

**Nippon Steel Corporation, FY2019 IR Briefing
(Held on May 8, 2020)
Summary of Presentation and Q&A**

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

Presenters

Eiji Hashimoto, Representative Director and President

Katsuhiro Miyamoto, Representative Director and Executive Vice President

● **Presentation by the President**

I would like to explain four points at this IR Briefing: (1) the impact of the spread of COVID-19; (2) the status of our immediate production response; (3) a roadmap for our long-standing biggest challenge of improving business performance and returning to operating profit on a non-consolidated basis; and (4) the Nippon Steel Group's vision and basic strategy.

(1) Impact of the spread of COVID-19

Our current business environment is harsh due to the impact of the spread of COVID-19. We anticipate our crude steel production level in the first quarter (April-June, 2020) will fall to around 7 million tons, which signifies an operating rate of approx. 60%. Moreover, the post-COVID-19 demand recovery is likely to be more subdued for the steel industry than other industries. Since even before the COVID-19 outbreak, our industry has been suffering from sluggish demand due to a slump in the global manufacturing industry, triggered by the U.S.-China friction, as well as from margin compression caused by high prices of iron ore and other materials, which resulted from high-level production by Chinese blast furnace (BF) steelmakers. In addition, we are concerned about a post-COVID-19 potential long-term slump in investment in the energy field, which we have identified as one of our strategic areas of focus, as a result of the oil price collapse. Moreover, emerging countries, which had been anticipated to see a structural increase in demand for steel, may fall into dire straits in the immediate future, thereby leaving little hope for any growth in steel demand.

At present, the only bright spot is China's construction market. As China is ahead of other countries in containing the COVID-19 infection and has resumed economic activities, the major mills in China are already operating at full capacity. We thus anticipate that competition with Chinese mills will be more severe going forward.

(2) Status of our immediate production response

After pursuing stable production with upside flexibility for a few years, we shifted to a further economical

production mode to be prepared for lower demand in fiscal 2019. We redefined “manufacturing capability” as the “capability to produce as planned” and strived to focus on cost and match production to demand. Confronting a temporary but drastic reduction in demand, driven by COVID-19, we now have to act more aggressively and pursue downside flexibility. Given the indispensable need to substantially squeeze output, six of our 15 blast furnaces (BFs) will be in a banking state (to stop production temporarily) while the remaining blast furnaces in operation will produce minimum output. The BFs scheduled to be in a banking state include those targeted for future closing as part of the structural reform announced in February 2020. These BFs may end up being closed. Depending on the post-COVID-19 secular demand trend, other facilities may potentially be forced to close as well as part of additional structural measures.

(3) Roadmap to improve business performance and returning to operating profit on a non-consolidated basis

Since the second half of fiscal 2016, Nippon Steel has been in deficit on a non-consolidated basis, which indicates the underlying status of our domestic steel business, but by making various efforts in implementing the initial plan for fiscal 2020, which was formulated prior to the outbreak of COVID-19, we finally had good prospects of generating a profit on a non-consolidated basis.

Various measures implemented to stabilize production have actually begun to show successful outcomes, resulting in a decline in the number of troubles since the second half of fiscal 2019 and the achievement of the cost improvement plan in the fourth quarter of fiscal 2019 (January-March 2020). There was also some improvement in long-term contractual prices in fiscal 2019, although progress was still insufficient. We have thus made steady progress in our efforts to improve profit from scratch, which means rebuilding our strength in manufacturing and enhancing our strength in sales and marketing.

In fiscal 2020, we plan to reduce fixed costs by ¥200 billion compared to fiscal 2019. The impact of structural reforms will not be fully generated yet in fiscal 2020 but maintenance costs will be substantially reduced as we clarify our future optimal production structure and thoroughly decide on which facilities to maintain or discard. Thanks to our improved capability in various operational elements, we also plan to achieve a reduction of over ¥50 billion in variable costs.

However, because of a temporary drop in production and sales volumes, caused by the COVID-19 impact, and the variable cost deterioration, inevitably caused by production reduction, we will unfortunately remain in deficit in the first half. This has led us to set a new target to “turn profitable after the containment of COVID-19 by all means under any business environment.” What we mean by “under any business environment” is that we intend to reestablish ourselves so that we can ensure an operating profit on a non-consolidated basis and generate sufficient profit on a consolidated basis even after incorporating new adverse factors, such as those

stated above, on top of the business environment assumptions we applied in the structural measures announced in February. We will take into account the post-COVID-19 change in market structure and the competitive landscape, and consider specific measures to adopt.

