

Nippon Steel Corporation, Third Quarter FY2019 IR Briefing (Held on February 7, 2020) 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

Q Is it possible that you may record more impairment losses, after recording the losses on this occasion?

A The forecasts for the current fiscal year 2019 have incorporated ¥490 billion for all impairment and other losses we can project at this moment including possible losses in Q4, on the top of the losses recorded in Q3.

On this occasion, we recorded impairment losses for three steelworks, namely, the Kashima Works, Nagoya Works, and Hirohata Works. The Kashima Works, due in part to its high export ratio, has been affected by a deteriorating overseas market and has been experiencing declining sales and profit. The Nagoya Works has stagnant profits in steel sheets for automobiles, which represent a high ratio of its sales, and is still undergoing the process of an improvement in long-term contract selling prices. Steel plates are also generating stagnant profits. The Hirohata Works is facing issues regarding the costs of its upstream process, which used to play the role of recycling by-product dust stock, but that mission has been completed. Its upstream process will be converted into an electric arc furnace. Some of the other steelworks, besides those three, likewise have declining earnings but they are due to temporary factors, such as disasters, and are not subject to impairment losses.

In addition, we are considering the reorganization of or withdrawal from unprofitable overseas businesses, and possible losses for these businesses have also been incorporated in the forecasts.

Q Can you provide details of the expected ¥100 billion profit contribution from the production facilities structural measures? In addition, will you give us the timeline?

A Labor costs, maintenance costs, and other fixed costs account for roughly 70% of this expected contribution of ¥100 billion on profit. Variable cost benefits from concentrating production at more efficient steelworks are also included.



We are expecting the full contribution of ¥100 billion to materialize after all target facilities are closed, which will be in a few years from now. The challenge we face is how far in advance we can realize the profit contribution. We will start reducing maintenance costs prior to the closure of the facilities. In the meantime, labor costs will not immediately decline even after the facility closure because we hope those affected by the facility closure will continue to work in the Nippon Steel Group in areas which are struggling with labor shortages and hiring difficulties, namely, at Nippon Steel and our group companies and at our subcontracting companies.

- Q Please explain the market environment you assumed as the base for the current structural measures. Also, how will your export ratio change as a result of implementing those measures?
- A While we are expecting a decline in Japan's steel demand over the medium to long-term, caused by Japan's declining population and other factors, we do not expect demand in the manufacturing sector to decline as radically. Domestic steel demand in fiscal year 2019 has already been expected to be below 60 million tons. While we plan to reduce our production capacity by 5 million tons through the structural measures, we do not expect this will cause any inconvenience in supply to our domestic customers. We see this as critically important. Our export ratio, as a result, is likely to decline from the current level.
- I heard that you evaluated the comprehensive competitiveness of each steelworks during the process of reviewing the structural measures. How did you evaluate the ratio of long-term contracts, including those for steel products for automobiles? I am asking this question because I think that profit improvement in the long-term contract business is an important task.
- A We have evaluated each steelworks comprehensively in terms of cost competitiveness, product responsiveness, relationships with customers, location, and other factors. In the case of high-grade products for automobiles, which are difficult to manufacture, we took into account factors such as manufacturing capability and cost in determining the steelworks where operation should be consolidated. After establishing an optimal production structure, the remaining challenge will be to realize sales prices which conform with the value of our high-grade products. We are engaged in various negotiations with each automaker. It is important that steelworks which cannot currently generate profits from production of such high-grade products will become able to do so under the new optimal production structure. We are also considering this kind of aspect.



