NIPPON STEEL

Nippon Steel Corporation FY2018, 4th Quarter IR Briefing
(Held on May 9, 2019)
Summary of Presentation and Q&A

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

Representatives from Nippon Steel
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Katsuhiro Miyamoto, Representative Director and Executive Vice President
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● **Presentation by Mr. Hashimoto, President**

In the fiscal year ended March 31, 2019 (FY2018), we recorded an increase in consolidated business profit from the previous year but I found the results disappointing. If we had realized our full potential, we could have earned more business profit. While profitability of our group companies in steelmaking, including overseas companies, as well as the non-steel segments have improved, we essentially fell in red in terms of non-consolidated operating profit, which shows profit of the main steelmaking operations, for the manufacture of steel products in Japan and sale of them in Japan and overseas.

(1) Sluggish profit of the domestic steelmaking business: reasons and how to overcome them

1) Production instability and rebuilding of "strength in manufacturing"

The first factor causing the sluggish profit was a decline in production, caused by unforeseen, adverse events. This phenomenon has occurred in the past few years, leading to a drop in non-consolidated crude steel production to the 41 million ton level in FY2018. As a result of a drop in production, various operational performance indicators have deteriorated, variable costs have increased, and the capacity utilization rate dropped, leading to an increase in fixed cost per ton and a decrease in profit. While heavy typhoons and other natural disasters cause part of the impact of the drop in production, we recognize that the main culprit was essentially our insufficient rebuilding of our "strength in manufacturing."

At the same time, however, I am seeing steady outcome of various measures we have taken in the past three years in rebuilding our "strength in manufacturing." First, we have worked on standardizing operations. We have thoroughly been standardizing work algorithms recorded in the heads of veterans and 74,000 items of work have already been standardized. In addition, there were issues concerning engineering skills in new installation and repair work of facilities. We have implemented measures to check all stages, from facility design to installation order placement and inspection. As a result, no engineering-driven accidents occurred in recent past. Concerning maintenance, we are also enhancing completeness of inspections.

In other words, we have strived to enhance comprehensive strengths in workfront line management, in both operations and maintenance. Further, we have been implementing initiatives to enhance managers' capability in production line management, so as to cope well with the challenge of a significant change consequent to arrival of a new generation of workers.

Given the sluggish production volume in FY2018, the outcome of measures taken may not appear to be evident. This stems from the fact that production of steel materials at an integrated steelworks requires many processes up to completion of the final products. All processes from upstream to downstream have to be improved in order to achieve a full potential of integrated production capacity. Unfortunately in FY2018, some of the processes remained short of their full capacity, blocking an increase in the overall integrated production volume.

Let me emphasize, however, that we have identified the processes and facilities that do not yet meet our requirements, have taken formidable appropriate measures, and have steadily and surely improved our production capability. We aim at achieving 42-43 million tons in crude steel production in FY2019, up from the 41 million ton level in FY2017 and FY2018, but yet behind 45 million tons or more produced in FY2013 and FY2014.

2) Enhancing our "strength in marketing and sales"

The second factor for the sluggish profit was insufficient passing-through of an increase in various costs to sales prices. Not only main materials of iron ore and coal but also per-unit costs in procurement of various auxiliary and other materials and of logistics have increased but these increases have not been fully reflected in sales prices of steel products.

There are two types of sales prices for steel products: long-term contractual prices that are determined based on individual negotiations with contractual customers and spot prices determined by the supply-demand balance in the market. At present, the spot market is mainly dominated by Chinese steel products and we unfortunately cannot control it. We aim at selling to customers at a reasonable premium to Chinese steel products and actually we have realized the premium in Japan and for exports.

It is with long-term contractual prices that we face a challenge. We believe we have not been paid sufficiently from contractual customers both in Japan and for exports. We are strongly determined to negotiate with customers to improve this and that is why I dare to purposely reveal that at the moment we are essentially making a loss in our domestic steelmaking business.

I highly respect Japanese automakers, which are one of our major customers, as they are globally competitive, generate huge earnings, and still intend to profit from a once-in-100-years big wave in technology innovation for their further growth with a genuine sense of crisis. The automakers also maintain a certain level of automobile production volume in Japan to enhance their domestic strength in development and production and to transfer their outcome to overseas transplants. I believe such a strategy of theirs would suggest that our strength in development and production of steel, a basic material, a strength at both our domestic steelworks and research centers, can be useful to them and even needed by them in the future as well. For us to continue manufacturing in Japan, we have to make once-in-40-50-years investment in facility refurbishing at once. We will ask for our customers' understanding of our situation and our determination to see that the value of our products is properly regarded and we earn profit needed for the investment. I have defined the "strength in sales and marketing" as the capability to allow us to secure appropriate margins and am promoting initiatives toward that objective. I am certainly hopeful and expecting that we will deserve the understanding of our customers.

In sum, in FY2019 we will focus on production stability and further improvement in long-term contractual prices. In other words, we will work on rebuilding "strength in manufacturing" and enhancing "strength in marketing and sales."

(2) Growth strategy

Concerning long-term growth strategy, we are steadily making progress.