(4) The Nippon Steel Group's vision and basic strategy

I believe that the COVID-19 outbreak has augmented the Nippon Steel Group's role of supporting the foundation of the Japanese economy. In order for Japan's manufacturing industry to overcome various global political and economic risks, our advanced technological and development capabilities, which appropriately address a wide range of needs and challenges among our customers and society, are very much needed in regard to manufacturing processes and offerings for products made of steel -- a basic material. In order to respond to such expectations, a certain level of domestic production capacity is indispensable. We are thus determined to maintain our mother mills in Japan.

Out of Japan's steel demand of 60 million tons, 20 million tons are for the construction industry and 40 million tons for the manufacturing industry. Half of the portion for the manufacturing industry comprises indirect exports, supported by customers' global competitiveness. The Nippon Steel Group's main customers are manufacturers. This means that our policy to prevail in global competition together with customers aligns with our basic market strategy to keep demand for indirect exports, representing one-third of all demand, in Japan. While aiming to restore cost competitiveness through structural reform, we intend to aggressively invest in strategic products that satisfy new needs and challenges. Dynamic selection is indispensable and painful structural reforms cannot be avoided.

In the post-COVID-19 era, the trend of "local production and local consumption" will further accelerate. We therefore intend to restore cost competitiveness by quickly shifting to an optimal production framework and making replacement investment to upgrade our major steel mills. At the same time, we will strive to aggressively enhance the quality and quantity of our globally-competitive strategic products, which are unrivaled by global peers and should overcome barriers of preference for local production. These strategies can be implemented only if we restore our strength in manufacturing and reinforce the ability to solve our own problems by pursuing the efficiency and independence of steelworks. This is also the essence of what we aimed at in the organizational reform and consolidation of steelworks, which we implemented in April.

In regard to overseas business, we will devote more efforts as previously planned. However, we have completed selection – whether to continue or withdraw – of businesses, including those operated by our group companies. We have withdrawn or are withdrawing from businesses that find it difficult to secure profitability due to changes in the market environment or those that no longer had a role to play and generated no synergies for the group. Our biggest theme going forward is the integrated steelmaking business in India. The

country's economy is currently distressed but there is no change in its demand growth potential. Its infrastructure building, along with industrialization and urbanization, is yet to come. From the viewpoint of supply, there is little risk of a build-up in government-led excess capacity in the short term, unlike China, as India's development is driven by the private sector and it is difficult to acquire land.

In sum, our two basic policies remain unchanged: (1) the restoration of domestic business through an early shift to an optimal production framework and the strengthening of strategic products; and (2) overseas business expansion based on business selection. These policies also represent our basic strategy to compete with major Chinese mills, which will undoubtedly aim to further expand their hegemony in overseas markets, including local production, on top of exports.

● **Q&A**

Q Please provide a breakdown of the ¥200 billion reduction in fixed costs. Can you realize an improvement of over ¥50 billion in variable costs even if present production cuts continue?

A (Executive Vice President Miyamoto) The ¥200 billion reduction in fixed costs comprises a ¥60 billion reduction in depreciation expenses thanks to the posting of an impairment loss; a ¥50 billion reduction in depreciation expenses accompanied by a change from the declining balance to the straight-line depreciation method; and a ¥90 billion reduction in maintenance costs and other expenses. Of the total, a reduction of ¥26 billion is attributable to the effect of facility structural measures. We will reduce maintenance costs for facilities to be shut down but will not reduce maintenance costs across the board for all facilities. We intend to raise efficiency in maintenance costs for production lines which will remain in operation.

As for variable costs, we will implement structural cost improvement measures in anticipation of the post-COVID-19 situation. A substantial production cut, however, would generate cost demerits, such as an increase in the coke consumption basic unit. In other words, cost demerits caused by production cuts may be generated aside from the variable cost improvement of ¥50 billion or more.

Starting with about ¥65 billion in annualized underlying business profit in the second half of fiscal 2019, we assumed that we would have achieved a business profit of ¥200 billion or more in fiscal 2020, without any impact from the COVID-19 outbreak. This would have been generated by a reduction in fixed costs and an improvement in variable costs, despite an increase in costs caused by relining a blast furnace in Muroran and other factors. However, the impact of the COVID-19 pandemic has been added as a demerit from the loss of marginal profit caused by volume decline and as a cost demerit from the production cut. The extent of these demerits depends on when the COVID-19 impact is contained.

