
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Summary of Q&A

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

Representative from NSSMC
Katsuhiro Miyamoto, Executive Vice President

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Q Production in the 4Q of FY2017 fell short of target again. I feel a sense of unease about the fact that the production shortfall is continuing. I believe that NSSMC has adopted various measures to deal with production so far but what kind of new initiatives do you intend to promote going forward?

A Production in the 4Q ended up being lower than when announced in February. After analyzing the causes of the decrease in production for the full year, we found that the troubles were less to do with aging facilities and were rather caused by making some operational mistakes and the fact that knowhow had not been accumulated sufficiently during the interval of generation change. Not all manufacturing processes incurred problems and processes where there were issues had been specified. We will address this by concentrating the knowledge and manpower of the entire company. In April, we introduced a corporatewide standardized equipment management system and we will make full use of this system.

We found cases where the trouble involved an increase in the load on equipment caused by rolling hard steel materials such as high-tensile steel. Parts ended up damaged earlier than previously and this led to the troubles. We believe that the cause was our inability to respond to recent changes in conditions such as the sophistication of types of products. In light of such changes as well, we are also undertaking an integrated review of facility management and operating knowhow.

In addition, some of the new equipment had not started up well. We think this is an issue regarding our engineering capability. At the same time, it owes partly to a decline in the engineering capability on the equipment vendor side. We therefore believe that we need to further strengthen our competency of equipment monitoring. Technical teams are desperately trying to introduce equipment by conducting design reviews and risk reviews and also thoroughly confirming that risk evaluation has not been omitted. In the 2020 Mid-Term Management Plan we are planning to make a substantial increase in capital investment. We have already allocated a considerable increase in repair expenses but we will increase this by a further 10% approximately. We will inject both funds and manpower and we will implement such measures thoroughly.

Q Could you explain the reasons of production shortfall of target in the 4Q of FY2017? You stated regarding your estimate of production volume for FY2018 that you aimed to increase production fourfold to 42 million tons or more from actual non-consolidated crude steel production of 10.5 million tons in the 4Q. Is this numerical target a somewhat optimistic estimate or is it a target that you are confident of achieving with a reasonable degree of certainty? Since actual production has continued to fall below target for the past several quarters, I would like to confirm your view on this.

A The production shortfall in the 4Q was caused by several persistent troubles. We think we will be able to achieve 42 million tons or more in FY2018. Non-consolidated crude steel production in the 4Q amounted to 10.5 million tons. This was achieved in spite of occurrence of quite a few small troubles. We believe this fourfold increase of 42 million tons is a figure that we can comfortably achieve. We are taking various steps to deal with the troubles, including allocating funds and manpower and making full use of the companywide standardized maintenance system that I just explained. At present, as the sales environment is favorable and demand is also strong, we will properly address this and be even prepared for more production volume.

Q In FY2017, NSSMC's production decreased by 2 million tons year-on-year and the company recorded a production and shipment impact of 70 billion yen. I estimate that if we include not only the volume impact but also the cost impact, this probably reduced profit by about ¥100 billion. If volume returns by 2 million tons and the situation becomes normal, I believe this will boost profit by around ¥100 billion rather than ¥70 billion. Is such a view correct?

A As you pointed out, profit declined by ¥70 billion year-on-year due to a decrease in production and shipments in FY2017. If volume is restored, that amount will be restored. Furthermore, owing to the troubles, not only a volume impact but also a cost impact arose. If we combine all these factors, I believe the impact will be at the level that you pointed out. To eliminate these troubles, we are implementing various initiatives as I just explained. We have identified the steelworks and processes that have problems, and we are allocating our top-level manpower of the work sites and the head office to these areas on a companywide basis as well. In addition, by eliminating problems in processes that have become bottlenecks while making use of lines with spare capacity, we think we will manage to achieve non-consolidated crude steel production of 45 million tons, as targeted in the 2020 Mid-Term Management Plan.

Q Regarding margin improvement, you emphasized the need to pass on raw material costs some time ago, but is this feasible? How certain are you regarding margin improvement?

A We see margin improvement as a very important issue. If nothing is done, even though we are receiving requests from customers for even higher-quality steel materials and an increase in production of high-grade steel, we may not be able to handle such requests. To avoid this situation, we intend to handle high-grade steel by certainly realizing appropriate reproducible prices.

We have strived for an improvement of ¥5,000 per ton to realize appropriate sales price for continuous supply. In FY2017, from the 1H into the 2H, the margin improved by ¥40 billion, or ¥2,100 per ton, but that is not sufficient. We are still in the process of dealing with this for further improvement.