In FY2018, we acquired Ovako AB in Sweden and made Sanyo Special Steel Co., Ltd. our subsidiary to enhance our special steel business.

We have also been in proceedings for the joint acquisition of Essar Steel India Limited, an integrated blast furnace steelmaker in India, with ArcelorMittal, our long-term partner, to drive a wedge into the Indian market, which has the highest national potential growth in demand. It is difficult to obtain land in India and almost impossible for non-Indian companies to construct a new steelworks. We therefore find this opportunity to acquire a brownfield integrated steelworks our only effective chance to enter into India. In addition, the acquisition of an existing operational company means high investment effects.

As you may know, we have established downstream production bases mainly of automotive steel sheets in ASEAN countries. As we have already established the structure to capture future growth in Asia, we intend to move on to the next stage to reap the benefits of measures taken so far.

(3) Optimal production frameworks

Lastly, let me explain about structural initiatives toward enhancing our profit base in the domestic steelmaking business. Our assumption in rebuilding "strength in manufacturing" and enhancing "strength in marketing and sales" is to achieve stable production at our present domestic facilities and fully utilize their capacity. However, more intensified competition is awaiting us in the future Asian market. I think in a few years we will enter into an era of full-scale competition with Chinese mills in the coast, which are establishing a supply structure of high-grade steel products, in addition to POSCO, our traditional competitor in South Korea. In preparing for measures to address this challenge, we are committed to realize optimal production conditions and drastically enhance our cost competitiveness and earnings power.

That summarizes my explanation on issues related to FY2018 results and how we tackle them.

● Q&A with Mr. Hashimoto, President

Q I read in the newspaper that President Hashimoto wishes to make Nippon Steel the most powerful steelmaker. When you say "the most powerful," does this include to become the world's largest steelmaker in terms of market cap?

A Our target is to become the best steelmaker with world-leading capabilities, no more and no less. Becoming the largest steelmaker in terms of market cap, which shows an objective stock market evaluation, should embody "the best steelmaker with world-leading capabilities". Nippon Steel's market cap was the biggest in the world steel sector several years ago but is now the fifth or sixth, behind some of our competitors. I think this is because the foundation of steel business in Japan has been shaken. While I am confident that we have been frontrunning in the world in terms of overseas growth strategy, we must strengthen our domestic steelmaking base in order to regain the No. 1 position in market cap and to become the best steelmaker with world-leading capabilities.

Q Let me ask about the enhancement of the "strength in sales and marketing." Up to the present, Nippon Steel has made efforts aimed at realizing the appropriate sales prices to maintain continuity in supply, but why have you not been able to achieve a sufficient outcome? Also, concerning improvement of prices for contractual customers, what kind of new measures are you planning to take to realize the appropriate sales prices?

A I have defined the "strength in sales and marketing" as the capability to allow us to secure appropriate margins that enable us to sustain business. I am trying to clarify and publicize this as best I can within the company and am promoting initiatives toward that objective.

I recognize that steel prices in Japan have become cheaper relative to overseas steel prices in the past few years.

One of the characteristics of Japan's pricing method for contracted deals is to set up the price based on thorough discussions with and agreement by the customer. This is how a stable pricing structure has been built with a certain degree of rationale on the buyer's side and the seller's side.

However, due to the entry of Chinese steelmakers in the global steel market in the 2000s, it has become increasingly difficult to maintain the conventional pricing structure, which used to have some rationale on both the buyer's side and the seller's side. The steel industry dynamics have dramatically changed since the early 2000's when China's presence became prominent. First, absolute prices and price volatility of iron ore and coal, major raw materials of steel, have risen. As a player in the upstream of Japan's industrial supply chain, we have strived hard to absorb fluctuation in cost but there are limitations to what can be done. Second, also driven by China, costs of auxiliary and other material procurement have gone up. In addition, although it is uniquely inherent to Japan, logistics and other expenses have also been rising in the recent years, partly due to labor shortage.

I understand that Japan's relatively cheap steel prices, compared to overseas prices, have had roots in such dramatic changes in the environment and partly by Japan's long-retained unique pricing practices. Nowadays, however, the structural changes have become too significant to be absorbed only by those companies in upstream operations of the supply chain. While those in upstream operations must certainly make utmost efforts, it is necessary that the burden be shared broadly, down to downstream customers. I think that we live in an age where consensus building on new pricing is mutually needed, by makers as well as by customers. Nippon Steel has been doing stable business based on prices agreed through thorough dialogues with contractual customers. We however wonder whether our company and our steel products have been properly evaluated by our customers. We are dedicated to maintaining high grade of steel materials, establishing a global supply system, and research and development. If such value were not properly rewarded by prices from customers, we would be unable to make stable supply, which would then cause inconvenience to customers. I firmly believe that a new consensus on pricing can be built upon thorough discussions with customers.

Q In the future, I assume that Chinese steelmakers will become more competent and compete in the overseas high-grade steel market with Nippon Steel. What kind of strategy are you planning to take in response?