Q You mentioned the determination to “turn profitable on a non-consolidated basis after the post COVID-19 containment by all means under any business environment.” How much crude steel production will you specifically require to turn profitable?

A (President Hashimoto) How the COVID-19 pandemic subsides and how its economic impact subsides are two separate issues. Concerning the steel industry, we must clearly figure out the post-COVID-19 economic environment, including how overall steel demand may change and how areas of demand may shift internationally. What we mean by saying “under any business environment” is that, once we get a clear, specific picture of the post-COVID-19 trend in global steel demand, we will be able to ascertain our acceptable level of fixed costs and establish an optimal production framework that realizes an appropriate level of fixed costs to make a profit. At present, however, the steel industry’s post-COVID-19 business outlook is still unclear.

Q Assuming that the COVID-19 impact is contained, do you think that the February 7 structural measures will allow you to achieve a sufficient reduction in production capacity?

A (President Hashimoto) We are currently focusing on having downside flexibility, by taking measures such as the blast furnace banking and changes in the operation and shifting of the downstream process. This, however, is not a secular response but simply a way to deal with the COVID-19 impact and its resulting substantial temporary drop in steel demand. There is a limit in reducing the blast furnace’s productivity while space to store more inventory resulting from continued pig iron production is also limited. A production cut therefore is our only choice.

In the meantime, how we will structure the post-COVID-19 production facilities is a separate issue. We adopted certain assumptions for the environment and production and sales volumes when we developed the structural measures announced on February 7. At this moment, however, we do not think that post-COVID-19 steel demand will return to the pre-COVID-19 level but we do not know whether a downward revision to the February 7 assumptions will be needed or the extent of such a downward revision. We believe we will have to look at the post-COVID-19 market structure and competitive landscape when reviewing our production framework.

Q Blast furnace (BF) steelmakers are making substantial production cuts, while electric arc furnace (EAF) steelmakers, with a lower ratio of sales to the manufacturing industry, have carried out smaller production cuts and are making a profit. In the U.S., some steelmakers have shut down

BFs and started adopting EAFs. Nippon Steel also has a plan to build an EAF in Hirohata. Although Japan is an exporter of steel scrap, are you thinking about changing the production structure to use more steel scrap, instead of focusing on the BF steelmaking method?

A (President Hashimoto) As you pointed out, the spread of COVID-19 has had a greater impact on manufacturers' activities than on the construction industry's activities while prices of steel scrap have come down. EAF steelmakers, which mostly serve the construction industry and can use aged scrap, therefore have relatively solid earnings.

Nippon Steel is also instructing some of its overseas production bases to try an EAF or a reduction process using natural gas. However, it is impossible to change to using the EAF method for our entire domestic steel production because we need high-grade steel scrap, which is not sufficiently available, in producing high-grade steel products that we supply to the manufacturing industry and to the energy field. Overseas EAF steelmakers also use pig iron or high-grade steel scrap in manufacturing high-grade steel products. Our Hirohata mill can produce high-grade products with an EAF simply because the output volume would not be substantial. Japan's high electricity cost is an additional problem. It is therefore not realistic to shift the majority of our production to the EAF method, as long as high-grade steel products continue to constitute our major domestic production.

In terms of responding to climate change, we intend to reduce the CO₂ emission unit of the BF steelmaking method. Industries that emit substantial CO₂ emissions are facing stronger headwinds and the time is ripe to seriously consider a reduction in CO₂ emissions by the BF method. China has accumulated insufficient steel scrap so its production structure mainly comprises BFs. China produces two-thirds of the world's pig iron produced by BFs of 1.2 billion tons and Chinese steelmakers are also striving to reduce CO₂ emissions at BFs, as are Japanese steelmakers. Technology competition has already begun and it would be a disaster if Japanese makers fell behind their Chinese counterparts and were forced to give up production. Various steps will be needed to reach the ultimate solution of hydrogen reduction. Regardless, we intend to seriously reduce CO₂ emissions in the BF method.

Q Will your fixed cost reductions and variable cost improvements at this time have a direct lasting impact even after demand recovers and production cuts are terminated?

A (President Hashimoto) It is extremely important to continue stable production with no operational and facility troubles, in order to keep the cost improvement impact as underlying profit. If a pick-up in demand leads to trouble, costs will end up increasing again. Another important factor, from the viewpoint of profitability, is to realize appropriate long-term contract prices. Even if costs improve, the benefit will flow out of the company unless appropriate prices are realized.