- Q I would assume that the facility closure on this scale would result in excess labor. Although you explained that you would not reduce the workforce, wouldn't this cause heavy labor costs to remain?
- A The expected impact of ¥100 billion on profit is based on the assumption that those involved in the closed facilities will continue to work in the Nippon Steel Group.
 - Nippon Steel as well as our group companies and subcontracting companies hire a substantial number of workers each year and some of them have difficulty in hiring personnel, mainly due to the tight labor market. We also need to fill up positions vacated by retirees each year. We therefore believe that those employees who lose their jobs because of the structural measures will be able to continue working within the Group. In the case of those working in our subcontracting companies, we intend to listen to the views of their management, engage in repeated dialogue, and then decide what to do.
 - Considering the overall personnel allocation in such a way, we are expecting a sufficient labor cost reduction impact to be generated.
- Q I think that, instead of adopting quick-fix measures or engaging in number crunching, you need to raise quality. While you have so far promoted your product quality, how are you intending to raise the quality of manufacturing, assets, and management?
- A Concerning strength in manufacturing, we have implemented both facility measures and intangible measures, which reduced the number of significant production troubles. Manufacturing quality is crucially important for us, as it is the fundamental basis of the manufacturing industry.
 - As for the quality of assets, we are deeply committed to our three-year plan to reduce assets by ¥400 billion, mainly by disposing of strategic shareholdings. We intend to disclose details in due time. In addition, as an accounting policy, we formulate extremely conservative estimates of the value of assets, including the impairment losses announced at this time.
 - With regard to the quality of management, we are promptly making management decisions and speedily launching various measures. In order to accelerate the pace, we will make a transition to a Company with an Audit & Supervisory Committee. This is a structure that allows proper supervision of management and at the same time enables quicker managerial decision-making and more meaningful discussions. Every one of us is highly aware that we cannot survive without having such a sense of speed. I hope you will see us in this light.
- Q Compared to your rationalization in the late 1980s, the closure of four blast furnaces this time appears to be a radical plan in such a short time, in my view. Does this mean that the closure of blast furnaces is almost complete? Or does this mean you may



close more blast furnaces in the future when considering a more optimal production structure?

A Our way of thinking in regard to the current blast furnace closure is to have the portion of closed production absorbed by other facilities, which means we do not intend to lose marginal profit or give away our domestic market share.

We currently believe this is the best we can do. While we will focus on earning marginal profit, if the business environment changes significantly we may then consider things flexibly again. Besides the blast furnaces, we will construct an electric arc furnace in Hirohata, and we have canceled the closure plan of an electric arc furnace operated by a subsidiary of the Wakayama Works. AM/NS India, which was acquired in India, also has MIDREX, COREX, and electric arc furnace facilities in addition to the blast furnace. By having such compact upstream steelmaking processes, we intend to speedily consider a timely optimal structure with some options in hand.

Q Are you incorporating some outcome from price negotiations with automakers in your full-year earnings forecasts? If not, what can be expected in the near future?

A We cannot say anything specific concerning price negotiations with automakers but please understand the following. We are negotiating the issue of domestic long-term contract prices with full determination and, as a result, our margin has steadily been improving. However, the ¥5,000-¥6,000 cost-up factors of the past few years, which exclude main raw material costs but include commodity raw material costs, logistics costs, other material procurement costs, and marine transportation cost hikes caused by the SOx regulations, have not been passed on to product prices. This is the reason for the decline in profit. We are still at the halfway stage in the sense that the cost increase has been steadily but not fully reflected. We need to pass on the cost increase to pricing in negotiations for the second half or next fiscal year. Moreover, we must ensure that negotiations lead to the realization of margin improvement in a purer sense.

This is in fact part of the reason why the Nagoya Works was forced to record an impairment loss. We have to make sure that the Nagoya Works becomes profitable again.

- Q You have launched drastic measures for your domestic production facilities but I think you must be in the midst of reviewing your global upstream production structure, as you are striving to grow on the global stage. Will you give us some hints on where and how you intend to proceed over a 10-year timespan?
- A Concerning what we plan to do, where and with which assets globally, our position of identifying our domestic manufacturing bases as "mother mills" will not change. Historically,



we have overcome various challenges with very strong customers in Japan and have developed various superb products. Going forward, our customers, such as automakers, basically plan to continue production in Japan, where their overall supply chain can overcome challenges. We are therefore determined to also continue integrated production in Japan and work together with customers to overcome challenges.

Bearing that in mind, the question arises: how do we develop our global manufacturing bases and, in particular, where do we manufacture slabs (semi-finished products), and how do we supply them? We need to think on the basis of each product line while comprehensively considering the facts that most costs are determined by upstream processing and that the level of high-grade steel products stems from the level of upstream and hot-rolling processing in Japan. AM/NS India is focusing on expanding commodity products and not yet thinking about high-grade steel. In the meantime, compact upstream facilities do provide us with various options. We will take such things into account.

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