To manufacture good steel materials such as high-tensile steel, various kinds of alloys are required but the prices of such alloys are rising. We will be able to reflect changes in the prices of major raw materials in steel products but the prices of alloys and other commodity raw materials in the market have also risen by a level of tens of billions of yen while logistical costs, personnel costs and other materials procurement costs are also increasing. We believe that we need to gain the understanding of customers regarding such cost impacts, in addition to the improvement of ¥5,000 per ton. In addition, we are sufficiently aware of this as the entire company's problem and we are fully committed and determined to deal with this.

Q I think that a price increase is inevitable, as manufacturing high-grade steel sheets including high-tensile steel entails a facility load and an operating load, but how did you evaluate the price negotiations with contract-based customers in FY2017. Also, in the case of negotiations going forward, what kind of materials do you intend to use as new weapons to win further price increases?

A We were able to precisely reflect an increase in major raw materials in price negotiations with contract-based customers in FY2017. Apart from this, we need to realize appropriate sales price for continuous supply and improve prices relative to the rise in commodity raw materials used in alloy steel and other products, but we believe we have hardly achieved that.

We can probably deal with this problem in light of the actual difference between domestic and overseas prices. I have heard that if foreign steel manufacturers cannot reach agreement on prices in price negotiations, they sometimes refuse to supply products and push for price increases. However, we are promoting business that assumes medium- to long-term relationships with customers based on stable supply, and we believe it is important to maintain this stance. That said, an improvement in prices is inevitable to maintain these relationships, and we need to gain sufficient understanding among customers, including handling these negotiations with a different stance from overseas steel manufacturers, which is what we are trying to do. Furthermore, we think it is necessary to seize the time when new negotiations become necessary, such as when customers require higher-grade products, and to clearly emphasize that we will not be able to invest in supply if we cannot raise prices to a certain extent. We will continue to take action to gain the understanding of customers and realize appropriate sales price for continuous supply. This includes the need to allocate funds to maintain our base supply capacity and the need to allocate funds to make additional responses that go even further.

We regard the issue of margin improvement as a serious problem as a company as well and we are tackling this issue with sincere awareness on a companywide basis at the level of the president and below.

Q Regarding the acquisition of Essar Steel India Limited (Essar Steel) based in India, I think that concern about a rise in the acquisition price, including the appearance of other bidders, has arisen. Is it possible that the amount of investment will exceed the target envisaged in the Mid-Term Plan and that investment profitability will deteriorate? I would like to confirm NSSMC's viewpoint on the use of funds.

A In the case of business investment, we are aiming for a considerably high return that incorporates risk cases in the cost of capital. In the 2020 Mid-Term Management Plan, we established a budget of ¥600 billion for business investment and the first one was Ovako AB, which is expected to achieve a sufficient internal rate of return (IRR). Some aspects regarding India are a little uncertain but we are undertaking this investment jointly with ArcelorMittal. ArcelorMittal has been good at reviving various companies while we, with our strong technological capability, have an advantage in introducing appropriate production processes while precisely monitoring costs. As the bidding has not actually been decided yet, we are at the stage of watching and waiting for the outcome at present but we constantly manage investment returns by sufficiently remaining aware of capital costs.

Q I would like to ask about measures aimed at realizing the profitability targeted in the 2020

Mid-Term Management Plan. Since domestic demand strongly appears to be peaking out, what degree of contribution do you expect from factors specific to NSSMC, namely, the energy sector and overseas businesses, which are strengths of NSSMC, rather than fundamental factors that influence the entire steel industry?

A First, one factor specific to NSSMC is to overcome the current issue of production troubles. We will restore negative factors to a normal state, which includes displaying the effects of capital investment, eliminating human errors and strengthening our engineering capabilities.

We are not actually expecting a large contribution from the energy sector. Therefore, if oil prices maintain their current recovery, we think that additional contribution can be likely.

We have strong expectations regarding our overseas businesses. NSSMC has overseas downstream processing capacity of 21 million tons, of which the United States accounts for 7.1 million tons. In the U.S., steel product prices remain high and our profitability has become very high. We expect to continue to earn sufficient profits. Even companies that are in the process of starting up are enjoying a robust market environment on a worldwide basis, and as their loss-making businesses will turn profitable, this category is also a promising area. Moreover, there is the ¥600 billion in business investment that we are preparing for in the 2020 Mid-Term Management Plan. Ovako AB and Sanyo Special Steel Co., Ltd. are recording profits at present as well, and if they become subsidiaries, they will be able to post profits on a consolidated basis immediately. While the tender for Essar Steel has not actually been decided yet and it is an insolvent company, it is generating sufficient EBITDA at present. If the company reduces its debt and implements other measures, profit contribution is likely to be achieved soon. Including such new projects, NSSMC intends to grow domestic operations, exports, and overseas businesses in a well-balanced way.