Q How are you thinking about resuming suspended facilities in sequence when demand returns after COVID-19?

A (President Hashimoto) Let me explain our basic policy on production framework. Our basic premise is to receive maximum orders and capture a marginal profit if there is demand and the price is appropriate. Fixed costs should be controlled within the range of marginal profit. As marginal profit is the source of profit, it makes no sense to lose more marginal profit by suspending a facility and reducing fixed costs. As such, the requirement for determining facilities to be temporarily stopped is whether alternate production by other facilities is possible or not in terms of volume as well as quality. Among the facilities whose production can be replaced by other facilities, facilities that will need additional expenses in the event of continuing operation should be suspended first.

We also upgrade aged facilities as needed but this does not lead to a higher marginal profit driven by volume growth. We therefore have to apply a different way to boost marginal profit at the same time. In fact, there are two ways. The first is to raise product prices, reduce variable costs, and raise the unit price of marginal profit. This essentially means enhancing strength in manufacturing as well as in sales and marketing as we have done so far. The second is to expand high-value-added products, such as electric steel sheet, in volume and quality, upgrade our product mix, and thereby raise the average unit price of marginal profit.

After the sharp drop in demand due to COVID-19 settles down and a recovery in volume begins, an important point in identifying what type of orders to restore and how to resume facility operation is to foresee which ones will potentially generate a profit. In the case of orders for commodity products with a low marginal profit, we may accept orders if we can secure a marginal profit by using existing facilities and without incurring additional costs. However, when considering a secular production framework, the correct choice would not be to assume that orders for commodity products will be restored. The premise should be to upgrade the product mix. We really need to make wise judgements.

Q Please explain the state of improvement in long-term contract prices in the harsh business environment for your clients' industries due to the impact of COVID-19.

A (President Hashimoto) I cannot mention the state of individual price negotiations but, as I mentioned at the beginning, we have accelerated efforts to ask our customers to reflect our product value and contribution in product prices and to share a fair burden of the supply chain since fiscal 2019. Moreover, we have made some progress, but not sufficiently. We will therefore continue to make requests to our customers. I believe the correction in long-term contract prices is not related to supply-demand

fluctuations or general market movements for commodity products. In the current restricted business conditions caused by the COVID-19 pandemic, we are continuing discussions with customers via web meetings and other means.

Q In 2019, when Sanyo Special Steel suffered from earnings deterioration and a decline in its share price, you maintained the attitude of respecting their independence as a listed company. This time, you recognized an impairment loss on shares of Sanyo Special Steel in the non-consolidated financial statements. Does this mean that you, as the parent company, will demonstrate greater leadership over Sanyo Special Steel?

A (Executive Vice President Miyamoto) As it has strength in bearing steel, Sanyo Special Steel's earnings deteriorated due to a decline in sales volume caused by depressed activities at its major customers in the automobile, industrial machinery, and machine tool industries. We naturally respect their independence as a listed company but would like to deepen cooperation in order to solidly execute the plan to generate ¥100 billion in synergies as the Nippon Steel Group, which includes Sanyo Special Steel and our Muroran Works.

Up to now, we have focused on capacity shortage, given the tight supply/demand balance for bearing steel. Now, the production downtrend has reversed the situation and our immediate challenge is how to minimize the negative impact of the production cut. Both Nippon Steel and Sanyo Special Steel will jointly respond well by using our knowledge and insight.

Q How do you feel about the past year's progress in enhancing your strength in manufacturing as well as in sales and marketing?

A (President Hashimoto) During fiscal 2019, my first year as President, I traveled from north to south and visited all of our manufacturing bases in Japan, including those of former Nippon Steel Nisshin Steel and Sanyo Special Steel. I talked with numerous employees, including those of cooperative companies, and conducted in-depth discussions regarding the situation and the challenges faced by Nippon Steel, using materials I had prepared by myself. I completed the first round of visits in the first six months and began my second round in the second half of fiscal 2019. During this endeavor, I felt a sense of progress in manufacturing strength little by little, and this has finally become evident in the data since the second half.

Concerning our strength in sales and marketing, I am committed to sharing the challenge with each general manager in marketing and have been talking about our biggest theme of why we are not generating sufficient profit with each of more than 20 general managers once every two months. I will continue this practice. I am also engaged in a trilateral dialogue with the heads of steelworks and the

heads of business units once every two months. Here again, I have felt a sense of progress over the past year.

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