



Nippon Steel & Sumitomo Metal Corporation FY2018, 2nd Quarter IR Briefing
November 2, 2018
Summary of Q&A

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

Representative from NSSMC

Katsuhiro Miyamoto, Representative Director and Executive Vice President

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Q Is it correct to understand that without the impact of natural disasters, NSSMC would have recorded an increase in earnings relative to your forecasts as of August 2?

A The negative impact of natural disasters increased by ¥25 billion from the forecast made on August 2, which resulted to decrease ordinary profit by ¥27 billion in the first half and ¥8 billion in the second half, that is, ¥35 billion on a full-year basis. In the first half, as the domestic sales environment was favorable and the overseas market was firmer than expected, we would have recorded an increase in earnings relative to our forecast made in August, without this impact. Actually, however, our first-half ordinary profit ended up in line with the forecast.

Q Raw material prices are currently on an uptrend. In addition, overseas hot-rolled steel sheet prices appear to be declining. Are you incorporating a certain degree of risk buffer in your forecasts for the second half?

A Our assumptions for raw material prices in the second-half forecasts are approximately US\$200/ton for hard coking coal and US\$60/ton for iron ore (fine). Since the earnings forecasts were made, raw material prices have slightly increased in the market. If current levels are sustained, there is a possibility that NSSMC's contract prices for main raw materials may also rise more than expected. In general, at the time of rising raw material prices, the steel supply/demand balance is tight and market prices of steel products tend to rise. We therefore hope to improve our sales prices.

On the other hand, as you pointed out, the overseas market is weakening but we have incorporated a certain degree of a decline in the overseas market in our earnings forecasts.

Q Please explain your margin. Which factors have contributed to the ¥9 billion margin improvement in the first half compared to the forecast as of August 2? Also, why are you not incorporating margin improvement in the second half relative to the first-half actual result, despite your ongoing efforts to further improve sales prices?

A The first-half margin improvement, relative to the forecast as of August 2, is attributable to realizing a higher than the assumed level of domestic prices, in addition to the higher level of the overseas market than initially expected.

For the second half, we have produced slightly conservative projections for the overseas market, based on current levels, while we expect the domestic market to remain firm. At the same time, costs of alloys and other commodity raw materials, other than main raw material prices, as well as logistic costs have been rising. We intend to negotiate with customers to reflect the increase in these costs in sales prices. In light of such circumstances, we estimate that the second-half margin will be at a similar level to that in the first half.

Q Let me ask about production troubles. According to your presentation, a drop in production of 0.3 million tons was caused by internal factors. What happened internally?

A In one of the major steelworks, the blast furnace conditions were not favorable. The heavy rains might have had some effect. In addition, we had some minor problems that briefly stopped the production line, which added up to a drop in production.

Q Regarding Essar Steel India Limited, you said that their actual annual production volume was 6.5 million tons while their nominal crude steel production capacity is 10 million tons. Is this gap caused by some major equipment problems? Is Essar making a profit at the current production level? You mentioned that Essar would aim to increase production to 8.5 million tons p.a. When are you expecting that will be achieved?

A Among Essar's three upstream production processes, the cost of its Midrex™ process, which uses LNG is high. I would therefore like you to understand that, due to economic considerations, Essar's annual production level has stayed at 6.5 million tons whilst its capacity is 10 million tons. Even at 6.5 million tons of production, Essar is generating fair EBITDA. After the acquisition is realized, we plan to raise production to 8.5 million tons p.a. by optimizing Essar's upstream production processes. As for the timing, you should assume a general construction period needed for such equipment.

Q Will you provide more specific details regarding the acquisition of Essar, namely, the size of the cash burden for NSSMC, the timing of cash-out, and when you expect to generate a return?

A The National Company Law Tribunal in India is currently reviewing the resolution plan. Approvals by competition authorities are also required. After receiving these approvals, a joint venture will be established, followed by cash-out. While Essar's debts will be discharged by paying INR 420 billion to creditors, capital expenditures will be funded by a combination of a capital injection of INR 80 billion and Essar's own cash flow.

NSSMC and ArcelorMittal (AM) will jointly operate this project in a spirit of equal partnership, just like our joint ventures in North America. However, AM is the resolution applicant for Essar and will therefore be a majority partner.

Essar is currently generating fair EBITDA and a profit contribution is projected from the first year after acquisition. However, we would not consider that as a sufficient level of return. We believe that sufficient profit contribution will be achieved only by expanding Essar's production to 8.5 million tons p.a. through process optimization, mostly in upstream processes. NSSMC decided to invest in this project after we confirmed that the potential return on this investment would exceed our internal hurdle rate based on expected amount and timing of Essar's cash flows.

Q I would like to ask you about your overall business portfolio. Previously, you focused on high value-added areas such as automotive steel sheets and high-grade steel pipes. I thought your recent M&A strategy would also focus on high-grade segments, such as the special steel segment. In contrast to this, I understand that the acquisition of Essar is a plan to make a large investment in commodity steel, with the objective of capturing demand in India. How did you

reach this investment decision from the context of your overall business portfolio? What will your future investment direction be?

- A NSSMC's business portfolio remains unchanged, with a focus on high-grade products including automotive steel sheets, high-grade steel pipes, and construction materials. The acquisition of Ovako AB and the decision to make Sanyo Special Steel our subsidiary were implemented in line with that strategy. The acquisition of Essar mainly targets commodity steel, as that is where demand exists in India at the moment. Eventually, along with the advancement of the industrial structure, we expect demand for high-grade steel product to grow. Meanwhile, India is an extremely difficult market for new entrants. For example, it is hard for an outsider to purchase land. We therefore thought, as the first step, becoming an insider was important. Once we are accepted in the local market, we believe we will be able to respond more easily to rising demand for high-grade steel products, which will emerge in tandem with the advancement of the industrial structure.

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