A I think that the key issue of the overseas market is the rising global trend of favoring domestically-produced steel products. As steel is of basic importance to so many industries, emerging countries with insufficient steel capacity are particularly eager to establish their own steel supply system rather than importing steel products. We also see emergence of protectionism. Protectionism, however, occurs in countries which already have domestically-produced steel products and a sufficient supply capacity in terms of volume and quality, and would not fall into a difficulty wherein customers could not produce end products when protectionism is escalated. These include countries where Nippon Steel has manufacturing operations. In this sense, the trend favoring domestic-made products and protectionism are not different concepts.

Even before the integration of former Nippon Steel and former Sumitomo Metals, we identified this trend of favoring domestic-made products, went ahead with overseas expansion, and have established a structure to supply products in each region as an insider. Going forward, the competition in overseas markets will become even more intensified and we will tackle the severe competition by leveraging and strengthening our global production framework that we have built up to now, ahead of our peers.

Q May I ask about your thoughts on allocation of management resources. I understand that you need to invest in rebuilding your strength in manufacturing, such as by refurbishing old facilities in Japan and making your know-how in the heads and hands of your workers into AI. However, from the perspective of growth in the mid- to long-term, strong growth is unlikely in Japan and earnings growth of overseas group companies therefore must be critically

important. Incorporating the acquisition of Essar Steel, you already have enough overseas bases on your plate. As Nippon Steel's future growth strategy, what are your thoughts on measures to further expand overseas operations or to enhance your group?

A If it were easy to build an integrated steelworks overseas, we might be able to choose a strategy of aggressively reducing production capacity in Japan. In reality, it is not easy to build a greenfield integrated steelworks of 10 million tons in capacity and there are few companies to be targeted for acquisition in Asia.

As a result, Nippon Steel intends to raise its corporate value by taking two strategies: 1) to increase competitiveness in its domestic steel business through the enhancement of domestic manufacturing steel mills and 2) to expand overseas operations based on competitiveness in Japan.

Given historical facts that many steelmakers in Europe and the United States could not maintain their domestic capacity, it is not easy to run after two hares but I firmly believe that Nippon Steel can do it. This is because we did maintain production capacity and competitiveness in a harsh environment where there was a reduction in demand by one third in 30 years in Japan, after its peak of 94 million tons in 1990. We have no intention of following the path of the steelmakers in Europe and the U.S. We are committed to two strategies of enhancing our domestic manufacturing base and of expanding overseas businesses.

● **Q&A on FY2018 Results, responses by Mr. Miyamoto, Representative Director and Executive Vice President and Mr. Ishihara, Managing Executive Officer**

Q Please explain why the production output in the 4th quarter fell short of the forecast.

A The production output in the 4th quarter was about 300,000 tons short of the forecast. During the 3rd quarter IR Briefing, I explained about "the impact of instability of another blast furnace (BF)" in addition to instable operation of a BF in Oita as well as the No. 5 BF in Wakayama at the end of its long service life. "The instable operation of this other BF" expanded in the 4th quarter, resulting in a drop in production. However, operations of all those BFs have already recovered at present. While the impact of the power failure, which occurred during the recent holidays, is still uncertain, I believe that we should be sufficiently capable to produce 42-43 million tons in FY2019 at our full-capability operation.

Q The present inventory level of rolled sheets and H-flange beams is high but a year-on-year increase in production is expected. Do you think that customers are ready to absorb such production increase?

A As you pointed out, the inventory level has risen partly due to an increase in imported materials, along with a drop in production by Nippon Steel and other domestic steelmakers.

When I said that Nippon Steel has a production capability of 42-43 million tons, what I meant was if demand is there, we can produce that much. I do not mean that we would go out of our way to boost production regardless of the demand environment.

In FY2018, as our production output was 2 million tons less than initially expected, we had to mainly reduce export orders. We also could not fully supply semi-finished product to our overseas JVs. In contrast, in FY2019, we believe it is possible to increase exports from the previous year, despite some uncertainties in the overseas demand environment, such as the US-China trade problems. The domestic demand environment, on the other hand, is currently showing signs of change, which we monitor carefully when thinking about production levels.

Q Concerning acquisition of Essar Steel, will you explain the current situation in acquisition processing and its impact on FY2019 earnings?

A At present, Indian National Company Law Appellate Tribunal is proceeding with the issue of fund allocation in the resolution plan. While the payment amount by Nippon Steel and ArcelorMittal has been confirmed, the issue of allocation among general creditors, unsecured creditors, and secured creditors is still being resolved. On May 13, hearings will be conducted at the Appellate Tribunal. If the Appellate Tribunal reach a decision but the issue is appealed to the Supreme Court, which will be in summer recess from May 13 to the end of June, a closing would be most likely in July or later.

In the meantime, Nippon Steel and Arcelor Mittal have already decided a post-closing JV structure and some people of both companies have already been to India, doing preliminary arrangement.

Essar Steel is currently operating under the management of its trustees. The company is increasing production output and generating cash. We therefore feel that rather than precipitating to close the deal, it is desirable that the relationship with creditors will be legally sorted out, without leaving any remaining issues.

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